CREDIT PERSPECTIVES | TAXABLE BONDS

MARCH 2025

ASSESSING TARIFF RISKS ON CORPORATE CREDIT

We believe corporate bonds offer an attractive combination of downside protection and positive carry to navigate the current economic environment. Further, an active management approach allows us to carefully calibrate exposure to the industries and companies most vulnerable to the effects of tariffs. We believe:

- Corporate credit spreads have widened broadly as the market has responded to tariffs by moving to reduce risk exposure.
- Our analysis suggests the impact on fixed income investors could be more muted than currently anticipated.
- Investors would be wise to stay the course while increasing their focus on managing risk.

A NEW US TRADE STRATEGY

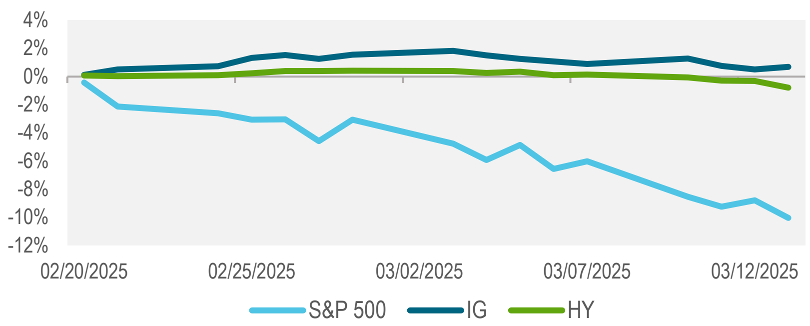
To start his second term, President Trump has rolled out a range of targeted tariffs. For an in-depth look at the administration's broader trade strategy and potential solutions, check out the insightful article from my colleague, GW&K's Global Strategist Bill Sterling: "Investment Implications of President Trump's Trade Policy."[1]

RISK-OFF MARKET

In response to rising tariff concerns, risk has traded off, leading the S&P 500 to plummet about 10% since hitting a new high in mid-February (**Figure 1**).

FIGURE 1

Index Returns since February 19, 2025



Data as of March 13, 2025.
Sources: GW&K Investment Management, Bloomberg.

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[1] https://www.gwkinvest.com/insight/investment-implications-of-president-trumps-trade-policy

ASSESSING TARIFF RISKS ON CORPORATE CREDIT *continued*

Similarly, investment grade and high yield spreads have spiked from year-to-date lows (**Figure 2**). High yield spreads have widened almost 80 basis points over this period to their widest level since August 2024. Investment grade spreads have held in better, as expected, but have moved 20 basis points wider to a level last seen in September 2024. Despite this volatility, investment grade and high yield total returns have significantly outperformed the equity market thanks to the rally in rates.

FIGURE 2

Spreads Have Widened Significantly

	Spread on 2/18	Spread on 3/13	Spread widening
Investment Grade	77	97	20
BBB	94	116	22
High Yield	256	335	79
BB	154	213	59

Source: GW&K Investment Management

ASSESSING THE TARIFF IMPACT

Our team estimates that only about 25% of the Bloomberg US Corporate Index should be adversely impacted by tariffs as currently proposed. To estimate this, we assessed the expected tariff impact on each sector within the index as "full," "partial" or "neutral/positive." **Figure 3** lists the sectors we believe will be directly adversely affected.

As a portion of the Bloomberg Aggregate Index, this exposure is even smaller, representing about 6%. Even these numbers might overstate the potential impact on credit quality. Those companies with more global exposure tend to be larger, with robust balance sheets and higher credit ratings.

FIGURE 3

Impact on Corporate Sectors

Full negative impact		Partial negative impact
Automotive	Food & beverage	Healthcare (devices)
Building materials	Other industrial	Technology (hardware)
Chemicals	Paper	
Construction machinery	Pharmaceuticals	
Consumer products	Refining	
Diversified manufacturing	Retailers	

Source: GW&K Investment Management

GW&K

ASSESSING TARIFF RISKS ON CORPORATE CREDIT *continued*

OUR VIEW AND POSITIONING

Our team continues to monitor the most tariff-sensitive sectors closely, watching for early indications of adverse effects on our bond holdings. We believe, however, that our portfolios are positioned to avoid outsized risks in these sectors. In automotive, for example, we are comfortable with our holdings' robust balance sheets and ability to manage through a tariff environment. In other sectors, such as consumer products and retailers, a favorable supply chain footprint has been key to our credit selection process. Still, we continue to see the best risk-adjusted value in some of those sectors that are least directly impacted by tariffs, including banking, communications, and domestic energy.

The recent outperformance of bonds over equities underscores the critical importance of maintaining active fixed income exposure during uncertain market conditions. Corporate bonds should offer downside protection in a risk-off environment while providing positive carry. Nevertheless, it is vital to remain vigilant against specific market and company risks. We are focused on actively limiting downside risk by positioning in high-quality companies with strong balance sheets and less sensitivity to proposed tariffs compared to their industry peers.

DISCLOSURES:

All material has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy of, nor liability for, decisions based on such information. This represents the views and opinions of GW&K and does not constitute investment advice, nor should it be considered predictive of any future market performance.

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GW&K is a Boston-based investment firm with $52.9 billion under management and half a century of creating long-term, trusted client relationships.

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