Fixed Income Views

December 2024

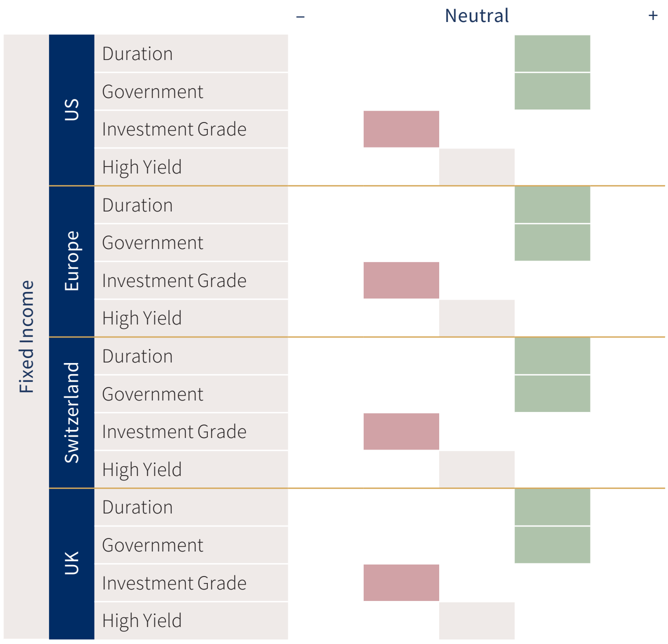
Fixed Income Allocation

Trump's re-election may not have as significant an impact on the global economy as initially feared. Tariffs may not increase as much as he has suggested, and their effects could be tempered or even offset by lower taxes and deregulation. Meanwhile, the business cycle—often the most important factor in investment decisions—remains relatively favourable: a combination of low inflation and ongoing growth is allowing interest rates to decrease while maintaining healthy profitability.

This favourable cyclical mix could persist for some time. Cash flow in the US private sector—comprising both households and businesses—remains in surplus, with few signs of the excesses that have historically led to retrenchment, even after several years of above-trend growth that have defied many predictions of an imminent recession.

It seems that the majority of the inflation decline is now behind us. Stubbornly firm inflation in the services sector is keeping US core inflation above 3%, while rising energy costs are pushing headline inflation in the UK and Eurozone back above their 2% targets. This is not unexpected: we have always believed that inflation would remain sticky in the 2-4% range, and it has not deterred central banks from cutting interest rates. However, looking ahead, the balance of risks may be shifting toward more, rather than less, inflation.

Our preference for longer-duration exposure has hurt in recent months, particularly in USD-denominated portfolios. As noted, we do believe that inflation risk could resurface next year. However, yields are now aligned with long-term neutral levels, and central bank policies may be more credible this time around, allowing yield curves to flatten once again. We continue to favour government bonds over credit—not because we are concerned about corporate defaults, but due to valuation reasons (a similar rationale behind our reduction in stock allocations). Credit spreads have not been lower in the post-GFC period.



Our positioning

EUR: Since June, we have favoured government bonds over credit. While credit spreads have tightened slightly, credits remain relatively expensive from a historical perspective and are priced for ideal conditions (low inflation, solid growth, and looser monetary policy). With the ECB likely to cut rates back to neutral in 2025, we prefer duration over credit risk.

USD: Similar to Europe, we maintain a neutral stance on our bond asset allocation, while holding an overweight position in US duration. Our positive outlook on US duration is driven by looser monetary policies, not just in the US but globally, as inflation returns to central bank targets.

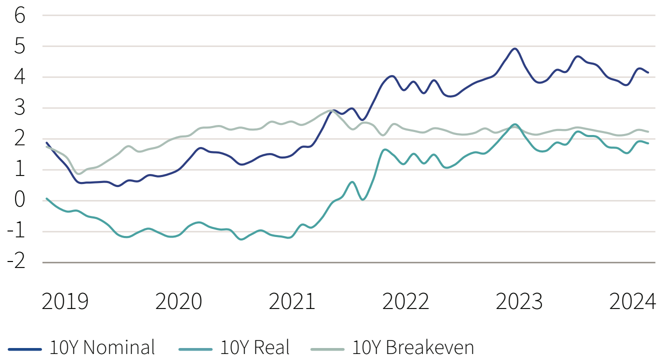
CHF: Our positioning in Switzerland is consistent with our views in Europe and the US. We maintain a neutral stance on speculative credit, an underweight position in investment-grade bonds, and an overweight position in government bonds.

Chart Flash

US and Eurozone

US 10-year yield breakdown (%)

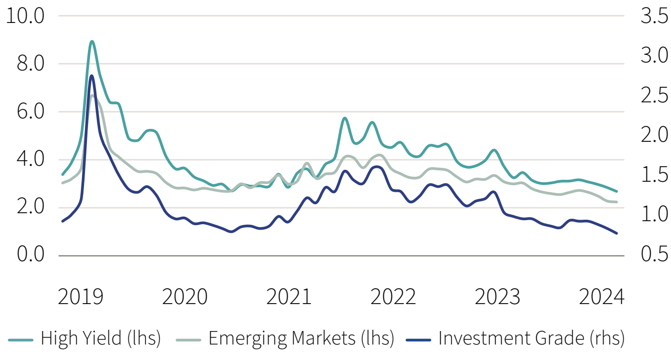
Yields lower



All data source: Bloomberg, 31.03.2019 - 29.11.2024. 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 (%)

Credit spreads unchanged



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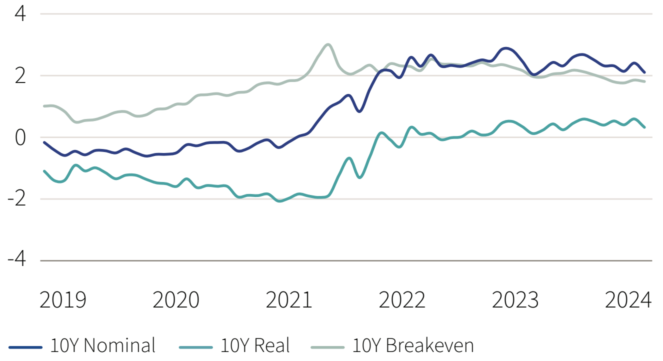
Following the US election, the focus in November shifted to the formation of President-elect Trump's cabinet and the future of global trade. Treasury yields remained elevated above pre-election levels as Fed Chair Powell maintained a cautious stance on rate cuts, signaling no immediate need for action. This came after October's headline CPI inflation, which met expectations at 2.6%, marking its first increase since March. However, with Trump's selection of Scott Bessent as Treasury Secretary, the 10-year yield fell, ending the month 12 basis points lower.

EU 10-year yield breakdown (%)

Yields lower again in November



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EU credit spreads evolution (%)

Falling credit spreads

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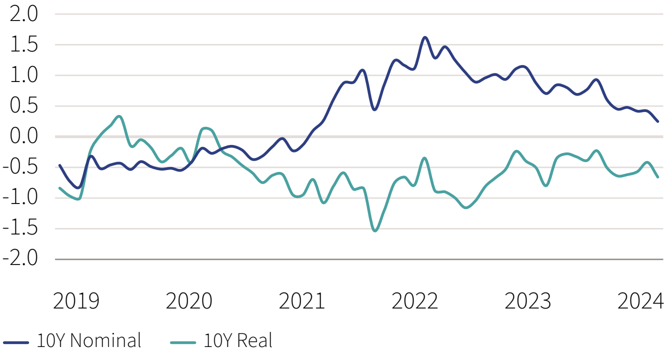
Bunds outperformed US Treasuries this month as market expectations for an aggressive ECB rate-cutting cycle increased. A surprise drop in eurozone PMIs pushed 2-year Bund yields to its lowest level since 2022, raising market expectations of easing to approximately 150 basis points by the end of 2025, up from 118 basis points at the start of the month. November also saw Bunds cheapen significantly relative to swaps, tightening the spread to its narrowest level since the euro's inception. Bunds briefly traded through swaps following the breakup of the German governing coalition on November 6.

Chart Flash

Switzerland

CH 10-year yield breakdown (%)

Yields down further



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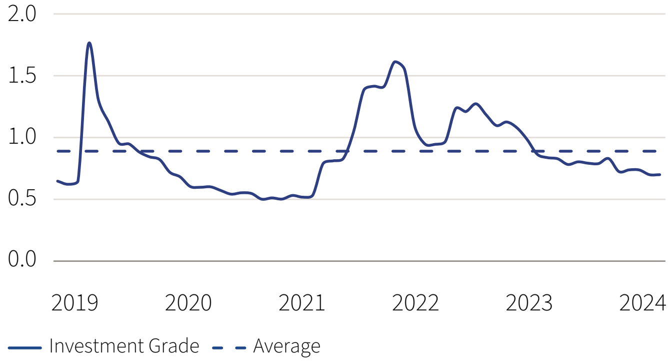
CH credit spreads evolution (%)

Credit spreads stable



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Swiss rate markets continue to price in a minimum 25 basis point rate cut in December, with the possibility of a 50 basis point reduction. This expectation is supported by the weak inflation print for October, with inflation surprisingly down to 0.6% from 0.8% year-over-year. With front-end yields down by 20 basis points, yields for longer-dated Swiss government bonds have also decreased by 15 basis points.

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