Fixed Income Views

September 2023

OUR VIEW AT A GLANCE

Key takeaways

- **The charts**: In response to robust economic data from the United States, global yields saw a slight increase, with the 10-year US yield rising by 15 basis points (bps.) , GBP by 6 bps., while EUR and CHF remained unchanged. Credit spreads also expanded, with Global Investment-Grade (IG) spreads up by 2 bps. and High-Yield (HY) spreads by 10 bps. from their July lows.
- **Our view**: With the conclusion of the Fed's Central Bank symposium in Jackson Hole, during which central bank speakers did not provide any new information, we anticipate the European Central Bank (ECB) will implement a final rate hike in September, and the Bank of England is likely to raise rates further in September.
- **Our positioning**: Last month, we balanced our European bond holdings with our US positioning, aligning our fixed income strategy more closely with the US. We may consider overweighting both asset classes in the future, but this would require stronger confidence in a favorable inflation and growth outlook.

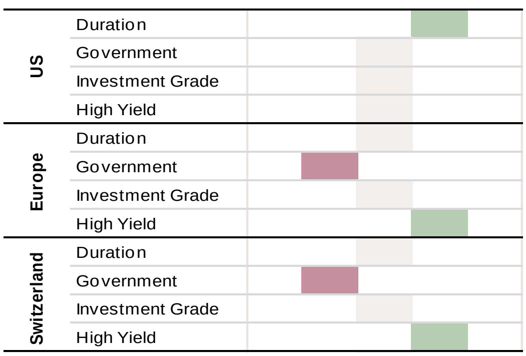
OUR MARKET VIEW

Economic strength is most visible in the US, where annualized growth as we entered the third quarter seems to have accelerated markedly. Against this backdrop, the US Treasury note yield in August rose briefly to its highest levels since 2007. Economies look most fragile in Europe, particularly in the eurozone, though unemployment is still historically low, and there is a marked divergence between weak subjective survey data and more resilient data on output and spending.

Inflation continues to trend lower, but at varying speeds. The trend is best established in the US, despite its more robust economy, whereas in Europe core inflation rates in particular have yet to peak convincingly.

Bonds are no longer expensive, and more bonds in the US and UK are once again offering yields which seem likely to exceed even the above-target inflation we expect to continue. However, with the final instalments of monetary tightening still uncertain, and with resumed rate cuts only a remote prospect, we think it is perhaps premature to turn more positive – particularly in Europe, where real yields remain lower, and where we only returned to neutral in July.

FIXED INCOME ALLOCATION

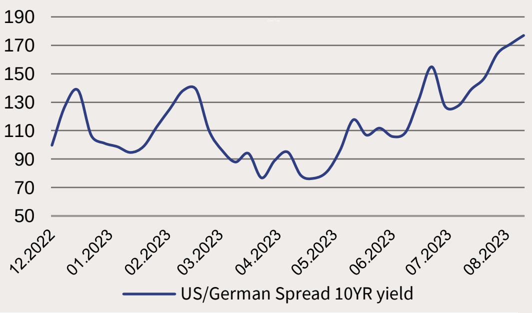


US: The 10-year yield reached 4.34% in August, its highest since November 2007. Due to the appealing yield, we maintain a slight overweight position in USD duration.

EU: In July, we upgraded our fixed income outlook from underweight to neutral. We still favor High-Yield (HY) bonds in the credit segment.

CH: We raised the asset class from underweight to neutral. Our preference for HY bonds remains in the credit segment.

CHART OF THE MONTH: US / German Spread of 10-year government bonds



The charts: Comparing the yields on 10-year US Treasury bonds to 10-year German government bonds since the start of the year.

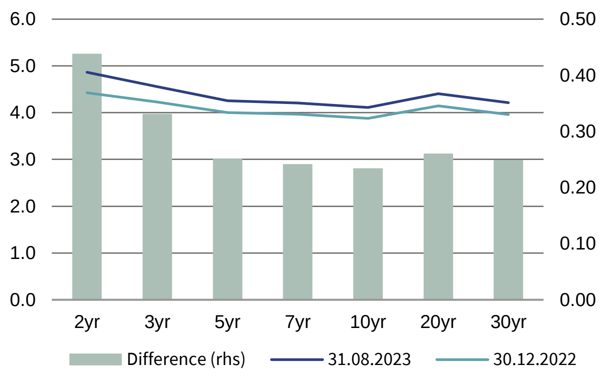
Our view: As the economic outlook in Europe continues to worsen, the yield spread between the US and Germany, serving as a proxy for Europe, has been rapidly increasing since June. This reinforces our expectation of both the Fed and the ECB pausing later this autumn. We believe the era of central bank 'hawkishness' has peaked

USD Fixed Income Market

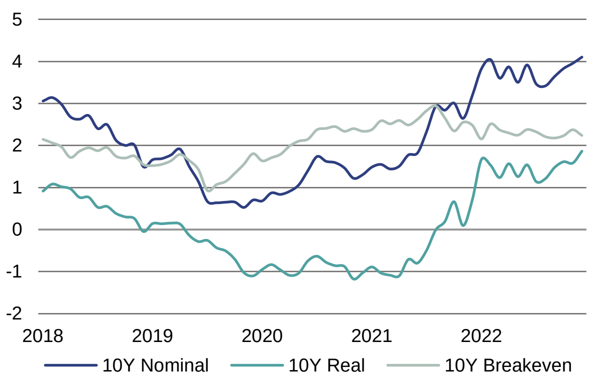
Key takeaways

- **The charts:** In August, Fitch downgraded the US long-term rating from AAA to AA+. US government bond yields increased by 20 basis points during the month, while credit spreads widened.
- **Our view:** Hawkish central banks, robust economic data, and the Fitch downgrade were the driving forces behind the rise in yields. Real yields also increased, while breakevens remained unchanged from last month. We remain convinced that the Fed's hiking cycle is nearing its end, with one last potential hike in the fall.
- **Our positioning:** We hold a neutral bond position with a slight overweight in US duration. We are open to the possibility of increasing our exposure to this asset class, dependent on the outlook for lower interest rates.

YIELD CURVE EVOLUTION (%)

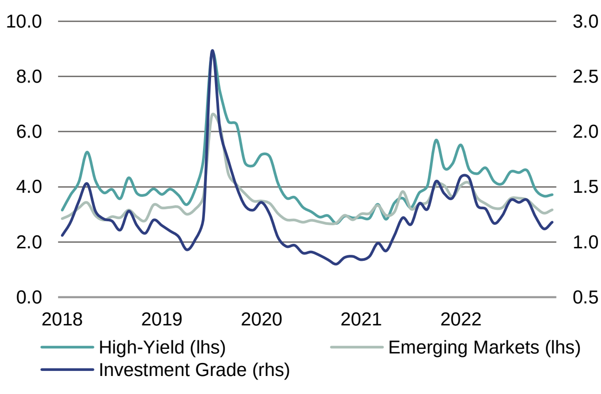


10-YEAR YIELD BREAKDOWN (%)

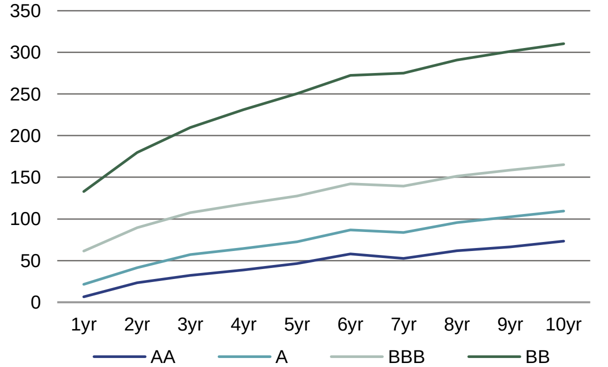


YIELD CURVE STEEPNESS 10-2 YEARS (BPS.)

CREDIT SPREADS EVOLUTION (%)

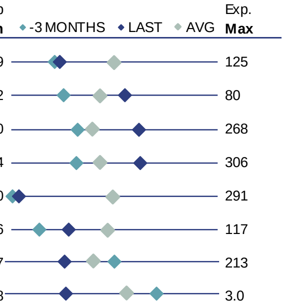


CREDIT CURVE (Spread vs. government bonds in basis points)



CREDIT LONG-TERM VIEW

	Last	Cheap Min	Exp. Max
US IG Credit Spread Deviation FV	-17	-59	125
IG OAS (Gov) Spread •	118	272	80
HY OAS (Gov) Spread •	372	880	268
Corporates BB/BBB-Spread •	111	54	306
IG Curve Slope (10-2yrs)	-10	-30	291
HY Curve Slope (10-2yrs)	-104	-336	117
EM Sovereign USD Spread •	317	657	213
EM Local Currency Yield •	4.2	5.8	3.0



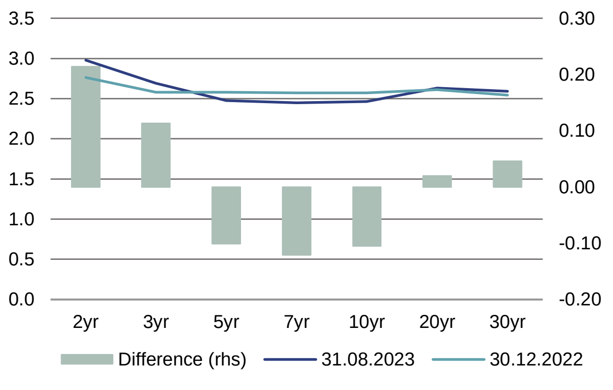
All data source: Bloomberg, as of 31.08.2023

EUR Fixed Income Market

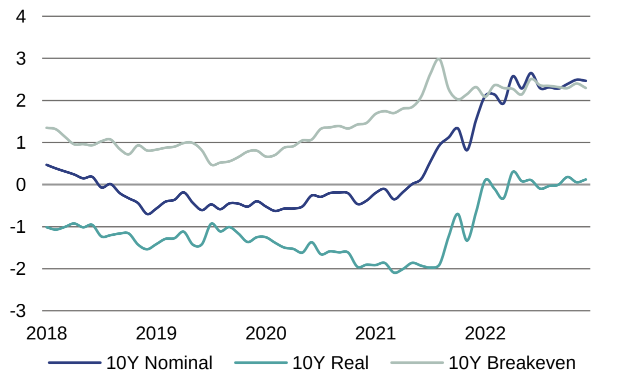
Key takeaways

- **The charts:** Core government bond yields were stable in August. German yields initially rose to levels last seen in March but later fell due to weak economic data, leading to wider credit spreads.
- **Our view:** We anticipate the ECB's final rate hike in September, but the deteriorating economic outlook increases the likelihood of a subsequent pause. The uncertain timing of this final hike may result in volatility, which we view as an opportunity rather than a risk.
- **Our positioning:** We raised our outlook for EUR duration and EUR Fixed Income. Overweighting Fixed Income in the future is possible, but it would require even stronger confidence in a favorable inflation and growth scenario.

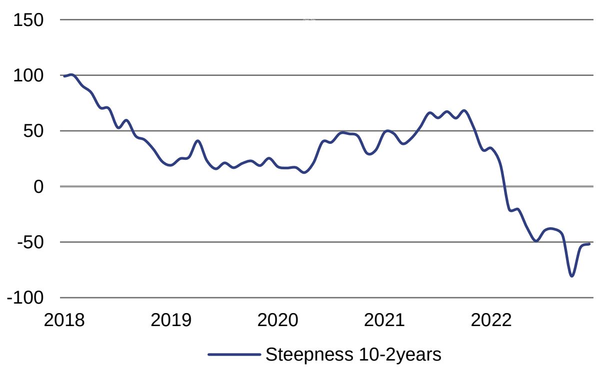
YIELD CURVE EVOLUTION (%)



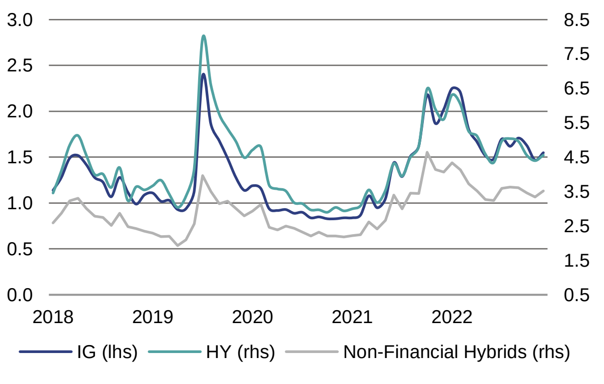
10-YEAR YIELD BREAKDOWN (%)



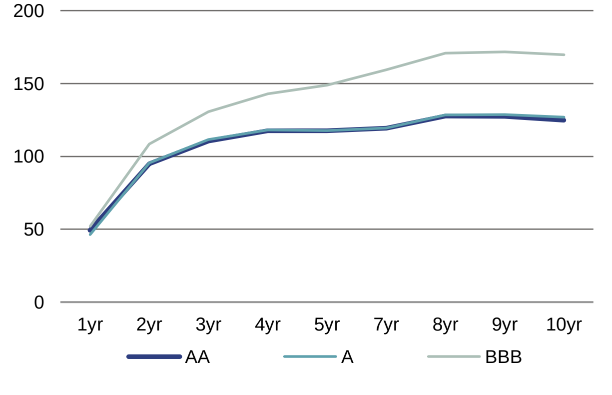
YIELD CURVE STEEPNESS 10-2 YEARS (BPS.)



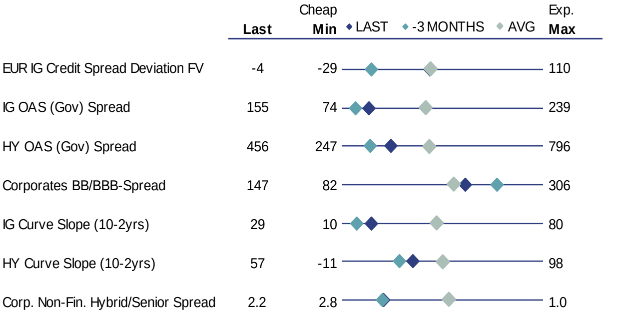
CREDIT SPREADS EVOLUTION (%)



CREDIT CURVE (Spread vs. government bonds in basis points)



CREDIT LONG-TERM VIEW



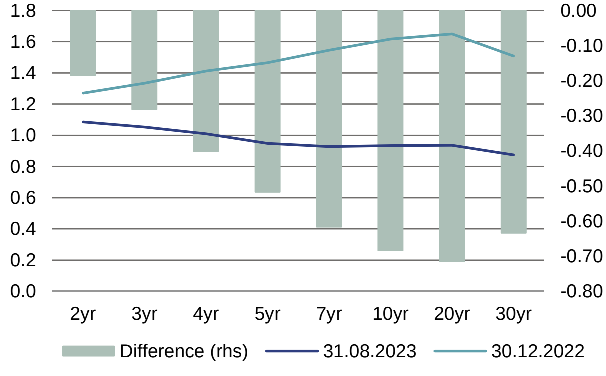
All data source: Bloomberg, as of 31.08.2023

CHF & GBP Fixed Income Market

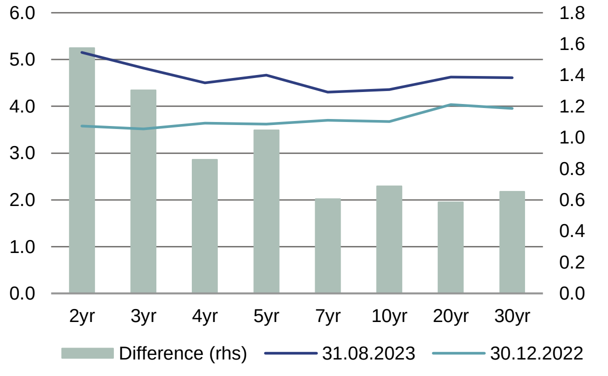
Key takeaways

- **Our view (CHF):** Since the last Swiss National Bank meeting, inflation has consistently slowed, now standing at 1.6%, and it's anticipated to slow further in the upcoming August reading. With the policy rate at 1.75%, the real policy rate lacks significant positivity, which could influence the decision regarding a pause in September. This decision may ultimately depend on the ECB. However, Swiss policymakers are expected to increase their benchmark rate in their forthcoming meetings.
- **Our view (GBP):** August was a volatile month for UK fixed income rates. Yields initially rose but later retraced. Breakeven inflation levels remain above long-term averages, and UK inflation remains well above the central bank's target.

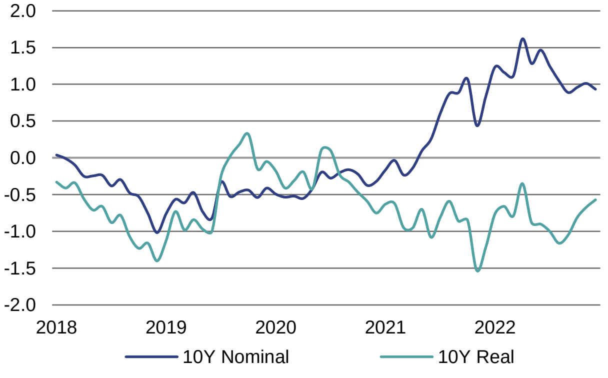
YIELD CURVE EVOLUTION (CHF, %)



YIELD CURVE EVOLUTION (GBP, %)

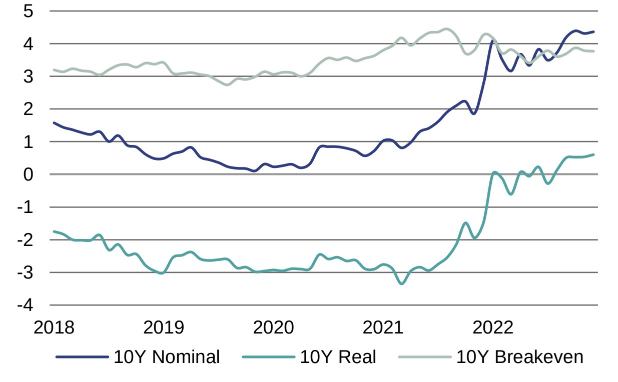


10-YEAR YIELD BREAKDOWN (CHF, RY* on core CPI)

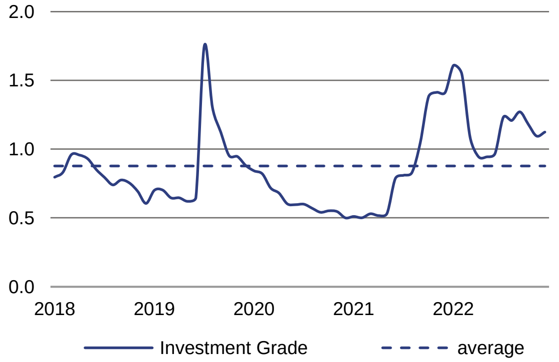


*RY = Real Yield

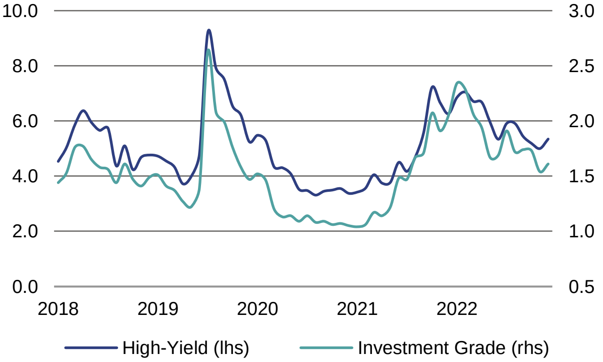
10-YEAR YIELD BREAKDOWN (GBP, %)



CREDIT SPREADS EVOLUTION (CHF, %)



CREDIT SPREADS EVOLUTION (GBP, %)



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