Fixed Income Views

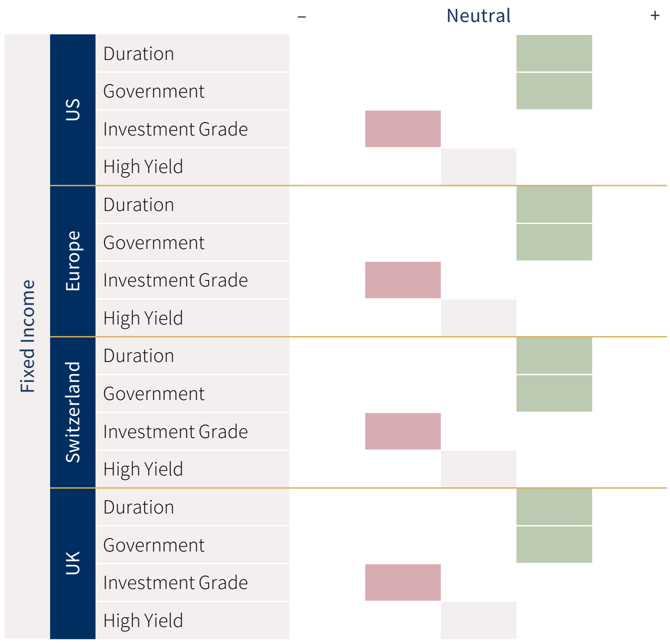
September 2024

Fixed Income Allocation

Our asset allocation committee held an ad hoc meeting to discuss the volatility beginning of August. It seemed to us that two possible reasons for it were being exaggerated: the possibility of a sudden US recession, and a reversal of the so-called Japanese “carry trade”. As a result, we left our overall asset allocation intact.

We do not expect inflation rates to return sustainably to targeted levels in the US or Europe just yet, but we do think that it will remain subdued enough for the European central banks to continue lowering their policy rates, and, importantly, for the Federal Reserve to start doing so soon too. The Fed’s rate cuts may not be as big as markets currently expect, as noted, but they will be enough, we think, to keep that constructive backdrop in place.

Within bond markets, we continue to favour longer-duration exposure across all currency bases, which has again supported performance. Recent gains, as noted, may be premature if US policy rates are not about to fall as sharply as markets expect, but we doubt whether a big or lengthy rebound in long-dated yields in particular is likely. We still doubt consumer price inflation will stick at targeted rates (2%) any time soon, but more medium-term inflation risk has arguably faded as wage growth has moderated on both sides of the Atlantic.



Our positioning

EUR: Since June, we have favoured government bonds over credit. We are not especially worried about corporate default rates, but credit spreads have only widened modestly recently (largely as a result of government yields falling). Government bonds generally have longer duration and are better placed to benefit if medium-term inflation risk fades.

USD: In line with our stance in Europe, we maintain a neutral position in our asset allocation positioning toward bonds and have an overweight positioning in US duration. We remain open to the possibility of further increasing our exposure, subject to developments in growth and policy outlook. In US portfolios, we also prefer government bonds over credits.

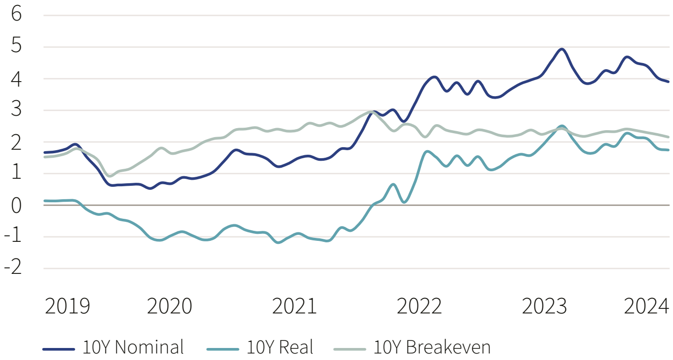
CHF: We maintain the same positioning in Switzerland as we do in Europe and the US. We are neutral on speculative credit, underweight on investment grade and overweight on government bonds.

Chart Flash

US and Eurozone

US 10-year yield breakdown (%)

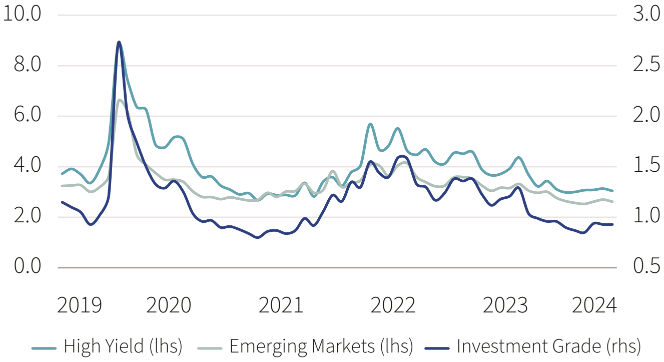
Yields lower again



All data source: Bloomberg, 31.03.2019 - 30.08.2024. 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 (%)

Sideways with a lot of volatility



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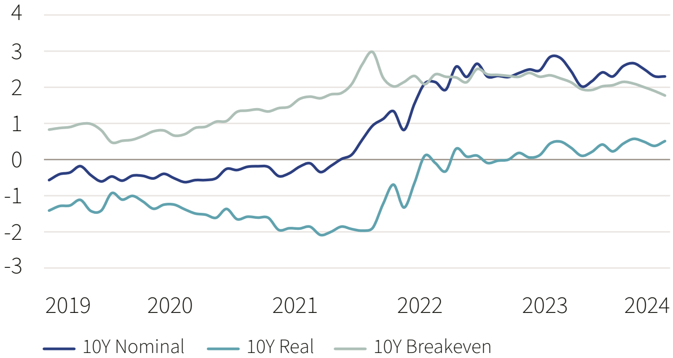
In early August, US Treasuries saw a sharp rally across the yield curve, driven by weaker-than-expected employment data, including nonfarm payrolls and unemployment figures. The yield on 10-year bonds fell by over 40 basis points, dropping below 3.8% for the first time since December 2023. Since then, 10-year Treasury yields have fluctuated within a range of 3.8% to 4.0%. Dovish signals from Powell's Jackson Hole speech and the FOMC minutes in late August reinforced market expectations of a shift in the policy rate cycle. Credit spreads for both IG and HY widened in the first days of August but narrowed back to their initial levels by the end of the month.

EU 10-year yield breakdown (%)

Yields volatile



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EU credit spreads evolution (%)

Sideways with a lot of volatility

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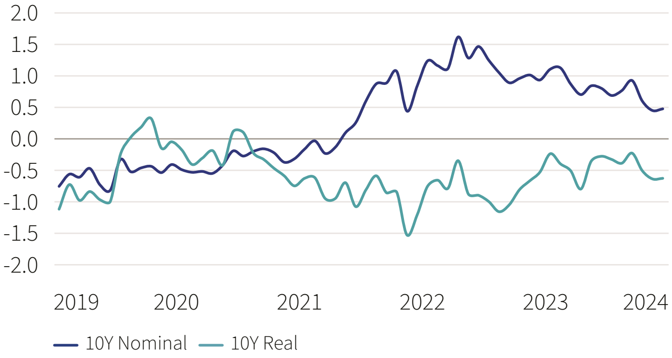
US-Treasuries and German Bunds began August with a rally following the unexpected US payrolls data, but 10-year yields later rose back near the 2.3% mark. Meanwhile, French President Emmanuel Macron has initiated discussions to appoint a new prime minister, explicitly excluding candidates from the leftist New Popular Front alliance. The OAT-Bund spreads remain elevated, approximately 25 basis points above pre-election levels. Spreads for corporate bonds widened last month but tightened as the month progressed, reverting from the widest levels seen.

Chart Flash

Switzerland

CH 10-year yield breakdown (%)

Yields unchanged



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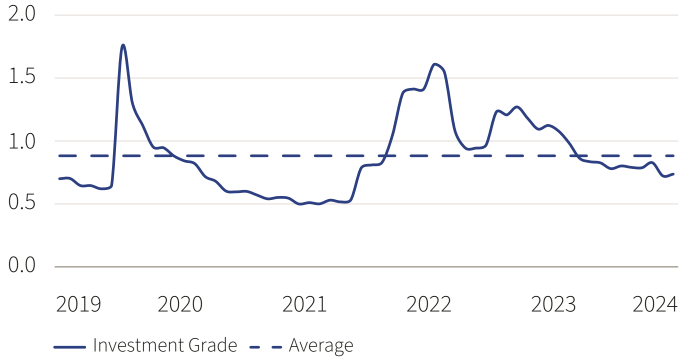
CH credit spreads evolution (%)

Credit spreads stable



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The yield on the 10-year Swiss government bond was around 0.47% at the end of August, a small increase from 0.45% at the end of July. Unlike US Treasuries and German Bundesanleihen, volatility in Swiss government bonds was significantly lower. Inflation remained muted, and the Swiss National Bank (SNB) maintained its interest rate levels in August, with a potential rate cut in September 2024.

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