RBC BlueBay
Asset Management

Positioning portfolios for 2025 ABS: a solution in volatile and benign markets

For professional investors only | Marketing communication

Securitised Credit team

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"We explore two possible scenarios for 2025 – volatile and benign – and discuss how asset-backed securities (ABS) can provide the solution in both outcomes."

The year ahead has multiple pockets of uncertainty such as rates and inflation, policy uncertainty, tariffs, and geopolitical events. At the same time, spreads are tight across broader risk markets, which limits the potential for spread tightening going forwards.

Given this backdrop, we explore two possible scenarios for 2025 – volatile and benign – and discuss how asset-backed securities (ABS) can provide the solution in both outcomes. In a volatile scenario, ABS has compelling properties including short spread duration, high quality, attractive carry, a floating rate nature, and embedded default protection. In a more benign environment, all these characteristics are still beneficial and at the same time catalysts, such as ratings upgrades, can lead to more spread compression and a higher total return.

Scenario 1: Volatility

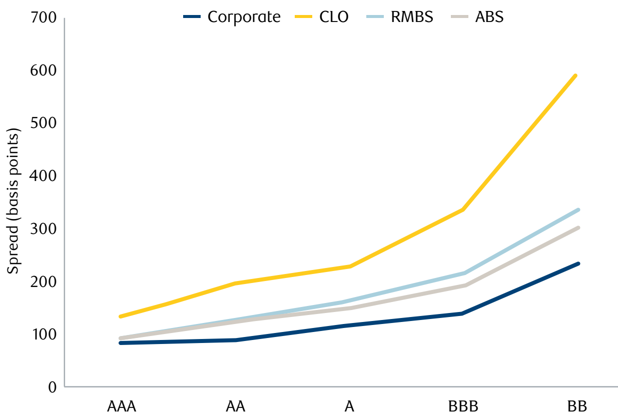
Market disruptions and volatility, almost by definition, occur when unexpected. Having said that, there are a number of factors we could point to today as potential sources of volatility this year – including a potential inflation rebound, higher for longer rates, and policy uncertainty. What makes the situation more fragile is that spreads are currently very tight across broader risk markets (Chart 1) and, as such, volatility events are not priced in, which could amplify any disruption.

How to position in the event of volatility?

In this scenario, investors would benefit from volatility if they have positioned their portfolios to be floating rate, higher quality, shorter spread duration with higher carry, as these characteristics can provide some cushion to drawdowns. It enables investors to re-position after any drawdown into higher beta assets that provide a more attractive total return potential in the event of a recovery.

How can securitised credit help?
Securitised credit markets are, by nature, skewed towards higher ratings, with the vast majority of outstanding bonds investment grade rated and isolated from an increase in defaults. In addition, bonds typically have shorter spread duration versus investment grade corporates and are floating rate. Finally, due to technical factors such as high supply, spreads and carry are attractive (Chart 1).

Chart 1: Securitised versus corporate spreads (GBP)



Source: RBC GAM, Bloomberg, DB, BAML, as at 14 January 2025, Indices AAA – ER10, AA – ER20, A – ER30, BBB – ER40, BB – HE10.

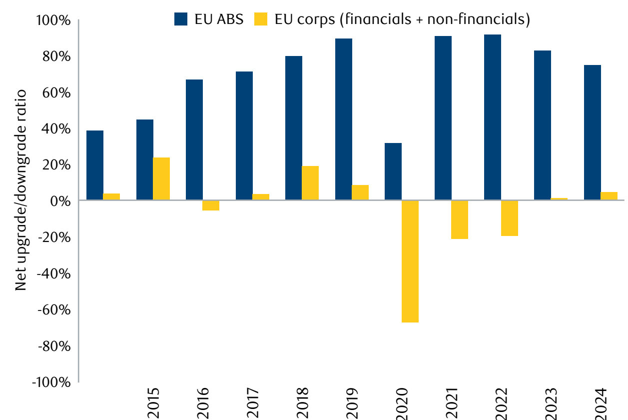
Scenario 2: Markets remain benign and range-bound

Tight spreads today limit the potential for spread tightening going forwards, but with the potential for a stable economic backdrop, and if inflation is well-behaved, there is a good chance that we see spreads remain range-bound in 2025. At the same time, demand for yield remains high, and any pockets of volatility could be well bid, reducing the time investors have to take advantage of them.

How to position for benign market conditions?
As in the case of volatility, high carry in good quality bonds is beneficial, however, to outperform you also need a catalyst to generate a higher total return. A good example of a catalyst is targeting bonds that are likely to receive rating upgrades. Then, post upgrade, you can sell at a tighter spread, not only generating the carry received whilst holding the investment, but also the price appreciation having sold the bond at a tighter spread.

How can securitised credit help?
ABS has an exceptional record of rating upgrades. In 2024, European ABS bonds received 1,328 rating upgrades versus only 195 downgrades. This was not a one off – over the last decade there have been considerably more upgrades than downgrades on an annual basis (Chart 2). This phenomenon is driven by the natural characteristic within ABS bonds that they de-lever and de-risk over time. Whereas corporate bonds are typically bullet maturities, ABS amortise over time, which de-risks them, and as a result they consistently get upgraded. This provides opportunities to generate total return even in a more range-bound benign market environment.

Chart 2: What are the catalysts for total return? Ratings upgrades



Source: Morgan Stanley, RBC GAM, as at 31 December 2024.

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