Where to be in 2025: Canadian Credit

High Quality Credit Poised to Outperform

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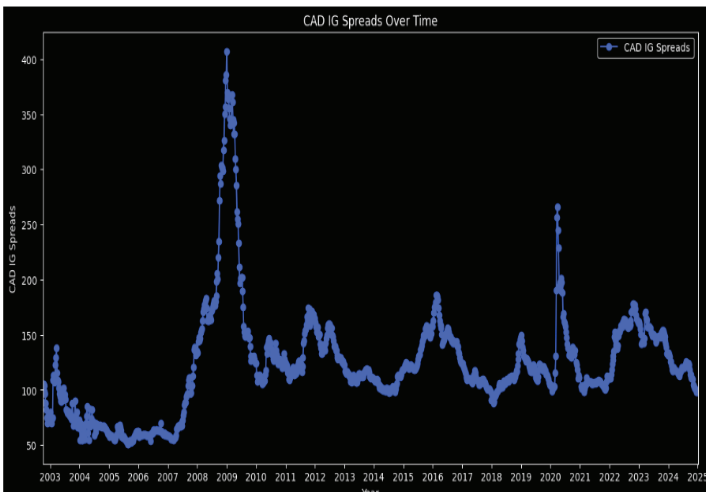
Volatility dominated the last 5 years. With equities at record highs, interest rates oscillating wildly, and an unpredictable U.S. administration on the horizon, no one expects volatility to abate. Canadian credit has cut through the volatility and outperformed other risk classes. We see no reason for that outperformance to change in 2025.

We've been here before

At the time of writing, Canadian Credit spreads are about 100 bps. CAD IG spreads have broken below 100 bps a total of 14 times since 2002. On average, spreads have stayed below 100 bps for approximately 20 weeks, including 219 weeks in 2003 and 15 weeks in 2017.



Bloomberg Can Agg Corporate 1 - 5 years OAS, Jan 1, 2003 - Dec 31, 2024. Source: Bloomberg

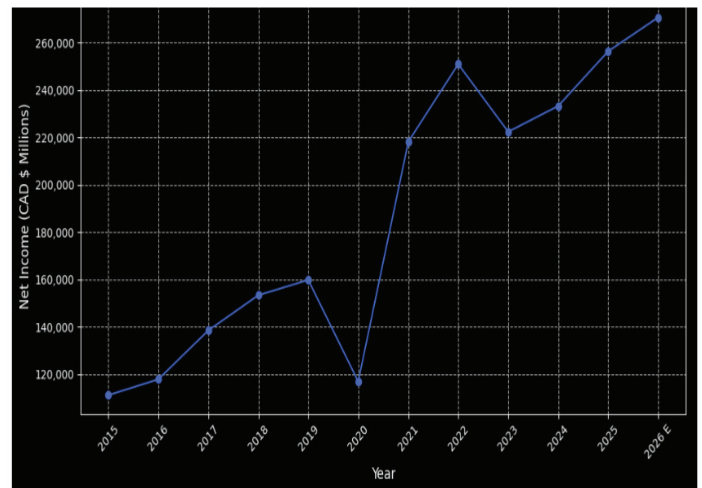
2025 Macro

Our current macroeconomic environment is characterized by subdued yet steady growth and continued moderation in inflation. Canadian GDP growth in 2025 should hover modestly below trend, constrained by factors such as ongoing restrictive monetary policy, marginally more painful mortgage resets, and a potential reduction in net immigration flows. Meanwhile, the Bank of Canada's estimates of an economy in excess supply since Q3 2023, combined with a softening labor market and the waning influence of mortgage interest costs on CPI, heighten the probability that inflation stays below the 2% target in 2025.

Corporate Fundamentals are Strong

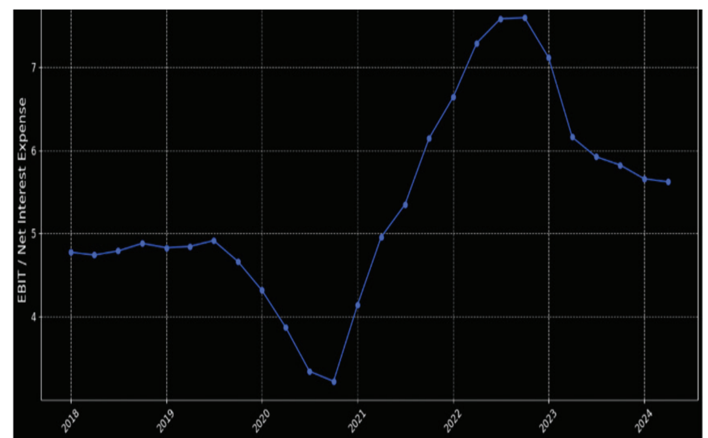
Corporate fundamentals remain robust on both sides of the border. In the U.S., the 2024 upgrade / downgrade ratios are up strongly from 2023 levels and IG industrial profit margins have handily eclipsed pre-COVID levels. In Canada, TSX earnings growth forecasts and interest coverage ratios are strong, as illustrated below.

TSX Aggregate Net Income, with Forecast



January 6, 2025. Source: Bloomberg

EBIT / Net Interest Expense TSX Companies: Well Above Pre-COVID Levels



January 6, 2025. Source: Bloomberg

This fundamental momentum suggests that even if the pace slows, baseline credit quality across North American IG issuers remains strong.

And in that corporate strength lies an important distinction between credit and other asset classes.

Unlike equity values that are historically stretched on virtually any metric, the same companies are not at risk of defaulting on their short-term debt.

And unlike long only fixed-income, credit is not at the mercy of volatile and increasingly unpredictable interest rates that are currently bouncing around at low levels.

Market Technicals Underpin Tight Spread Range Expectation

When considering spread levels, it's critical to adjust for the marked shortening of CAD IG duration since 2022. Shorter duration for the market means less risk and lower risk premiums in the form of spreads. Duration-adjusted analysis suggests there could be as much as 15-20 bps of additional compression before current valuations reach their 2021 tights on a like-for-like basis.

More broadly, supply / demand market dynamics are supportive of tighter spreads.

On the supply side, we expect less new issuance supply in 2025 than the record set in 2024 and there has been a persistent undersupply in Canadian financials. Also, although potential issuance from new entrants and robust sustainability-linked financing is likely to drive increased supply, the new issuances will increase the overall depth and appeal of the market.

On demand, there are three factors that will create a tailwind.

First, there is a substantial wall of maturities in 2025 that will recycle money back into the market.

Second, the inclusion of certain Maple bonds into local indices will drive demand from benchmark-focused investors.

Last, mutual fund inflows are expected to continue as the BoC continues to cut rates, while global yield-buyer interest should remain intact as currency-hedged valuations for overseas investors remain compelling.

These types of strong market technicals have historically coincided with periods of stable or tightening spreads.

In these environments we are confident in our ability to add alpha through relative value trades combined with carry.

Pockets of Value

A way to add alpha in this tighter spread enviroment is to identify and trade in pockets of value.

Canadian bank debt is one of several examples, as shown below. Depending on the issuer and security, current pricing suggests that there is the potential for bonds in the pocket to increase in value or to withstand volality better than more expensively priced bonds.

Current Constant Maturity Spreads vs. 2021 Tights

Issuer / Security	2 yrs	3 yrs	5 yrs	7 yrs	10 yrs	30 yrs
Nat Bank, Bail-in	25	25	30	25	20	5
RBC, TD Bail-in	20	20	20	15	10	-5
Nat Bank NVCC Sub-Debt	20	25	35	30	30	20
RBC NVCC Sub-Debt	25	30	40	35	35	25

January 6, 2025. Source: Canadian Bond Dealers

Potential bumps

Macro and policy shocks could challenge our baseline expectations. Tariff threats remain a significant risk factor, which, if manifested, would have a harmful impact on the Canadian economy. And, as always, both the known unknowns and the unknown unknowns in the form of geopolitical risk, which is arguably increased by the incoming U.S. administration, underscore the importance of closely monitoring geopolitical developments and reacting quickly when necessary.

Positioning and conviction

This left-tail risk and the current risk / reward trade-off at current valuations has resulted in our decision to enter 2025 with overall risk slightly below our long-run averages. In creating our portfolios, we have purposefully emphasized quality and liquidity.

Considering the totality of 2025, our expectation is that the year will not necessarily be orderly, even if credit markets are positioned more favourably than equity and long-only fixed income markets.

Our risk pre-positioning and the tools at our disposal give us maximum flexibility to react to market risks and then to take advantage of market opportunities.

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