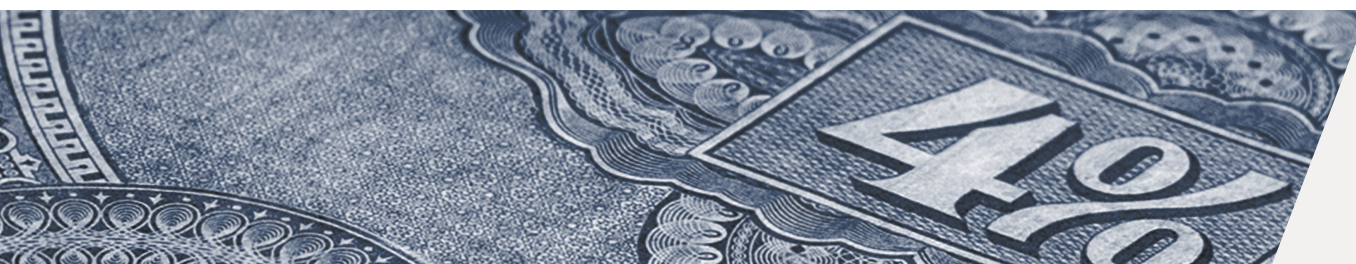


Fixed Income Views

May 2024



Fixed Income Allocation

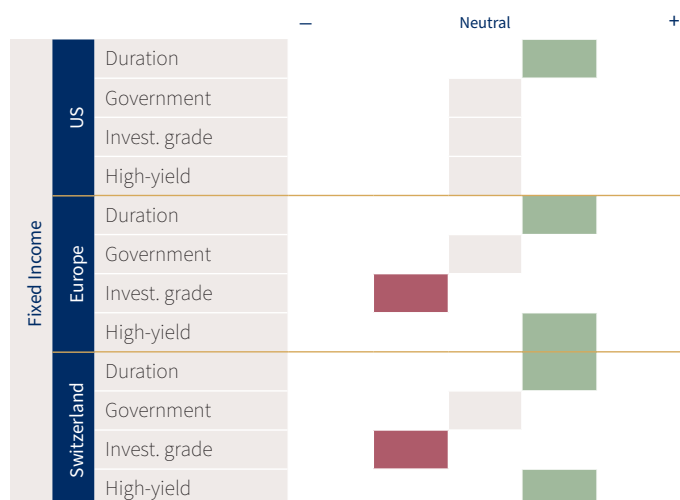
At the start of the year, money markets were expecting roughly seven 25 bps US rate cuts in 2024. By end of April that had fallen to barely one. After such a rethink, it would hardly be surprising if expectations of a renewed rise in interest rates were to take hold.

US inflation has been stubbornly firm, but not alarmingly so, given that we think we are likely now in the “last mile” of the disinflation journey. Meanwhile, the US economy continues to look relatively resilient, despite a softer-than-expected GDP headline in the first quarter, but not sufficiently so as to revive fears of a reversal in that disinflationary trend.

We have always been in the “higher for longer” camp. We did not see expectations backing up this far – but then the US economy has been even more resilient than we’d thought it might be. It would be foolish to rule out the possibility of rates having to rise further – “even higher for even longer” – but we still doubt that will happen.

The door is still open for European policy rate cuts in the months ahead: economies are softer, and in the eurozone – where the ECB has effectively told the markets to expect a cut in June – inflation is softer too.

Within bond markets, we continue favour longer-duration exposure across all currency bases, despite bonds’ renewed weakness. Even as US interest rate expectations have backed up, we still see the risk-return balance as skewed positively: if US policy rates were to rise further, we doubt that long-dated yields would stay much higher for long, and indeed could imagine a more pronounced rally unfolding in due course as renewed recession fears took hold. We have no strong preference for credit quality, favouring credit and government bonds equally.



Our positioning

EUR: Our long duration view for European bonds has not worked out this year: long-dated German government bond yields have continued to rise (with prices retreating further) in April. As the ECB approaches its first interest rate cut, anticipated in June, we expect an improvement in the bond outlook. A slight divergence persists between European and US portfolios: we retain an overweight in sub-investment grade bonds (“high yield”, speculative bonds) in Europe, financed by an underweight in investment grade credit. They remain an important source of income in European portfolios and have not yet been affected materially by the recent rebound in market noise. In US portfolios we stay completely neutral along the entire credit quality curve.

USD: Our positioning of US bonds remains unchanged from last month. Similar to Europe, we maintain a neutral position on bonds in our asset allocation, with an overweight in US duration. We are open to the possibility of further increasing our exposure, depending on developments in economic growth and policy outlook. In US portfolios we stay completely neutral along the entire credit quality curve.

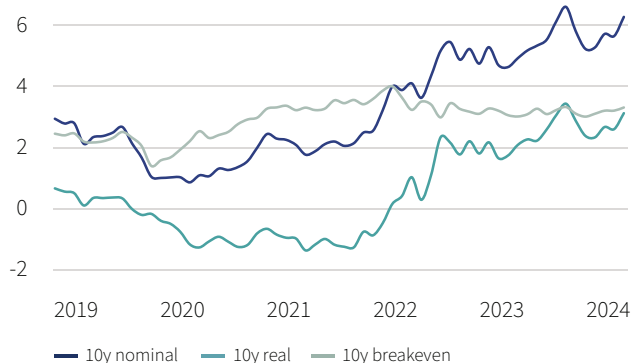
CHF: In contrast to the US and Europe, our long duration position in Switzerland has contributed further to positive performance. In addition to this, we are underweight in investment-grade credit, favouring speculative grade bonds.

Chart Flash

US and Eurozone

US 10-year yield breakdown (%)

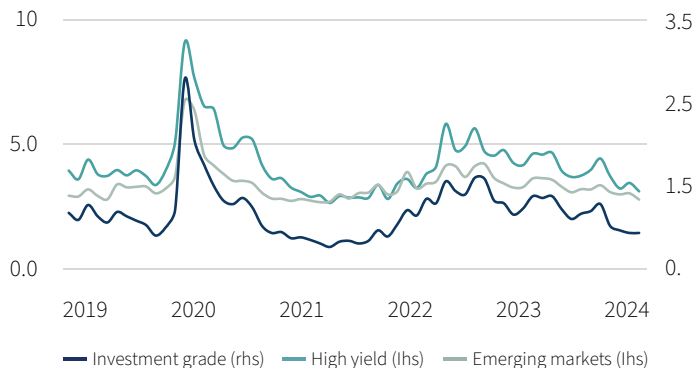
Yields are up in April



All data source: Bloomberg, 31.03.2019 - 30.04.2024. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

US credit spreads evolution (%)

Spreads are still tight

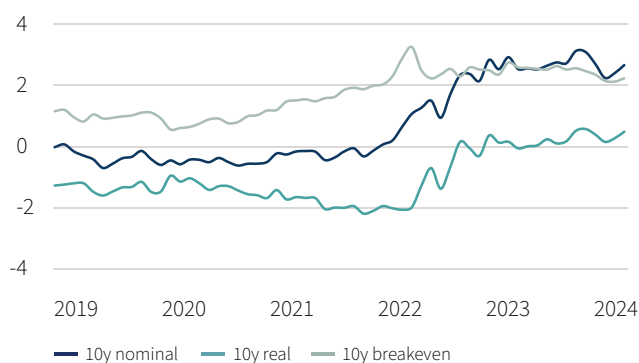


All data source: Bloomberg, 31.03.2019 - 30.04.2024. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

The upward trend in US Treasury yields continued in April, driven by stronger-than-expected inflation data, with yields rising over 40 basis points in the last month. Not only have long-end yields increased, but market expectations for Fed rate cuts have also been adjusted. In December, markets anticipated six rate cuts in 2024; by the end of April, forwards were pricing in fewer than two cuts by the end of the year, which is lower than the three cuts implied by the Fed's own dot plot for 2024. Our expectation for a first rate cut later this summer remains unchanged, though the risk of a delay is now significantly higher than at the start of the year. However, as long as the trajectory of inflation remains consistent, we still anticipate the Fed will soon cut rates, which should, in turn, support a decrease in long-end yields.

EU 10-year yield breakdown (%)

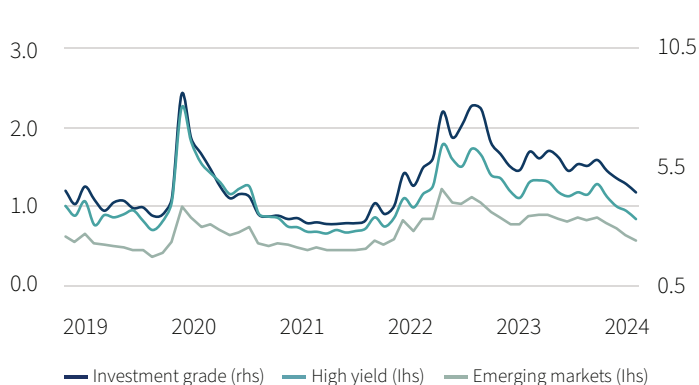
Break-out of long-end yields in Germany?



All data source: Bloomberg, 31.03.2019 - 30.04.2024. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

EU 10-year yield breakdown (%)

Some spread volatility in April



All data source: Bloomberg, 31.03.2019 - 30.04.2024. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

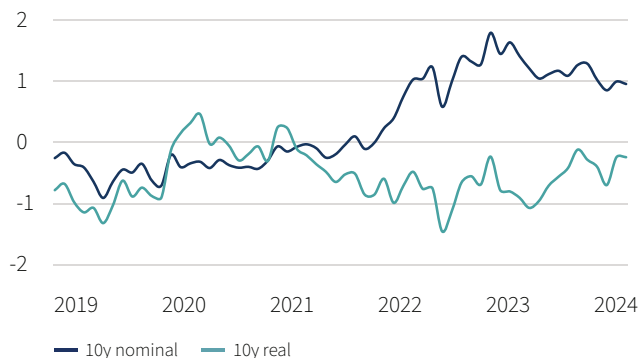
10-year German government yields have broken out of the sideways range maintained since mid-January. Similar to the US, we have observed a repricing of expected ECB rate cuts for this year, with the number now reduced to three from seven at the end of December 2023. However, unlike the US, current inflation data still support our expectation of an initial rate cut as early as June this year, reinforcing our view that the ECB will start its cutting cycle ahead of the Fed. Eurozone inflation has decreased to 2.4% and core inflation to 2.7% in April. Although economic data in Europe are showing slight improvements, they still pose no risk to the ECB's outlook.

Chart Flash

Switzerland

CH 10-year yield breakdown (%)

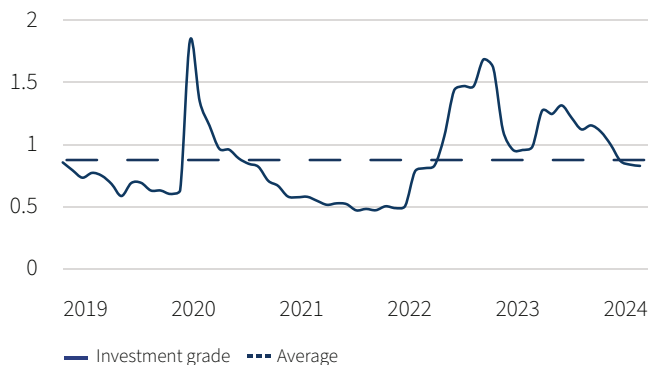
Yields continue move sideways...



All data source: Bloomberg, 31.03.2019 - 30.04.2024. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

CH credit spreads evolution (%)

...just like corporate spreads do



All data source: Bloomberg, 31.03.2019 - 30.04.2024. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

The SNB surprised the markets by reducing rates from 1.75% to 1.50%, marking the first rate cut among G10 central banks. Since then, news flow has been subdued, and yields for 10-year Swiss government bonds have moved sideways with very low volatility. Markets are pricing in another cut by June and a third by the end of the year, which supports our view of lower yields at the long end of the yield curve. Compared to most other Western economies, inflation in Switzerland is well below 2% (1.2% for February), providing the SNB with monetary room for maneuver.

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