Fixed Income Views

July 2024

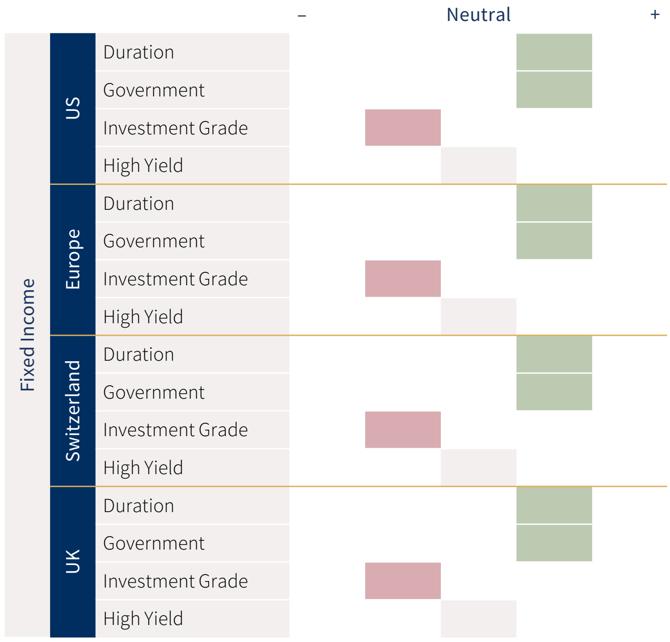
Fixed Income Allocation

Last month a busy geopolitical agenda had been made even more so by the announcement of unexpected parliamentary elections in France, and an earlier-than-expected general election in the UK. But neither development is likely to materially affect our asset allocation longer term. We still think the levels of global interest rates and corporate profitability are the key variables.

The backdrop is a mix of ongoing economic growth with disinflation, which has been delivering healthy profitability alongside the prospect – now the reality – of declining interest rates. The US economy remains the most robust major economy, but business surveys suggest that European growth rates may have bottomed and be poised to revive.

Interest rates are not falling as fast or as far as money markets were initially expecting, but "higher for longer" seems to have been priced for in a couple of months now. The SNB and now the ECB has felt able to start cutting rates, and we think the Bank of England and then the Fed will follow suit in the third quarter.

Within bond markets, we continue to favour longer-duration exposure across all currency bases, which has supported performance in the last month after US inflation in May undershot expectations and the ECB followed through on its rate cut guidance. In this context we still see the risk-return balance as skewed positively: with yields now back at "old normal" levels, and inflation closer to targets, there are fewer inflation "vigilantes". If yields were to spike higher again, we doubt they would stay elevated for long, and can imagine a more pronounced rally unfolding in due course as renewed recession fears took hold.



Our positioning

EUR: Last month we closed a long-standing overweight in European high yield credit, and in US investment grade credit, to move overweight in government bonds and coincidentally to leave both eurozone and US fixed income portfolios fully aligned. We maintain a long-duration view for European bonds and anticipate further rate cuts by the ECB later this year, which should support our position.

USD: Similarly to Europe, our Asset Allocation positioning to bonds is neutral, but we are overweight on US duration. We remain open to increasing our exposure further, subject to developments in growth and policy outlook. In our US portfolios, we prefer government over corporate bonds.

CHF: In contrast to the US and Europe, our overweight positioning in long duration in Switzerland has already paid off. As in the US and Europe, we are neutral on speculative credit, underweight in investment-grade credit, and overweight in government bonds.

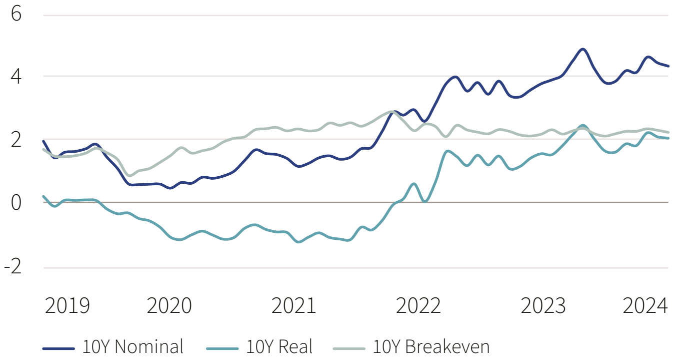
Rothschild & Co

Chart Flash

US and Eurozone

US 10-year yield breakdown (%)

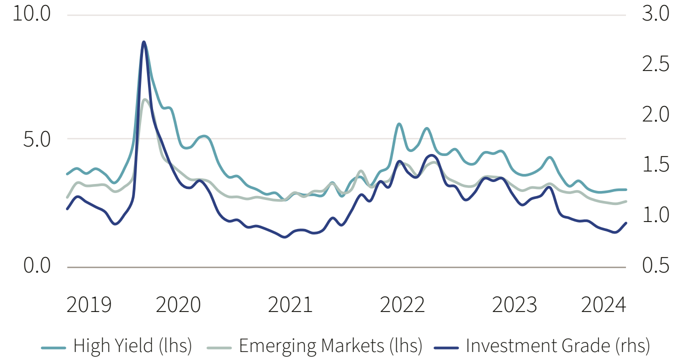
Yields are lower in June



All data source: Bloomberg, 31.03.2019 - 28.06.2024. 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 (%)

IG Spreads wider but less than in Europe



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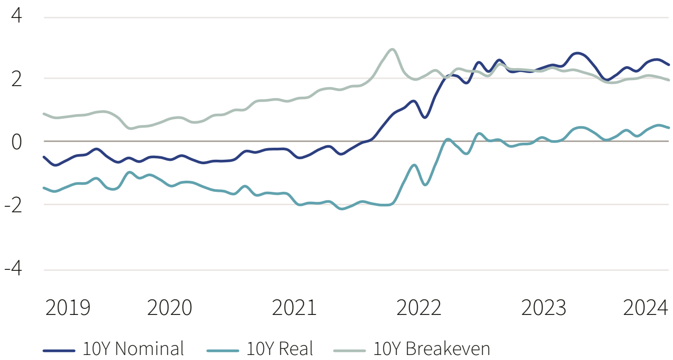
US Treasuries performed well in June, with yields on 10-year US-Treasuries falling by 10 bps. Before yields finally edged lower, there was considerable volatility due to mixed macroeconomic data in June. At the beginning of the month, a very strong labour market report for May led to a sell-off in Treasuries. However, with May inflation data coming in lower than expected, Treasuries rallied strongly. The announcement of unexpected parliamentary elections in France was the main driver for the subsequent decline in yields. By the end of June, forward markets were pricing in fewer than two cuts by the year- end, which is more than the Fed's updated dot plot implies (one cut for 2024).

EU 10-year yield breakdown (%)

France snap elections driver for lower yields



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EU credit spreads evolution (%)

Credit spreads widened

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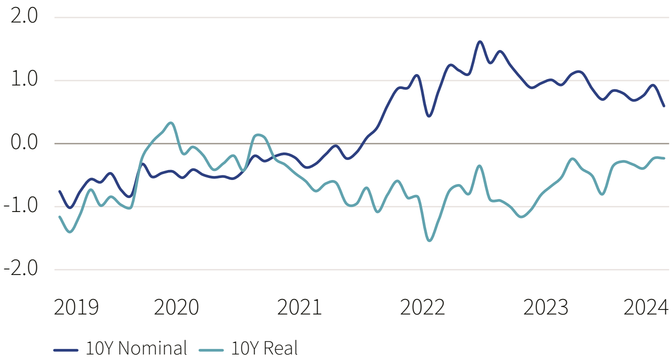
President Macron surprised markets by calling snap elections, which drove German government bond yields lower. Technically, yields for German government bonds have broken the uptrend that started at the beginning of 2024. We expect more cuts by the ECB later this year, aligning with the capital market's expectations of almost two full cuts being priced in. Credit spreads widened significantly following the announcement of the snap election by 15 bps for investment-grade and 50 bps for speculative credits. We expect more volatility ahead until the final results of the France parliamentary elections are announced in July.

Chart Flash

Switzerland

CH 10-year yield breakdown (%)

Yields are lower in June



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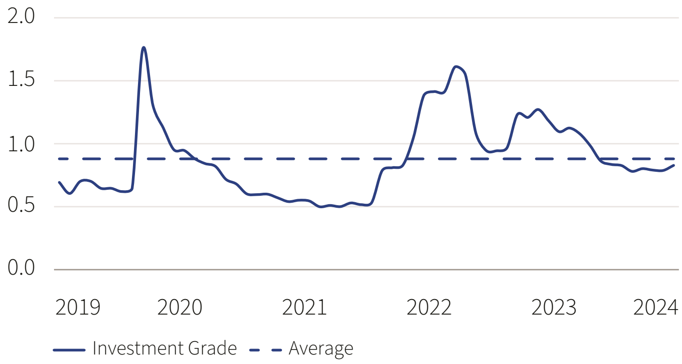
CH credit spreads evolution (%)

Credit widened a bit



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Swiss government bonds experienced a strong rally in June. The SNB cut rates for the second time, from 1.5% to 1.25%, making it the first G10 Central Banks to implement a second cut. This is surprising, given that inflation has reaccelerated since March, rising from 1.0% to 1.4% in May. Interest rate markets are pricing in a third cut by the SNB in December 2024.

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