

Invesco Fixed Income

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Global macro strategy

Trump delivers on his campaign promises - what does it mean for macro and markets?

President Trump began his second term as president with a bang – a record 26 executive orders on day one, with many pronouncements during his first week. None of the executive orders were unexpected. They were all laid out in the campaign, or as part of the disavowed and reclaimed Project 2025.

While a number of the executive orders are more political in nature – e.g. pardoning and commuting the January 6th sentences and pulling out of the Paris Climate Accord – there are several that, while also political, could have an outsized impact on the economy and markets. The two we are watching most closely are the orders around tariffs and immigration.

Tariffs

On tariffs, while there were a number of threats to impose 25% tariffs on goods from Canada and Mexico and an initial 10% tariff on goods from China, all decisions were delayed until February 1. This has led many to believe that tariffs are more likely to be used as a negotiating lever than actually be implemented. We believe it is too early to make that determination. Our sources tell us that the delay until February 1 was driven by the desire to wait for the confirmation of Commerce Secretary designee Howard Lutnick so he could be involved in any follow-up conversations with various countries, and the fact that there are still ongoing debates among

officials about how to use tariffs and how far to push the tariff levels for each country.

Immigration

On immigration, as expected, Trump declared a national emergency at the border and is setting up the infrastructure to increase deportations. We are watching how far he pushes this effort and how it will impact key sectors like agriculture, hospitality and construction. There are currently 1.4 million people who have already been through the court system and are eligible for deportation, and there are another 3.7 million in process.¹ Just dealing with those people would be a major development.

Impact of Trump administration policies on US macro

The economic impact of these policies will likely be felt gradually. Labor market policies will likely take time to affect the economy, as we believe there is currently some slack in the labor market. On tariffs, there were no across-the-board tariffs on day one as feared, but rather, a few countries were singled out.

Growth

2025 is set to be an intriguing year, marked by a new president and an administration ready to challenge

1. Source: US Immigration and Customs Enforcement, US Department of Homeland Security, US Customs and Border Protection, Migration Policy Institute. Data as of Jan. 24, 2025.

long-standing norms, which will likely create some economic volatility. However, we expect a continuation of the US economy's current momentum initially, with strong growth (nominal growth around 5%) and steady inflation. The election has improved business confidence, and the narrative of American exceptionalism will likely persist for some time, but we expect growth to eventually converge toward its potential, as government policies start to impact the economy.

Since the beginning of 2023, the US economy has grown at an average annualized rate of 2.9%, representing growth above potential.² We expect several factors to further stimulate this strong economy: easier financial conditions, the resolution of election uncertainty, the decreased risk of a hard landing and a policy environment that favors less regulation and other growth-friendly policies.

In our baseline scenario, growth momentum continues in the first half of the year, with annual GDP growth averaging 2.6%. We do not expect policies introduced by the new administration to change this momentum quickly. Instead, expectations and animal spirits should contribute further to the growth story. The labor market currently shows some slack, which should support growth, even amid slower labor force growth. This slack, combined with slowing immigration and deportations, will likely be gradually absorbed, leading to a tightening labor market and stabilizing wage growth later in the year.

Inflation

We expect inflation to decrease slightly in the winter, due to base effects, deflation in goods, a normalization of shelter prices and a slowdown in wage growth. However, we expect progress to stall after the winter, due to a tightening labor market and reduced support from global goods and commodities prices. Tariffs will likely add to inflation, complicating the Federal Reserve's (Fed) outlook. We expect the core Personal Consumption Expenditures (PCE) Price Index to hover around 2.5%.

A US economy growing in the 2.5-3.0% range, healthy job creation amid a tightening labor supply and sticky inflation suggest that the Fed will likely slow or pause its rate-cutting cycle in 2025. While our base case assumes two

rate cuts this year, the timing remains uncertain. We expect the Fed to cut in the second half of the year, as growth slows toward its longer-term potential rate.

Markets

This growth and inflation backdrop should be very good for market fundamentals and should support risky assets going forward. On the other hand, a slower rate of central bank rate cuts means that financial conditions will likely be less supportive of markets. Given solid fundamentals, we favor staying fully invested but believe that tight valuations and a less supportive Fed argue for prudent risk taking

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Interest rate outlook

US: Overweight. In the near term, we expect volatility to be high, due to the new administration's policies and seasonal inflation effects. In the medium term, US rates carry the highest risk premium we've seen in a decade, as the market has adjusted to stronger economic data by delaying expectations of Fed rate cuts until the summer. We expect growth to be robust in the first half of the year and moderate in the second half, with supply risks being a focal point, though we do not expect significant increases in Treasury duration supply until early 2026. As near-term risks diminish, we expect the rates market to yield strong excess returns compared to cash. In the long term, Treasuries appear undervalued relative to long-term drivers, with any significant increases in yield likely to be driven by debt concerns. However, the narrow Republican majority in the House may hinder legislation that significantly raises the debt/GDP ratio. We view long-term rate returns positively, based on valuations.

Europe: Overweight. Despite the recent rise in yields driven by the US bond market, we remain positive on European sovereign bonds and see this as an opportunity to add duration exposure. We expect the European Central Bank (ECB) to lower rates below 2% this year, due to falling inflation and a challenging economic environment. While the outlook is currently downbeat, a resolution to the war in Ukraine could boost consumer confidence and reduce precautionary savings, supporting demand. Additionally, there is potential for fiscal expansion in Germany. However, significant headwinds remain, particularly if President Trump imposes trade tariffs on European imports into the US.

China: Neutral. We expect the Chinese onshore interest rate environment to remain accommodative in the near to medium term. We are closely watching macro targets for 2025 and the Ministry of Finance's long-term bond issuance. Potential tariffs to be imposed by US President Trump in 2025 and their impact on the exchange rate will likely complicate moves in front-end yields. In addition, easing measures by the central bank, given already low rates in the onshore market, will likely drive potential asset reallocation by local investors. We expect more proactive guidance from the central bank through its open market

operations and window guidance for the long-term segment of the bond market.

Japan: Underweight. Despite the Bank of Japan's (BoJ) dovish stance at the December meeting, Japanese government bond (JGB) yields have continued to break to new highs. This reflects higher yields in the rest of the world and possibly a perception that the BoJ is behind the curve. Recent data continue to point to further rate hikes ahead. Growth has been solid, inflation momentum has reaccelerated to well over 2%, wage demands are increasing and the yen has depreciated sharply in recent months. The market is currently pricing less than a 50% probability of a hike at the upcoming January BoJ meeting, which seems relatively low. In addition, there doesn't seem to be much risk premium for a series of BoJ hikes, towards a more normal real policy rate. Short-term rates are, therefore, likely biased higher. Long-term rates are, however, relatively high, with 30-year JGB yields at 2.33%.³ The recent reduction in long-term issuance, combined with the skew of BoJ quantitative tightening toward the short-end, should lead to some flattening of the yield curve ahead, as the 30-40 year sector remains stable while sub 10-year yields move higher, driven by BoJ hikes.

UK: Overweight. The UK interest rate market has experienced a dramatic repricing, with yields rising over the last three months across the yield curve. The price action can be explained by the interaction of global influences, domestic data and fiscal policy changes. UK rates have largely tracked US markets, potentially indicating that much of the UK selloff is related to changing global expectations for growth and inflation. However, domestic factors have also played a part, including fiscal easing and the jump in gilt issuance across the curve, announced in late October. Domestic data have been more mixed. Growth indicators have disappointed, but wage growth has surprised to the upside, and other indicators of inflation pressure are ticking higher. The question is, are these factors fully incorporated in market pricing? The market is pricing less than 50 basis points of cuts in 2025, relative to a likely base case closer to 100 basis points, so short end pricing now looks attractive, in our view.

Long-term gilt yields present a more complex story. Weak growth and higher yields have eaten into the Chancellor's

3. Source: Bloomberg L.P. Data as of Jan. 23, 2025.

fiscal buffer, threatening a further increase in issuance in the new fiscal year. In addition, global influences on term premium, from higher issuance and lower demand from price insensitive buyers, could increase, not decrease, term premium. Perhaps the best near-term catalyst will be a moderation of inflation, which could allow the Bank of England (BoE) to cut, boosting growth and easing fiscal pressures, as the UK would be seen as avoiding a stagflationary outcome.

Australia: Overweight. Pricing looks relatively fair at the front end of the yield curve, in our view, with just under 70 basis points of cuts priced in for 2025, to a terminal rate of 3.65%.⁴ Further out the yield curve, valuations look relatively cheap, with the curve steep on an absolute and relative basis. The 5y5y forward swap rate is 4.88%, which looks very high relative to any long-term estimate for neutral.⁵ Similarly 30-year Australian Commonwealth Government bond (ACGB) yields are now close to 5%, which we believe offers attractive long-term value.⁶ On a relative basis versus US Treasuries and UK gilts, ACGBs now looks less attractive than in October,

after a substantial outperformance. The Reserve Bank of Australia is now priced to cut meaningfully more than both the Fed and the BoE, which should limit further outperformance going forward. However, it should be noted that Australia benefits from favourable fiscal fundamentals compared to many developed market peers.

4. Source: Bloomberg L.P. Data as of Jan. 23, 2025.

5. Source: Bloomberg L.P. Data as of Jan. 23, 2025.

6. Source: Bloomberg L.P. Data as of Jan. 23, 2025.

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Currency outlook

USD: Neutral. The outlook for the US dollar appears robust, given the Trump administration's determination to drive growth higher and the potential for trade tariffs to elevate inflation, thereby maintaining higher interest rates for a longer period. However, the greenback has appreciated sharply since the November election, and a significant amount of optimism is already priced in, in our view. The threshold for further substantial appreciation is high, and we must observe the extent of the new administration's policies on taxation, immigration, and trade tariffs before making forecasts. There are some market parallels with the previous time President Trump was elected; the dollar rallied sharply ahead of his inauguration but gradually declined over the following 18 months. While there are notable economic differences between now and then, if President Trump fails to deliver on his election rhetoric, we may see a more challenging time for the dollar.

EUR: Neutral. Given our pessimistic outlook for the European economy and our expectation that the ECB will lower interest rates more than the market currently anticipates, it is not surprising that we remain cautious regarding the euro. That said, the euro has underperformed in recent months, and its valuations against major peers already reflect a challenging economic environment. To accurately forecast the currency's trajectory, we must gain a clearer understanding of the trade policies the new US administration will implement and assess their potential impact on the euro area.

RMB: Overweight. We remain overweight the renminbi, as we expect it to be resilient relative to peers on a basket basis amid market volatility, and despite moves in the USD/RMB exchange rate. The market has been showing concerns about potential trade tariffs under a new US administration but we expect the renminbi to deliver relatively strong performance against peers in the currency basket, partly helped by stimulus measures, more pragmatic measures by the US and proactive management by Chinese policymakers. We acknowledge that some international investors remain skeptical about China's potential policy effectiveness and current renminbi positions are relatively light.

JPY: Overweight. It is hard to see substantial yen appreciation versus the US dollar in the short term, given relatively strong US growth, the hawkish Fed shift and the scope for US trade tariffs.

However, US growth expectations are relatively high already, leaving some room for disappointment, and it is possible that Japan will try to head off tariffs by increasing currency intervention to support the yen. Current USD/JPY exchange rate levels at 158 are not far from the level where the Ministry of Finance previously intervened.⁷ The yen has more room to appreciate against European and Asian currencies, in our view. Interest rate differentials are narrowing sharply, relative growth is arguably better in Japan and the tariff impact is likely to be equal or more negative for China and the European Union. The euro, British pound, Swiss franc and renminbi exchange rates versus the yen all look too high at present relative to macro fundamentals. Significantly, the yen longs versus the euro, Swiss franc and renminbi are not very negative carry to run, allowing a more patient approach.

GBP: Underweight. Weak growth dynamics and a perception that the UK fiscal and monetary authorities lack credibility is likely to weigh on the pound. The market remains relatively long the pound due to its high carry, making it vulnerable to outflows should negative growth feed into a worse fiscal outcome and/or the BoE is perceived as overly dovish in the face of upside inflation risks. Valuations on a real trade weighted basis remain relatively rich, in our view. The pound doesn't offer a huge carry premium relative to other developed market currencies with better fiscal and growth fundamentals, such as the US dollar, the Australian dollar and the Norwegian krone. An improvement in the growth-inflation trade-off, via better UK supply-side performance, would be necessary to improve the pound's performance, in our view.

AUD: Neutral. The Australian dollar depreciated by almost 4% on a trade-weighted basis over the fourth quarter and 10% versus the US dollar.⁸ It is easy to rationalize the Australian dollar's underperformance versus the US dollar, given the shift in relative interest rates and growth dynamics. However, it is harder to explain why it has underperformed European and Asian currencies that are far more exposed to the threat of Trump administration tariffs and have equally bad, or worse, growth dynamics. It is possible that commodity weakness and the waning of Chinese growth optimism since October has weighed on the Australian dollar, but this now seems relatively overdone, particularly on crosses like the EUR/AUD or GBP/AUD exchange rates.

7. Source: Bloomberg L.P. Data as of Jan. 23, 2025.

8. Source: Bloomberg L.P. Data as of Jan. 23, 2025.

This section highlights the views of Invesco Fixed Income's credit analysts across a broad range of fixed income assets managed by Invesco.

Global credit strategy

Global credit outlooks for 2025

Introduction

David Todd

Head of Global Credit Research

This year kicked off with a trip around Asia and clients were keen to talk about Trump 2.0, the outlook for rates, credit and the US dollar, as well as the state of the UK economy. It felt like we were in the midst of a storm of headlines from President Trump and his team but despite this, both "risk-free" rates and risky assets have been remarkably stable. The MOVE index, which gives an indication of US Treasury volatility, stayed close to the lows of the last few years and, while UK gilts were testing new highs, the moves were far less severe than the reaction to the 2023 autumn budget during Liz Truss's very short term as UK prime minister.

We believe that a pragmatic Team Trump will emerge from the eye of the storm and highlight our "bull-case" view that US investment grade credit spreads could trade meaningfully tighter, despite current "rich" valuations, due to very healthy fundamentals and technicals, and in the context of a 4% neutral rate. We didn't hear too much pushback from clients on this, just a level of uncertainty and tentativeness around putting new money to work. A year ago, many investors had missed the 5% yield opportunity by the time January came. It feels quite similar today, in that flows are not obviously being attracted by the higher yields on offer. Those yields may not be around for too long!

US investment grade

Stronger macro and enhanced US IG market dynamics in 2025

Bixby Stewart, Senior Analyst

In 2025 we expect a stronger macro backdrop, firm corporate fundamentals, elevated yields and improved market dynamics to support our constructive view for US investment grade credit markets.

Spreads are historically tight, but we expect them to continue trading in a tight range. With yields above 5% for high quality businesses with great balance sheets, we expect a continued robust demand pipeline for the investment grade asset class.

We also expect modest spread tightening in 2025, largely supported by an improv-

ing macro outlook and a higher quality, more liquid US investment grade asset class. The US investment grade market should enjoy better dynamics than we've seen in previous years, due to lower average dollar prices, strong balance sheets, historically elevated yields, lower duration and better liquidity, owing to the growth of portfolio trading.

Investable themes for 2025

We see several investment opportunities in 2025, and many revolve around the following themes:

- **Positive on banks and financials.** Financials will likely be beneficiaries of deregulation under the Trump administration. Sector valuation remains attractive, in our view, fundamentals continue improving and, banks and financials may serve as a tariff hedge, given the presumed minimal impact of tariffs on the sector.
- **Underweight energy** based on a lacking margin of safety in credit valuation and President Trump's intent focus on lowering energy prices to achieve his inflation goals.
- **Investing in AI through utility hybrids.** Utility hybrid securities offer a unique way to invest in AI-driven power demand at high yields without sacrificing credit quality.
- **"America First" policy focus** should benefit domestic manufacturers at the expense of multinationals that could suffer in a strong US dollar regime.
- **Growing GLP1 adoption** could cause historically "safe haven" non-cyclical names to be at risk as consumer preferences change, for example, away from packaged foods, alcohol and "junk" food.

US high yield

Growth oriented policies, disinflation and deregulation are a good set-up for high yield in 2025

Andy Geryol, Head of Global High Yield Research

Solid growth in 2024, along with disinflation and a change in Fed posture, helped buoy fundamentals, leading to better than expected returns for the year. Despite even tighter spreads to start 2025, we remain constructive on the US high yield asset class, given strong fundamentals, growth-oriented policies of the incoming administration and expected incremental disinflation. We anticipate the majority of this year's total return will come in the form of income, which remains at attractive levels compared to recent years. The deregulatory bent of the new administration, combined with solid fundamentals and an appetite for risk assets will likely lead to elevated mergers and acquisitions and more issuance. The quality skew in US high yield is near an all-time high, as measured by the mix of BB to CCC issuers. Higher quality companies have many options when it comes to inorganic growth in this type of environment. We will need to guard against overly aggressive behavior that could turn the tide on fundamental improvement. Similarly, we need the new administration to maintain discipline in its growth programs to avoid stoking the flames of inflation and pushing the Fed's stance on rates hawkish. Default rates remain low, particularly when excluding distressed debt exchanges. We expect the default environment to remain benign but will watch for signs of bold balance sheet actions and/or economic overheating as precursors to more challenging future fundamentals.

European investment grade

European macro environment poses challenges

Sam Morton, Head of European Investment Grade Research

After strong performance in 2024, we believe the potential for significant spread tightening in European investment grade credit is limited in 2025. Spreads are close to the post-GFC tightness and, while we do not expect a meaningful pick-up in rating downgrades, we expect the weak growth outlook in Europe to create a challenging operating environment across industries. Given this backdrop, manage-

ment teams are displaying conservatism and we expect this to continue in 2025. Although US tariffs initially appear to be targeted elsewhere, we are concerned that key European industries could be caught in the crossfire. Technicals should be supportive, with a relatively low level of net issuance, thanks to large maturities. From a sector perspective, we are overweight banks, insurance and communications, but have become incrementally selective in the AT1 and corporate hybrids asset classes.

EM credit

Attractive EM yields - but US policy uncertainty and tight spreads leave us mildly cautious

Adrian Garcia, Head of Emerging Markets Corporate Research

With president Trump now in office, US policy uncertainty is unusually high. Many policy proposals made by the new president and his staffers, including massive US territorial expansion, are yet to be clarified. However, we place little stock in much of this, as the exact near-term policy priorities, how aggressively they will be pursued, and the administration's commitment to any given policy, still need to take shape.

In the first Trump administration, the president proved responsive to negative feedback from financial markets, especially the equity market. Current market valuations indicate that investors generally believe this will be the case again, although this is also uncertain.

While there are other considerations for emerging market (EM) debt aside from US policy, it is at the forefront - and a key potential driver - of downside volatility. When we couple this policy uncertainty and its potential for disruption with historically tight spreads across EM sovereign and corporate debt, we are left cautious, as we see risks skewed to the downside. Our sentiment is tempered, however, by relatively good fundamentals across EM and historically attractive yields. In the short term, we could see spreads widen, driving negative total returns for the asset class. But over the medium to long term, the elevated yields offered by the asset class should deliver compelling total returns.

EM credit outlook

Our base case is that fundamentals will remain solid, as we believe there is a low likelihood that Trump pursues trade and security policies at the extreme end of what he has proposed. However, the constant threat of trade war will likely cap any US Treasury rally and enthusiasm for EM. EM governments and central banks remain fairly well positioned to deal with this tense situation, but the core issue remains Trump's position vis-à-vis China, Mexico, and the European Union. Until clarity is brought to this issue, it seems highly unlikely that there will be further compression in EM spreads.

Risks

The scope of potential Trump policies remains the core issue for EM. If Trump decides to take a maximalist approach to trade policy with immediate and prolonged trade wars while also raising broader questions about US fiscal solvency with unfunded tax cuts, there is the potential for rising inflation, slower growth and increased geopolitical tension. Our base case is that the "soft landing" will largely continue with modest trade disputes resulting in retooled trade agreements and tax cuts that are partially offset by spending cuts, adding to the deficit but not exploding it. We are currently less focused on the risks of a China-Taiwan conflict, the Russia-Ukraine conflict and the potential for a broader conflict in the Middle East. But there is not much indication of where Trump might steer American policy in these situations, so we are watching them closely.

Asia credit

Positioning for uncertainties

Yi Hu, Head of Asia Credit Research

The Asia credit market starts 2025 amid greater than usual macroeconomic uncertainty and potential volatility. Policymakers and investors are weighing the potential tariffs being considered by the new Trump administration and its impact on Asian economies and policy settings. This is in addition to the challenging task faced by some central banks in the region to boost domestic economic growth. Hence, despite improvements in many issuers' credit fundamentals, downward pressure may emerge, especially in the commodity and property sectors.

Strong market technicals

Strong technical factors have recently supported Asian credit market performance, which we expect to continue in the year ahead. Local demand, especially from Asian banks, has been a key driver behind strong performance of investment grade bonds. Chinese banks increased their foreign currency bond investment on a net basis by USD33 billion in the first 11 months of 2024.⁹ On the other hand, net redemption (as bonds mature and are repaid by issuers) in Asia has averaged around USD40-80 billion annually.¹⁰ With global investors' allocation to Asian bonds at already low levels, we expect the Asian credit market to remain well supported by favorable supply-demand dynamics.

Policy

Asian policymakers have been proactive with market friendly measures, which are expected to offset shocks. In recent months, we have observed fiscal stimulus and capital market supportive measures in China, a dovish stance from the Bank of Japan and strong support from the monetary and fiscal authorities in Korea.

Because technical factors will likely drive the Asian investment grade space, we expect idiosyncratic risks to differentiate Asian high yield bonds in 2025. We prefer the higher quality and defensive part of the credit curve. In financials, we favor tier-2 bonds from banks in Thailand, Korea and Singapore, and life insurance companies in Japan, while we are underweight banks in Hong Kong. In the investment grade corporate space, we are overall neutral due to what we consider to be tight valuations. Among high yield corporates, we prefer defensive names and resilient double B rated issuers, such as issuers in the renewable energy, infrastructure, gaming and non-discretionary consumer sectors, over single B rated issuers.

From an investment themes perspective, we prefer corporates in India thanks to its resilient macro environment, policy supported issuers, such as state-owned enterprises, and issuers with strong balance sheets, such as China's leading technology companies. We are selective on sectors facing headwinds or tariff risks.

9. Source: PBOC, Invesco. Data as of Nov. 30, 2024.

10. Source: JP Morgan. Data as of Nov. 30, 2024.

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The bottom line: LA fires – macro and credit impacts

The tragic LA fires have raised several questions about their macro and credit impacts. But while the humanitarian crisis is dire, the fires have not materially changed our broad macro views, and from a fixed income perspective, we believe the impact is also manageable. Below, we speak with the IFI team about the implications of the fires in the key areas of macro, insurance, utilities and municipals.

Q: Rob, what is the impact of the LA fires from a macro perspective?

As a humanitarian crisis, the fires will have huge impacts on the neighborhoods and individuals they have affected. But we do not believe the fires will have a major impact on the performance of the broader US economy. Consequently, the fires have not changed our overall macro views on US growth and inflation - we still expect solid growth in 2025 and gradually declining inflation.

To provide context, it is estimated that around 15,000 structures have been damaged in the fires. This compares to an average of around 1.5 million housing

starts per year. Therefore, the fire damage represents a small fraction of the US housing stock. The fires do, however, have the potential to have a big impact on individual sectors, such as insurance and utilities, and the municipal asset class.

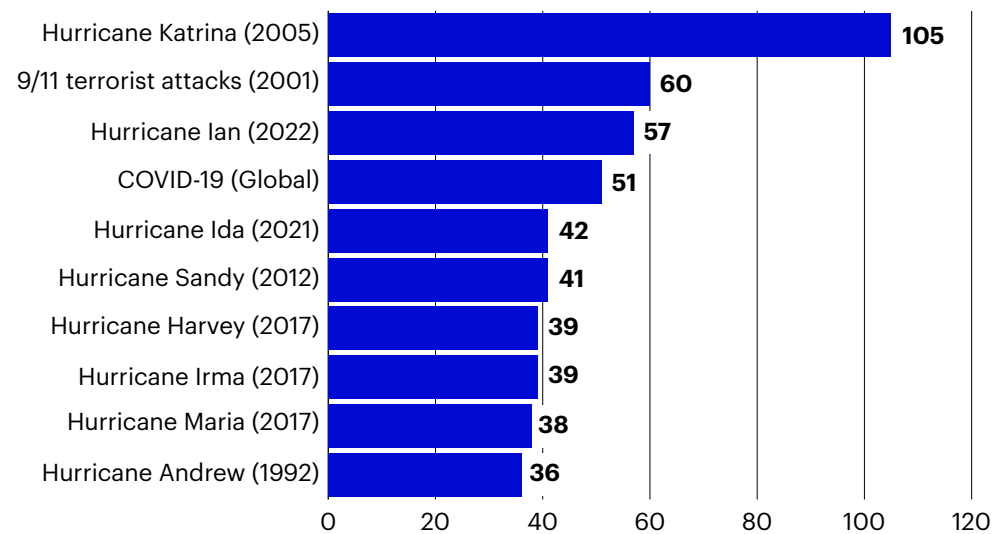
Q: Matt, how do you see the fires impacting the insurance sector?

Insured losses are likely to be concentrated in the residential segment, with lower losses in commercial fire and personal auto. Insured losses could top USD30 billion, according to consensus estimates. Despite this large number, we expect the fires to be a significant but manageable event for the insurance industry.

This is partly because the insurance sector is well capitalized. Also, the sector has weathered even larger events in the past, such as hurricanes (Figure 1). The fires will likely hurt insurers’ profitability, but this is not a solvency or credit story, in our view. Standard and Poor’s has said it does not expect the fires to trigger ratings changes for insurers.

Figure 1: The LA fires’ USD30 billion cost estimate would put it outside the top-10 disaster costs for insurers

Top-10 costliest US catastrophes (USD billion, adjusted to 2024 dollars)



Source: Insurance Information Institute, Property Claims Services by Verisk Analytics, Credit Sights. Data as of Jan. 14, 2025.

Q: Spencer, what is the potential impact on California's utilities?

Of California's three major utilities - Edison International, Pacific Gas & Electric and Sempra - only Edison International is exposed to the fire-affected neighborhoods. The markets have punished Edison's bonds, and spreads have widened since the fires began.

There is currently a question as to whether Edison's equipment may have sparked the fire. Edison has said it is not responsible. California utilities have access to a fund they can tap in the event of wildfires that provides liquidity to repay damages if they are found responsible. There is a USD1 billion deductible, and if Edison is found imprudent, it would also have to pay some USD4 billion to help replenish the fund. In terms of the impact on Edison, it must first be determined if Edison started the fire and the extent of the damage.

Q: Mark, how could the fires impact the municipals asset class?

Historically, municipal issuers have had an extremely low occurrence of default, including after natural disasters. The financial impact of natural disasters is heavily dependent on the municipality's credit quality beforehand. We believe Los Angeles will begin the rebuilding process from a relatively strong economic and financial position.

In the past, federal and state financial assistance after disasters has been significant, in addition to insurance proceeds. But such reimbursements take time, which is partly why a municipal government's recovery is largely dependent on its credit strength, pre-disaster. A key

element is the issuer's access to the debt market and cash reserves. In the short term, liquidity and reserve levels are important to cover clean-up costs, the uncertain timing of FEMA reimbursements and upcoming debt service payments. We believe LA county's large size and importance to the state and national economy increase the likelihood of political support in the form of federal and state aid. On Jan. 13, Governor Newsom proposed that the state legislature expedite USD1 billion in emergency response funding for areas affected by the fires.

In terms of scale, while the damage caused by the LA fires is extensive, we believe it will be far less than the damage caused by the 2018 Camp Fire, in which 90% of the town of Paradise was destroyed. While it has taken six years, the town has been rebuilding and, by 2024, had essentially fully rebounded in terms of assessed property values. While there are some long-term financial risks from this event, including population out-migration, this isn't expected to have a material credit impact. In addition, rebuilding typically increases sales tax revenue to the municipality over the long term.

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Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/ or interest.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

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