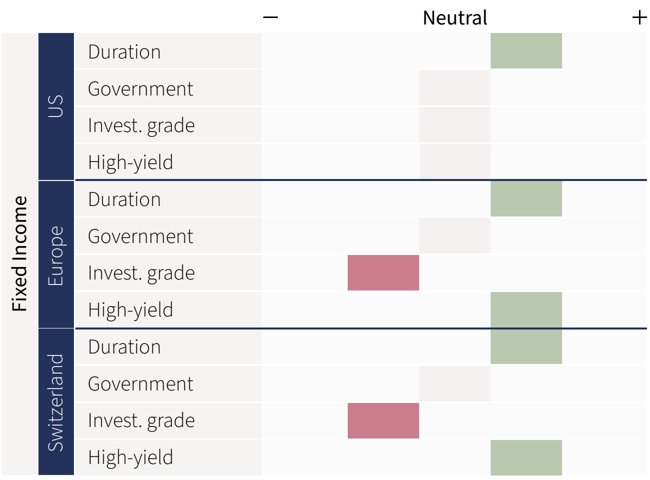
Fixed Income Views

March 2024

Fixed Income Allocation

The key to market returns of late has been the combination of economic resilience with a decisive slowing in consumer prices. The resultant mix of healthy corporate profitability and disinflation has allowed central banks to stop raising interest rates, and encouraged money markets to believe that the next moves in policy rates will be downwards. In early 2024, that mix has tilted a little more towards economic resilience and firmer than expected inflation data (in particular in the US). As a result, the prospect of lower interest rates has receded a little.

We finally closed a long-standing underweight in bonds in European portfolios in the summer, leaving us neutral in all portfolios (we had closed it for US portfolios in late 2022). As bonds have given back some of their gains in early 2024, a better entry point for moving to an outright overweight position may be approaching. But to add further to bonds from cash would take us close to being "fully invested", and we continue to think that this would be a little over-confident just now.



Our positioning

EUR: In November, we moved to an overweight in duration for European portfolios, matching an earlier move in US portfolios. This allowed us to capitalise a little on the end-year rally, which was led by longer-dated bonds, but it has worked less well in 2024 to date as yields have backed up a little. The only divergence between European and US portfolios remains that we retain an overweight in speculative grade bonds in Europe, financed currently by an underweight in investment grade credit.

USD: During the summer, we adjusted our positioning to a neutral stance on bonds with a slight overweight in US duration. We remain open to the possibility of further increasing our exposure, subject to developments in growth and policy outlook.

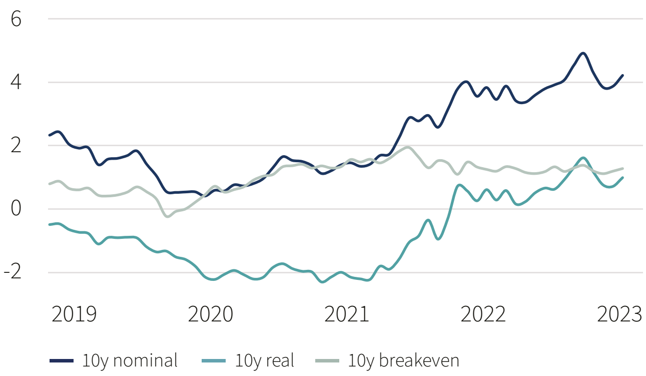
CHF: Similarly to the Eurozone, we have a slightly overweight positioning in our duration exposure. Additionally, we are underweight in investment grade credit in favour of government bonds.

Chart Flash

US and Eurozone

US 10-year yield breakdown (%)

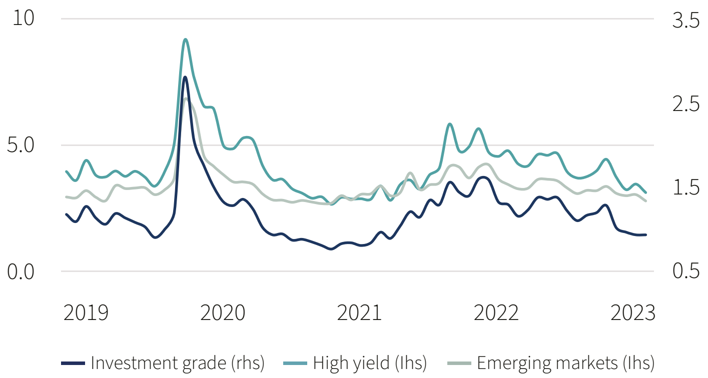
Correction after the 2023 year-end rally



All data source: Bloomberg, 28.02.19 – 29.02.24. 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 on corporate bonds narrow further

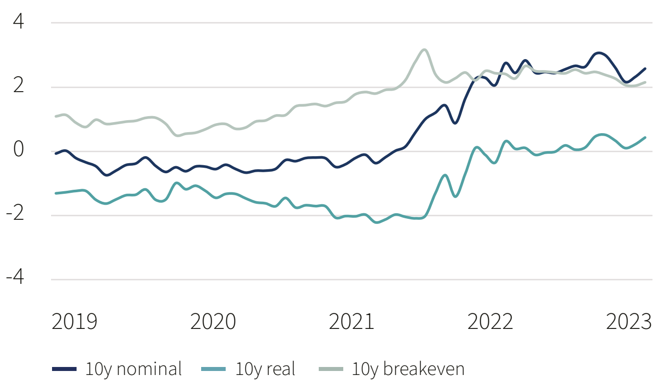


All data source: Bloomberg, 28.02.19 – 29.02.24. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

After a strong rally in the last quarter of 2023, where yields dropped by over 100 basis points from 5% to 3.8%, there has been a subsequent increase of 50 basis points. This rally in yields, particularly notable in February, came after markets had become overly confident in excessively dovish central bank expectations in December. However, this sentiment was tempered by the release of robust economic data and a significant upside surprise in January's inflation figures, with CPI year-on-year growth reaching 3.1%, surpassing the anticipated 2.9%. As a result, expectations for the timing of the Fed's first rate cut have become more realistic. Initially priced in for March last year, markets now anticipate the first cut to occur in July, a timeline we find more feasible given current economic conditions.

EU 10-year yield breakdown (%)

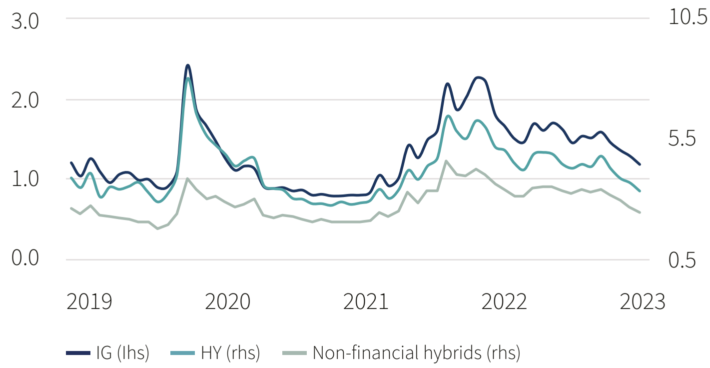
Correction after the 2023 year-end rally



All data source: Bloomberg, 28.02.19 – 29.02.24. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

EU credit spreads evolution (%)

Spreads on corporate bonds narrow further



All data source: Bloomberg, 28.02.19 – 29.02.24. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

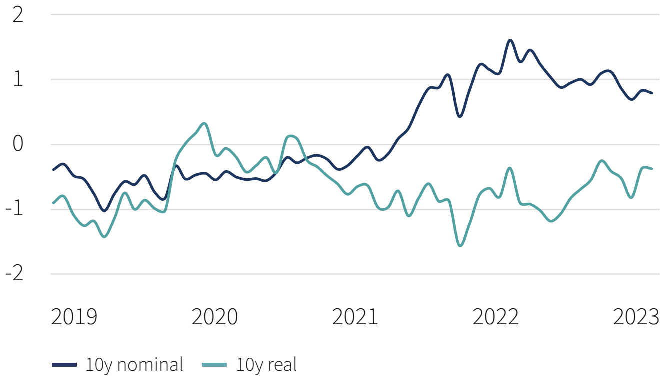
The repricing of German government bonds year-to-date closely mirrors that of the US, with 10-year bonds experiencing an increase of nearly 50 basis points to 2.5%. However, they still lag behind the highs observed during the rate-hiking cycle in October 2023 by 50 basis points. This upward trend in yields, akin to the US, reflects a recalibration of Central Bank policy expectations. While there have been some improvements in leading indicators for the Eurozone, albeit on subdued levels, inflation data releases have not delivered the same amount of surprises as seen in the US. With headline inflation at 2.8% and core inflation at 3.3%, both figures remain elevated, reducing the likelihood of near-term rate cuts by the ECB. Nevertheless, the overall trajectory suggests a favorable path for the ECB to consider easing monetary policy sooner rather than later, provided that the inflation outlook remains supportive.

Chart Flash

Switzerland

CH 10-year yield breakdown (%)

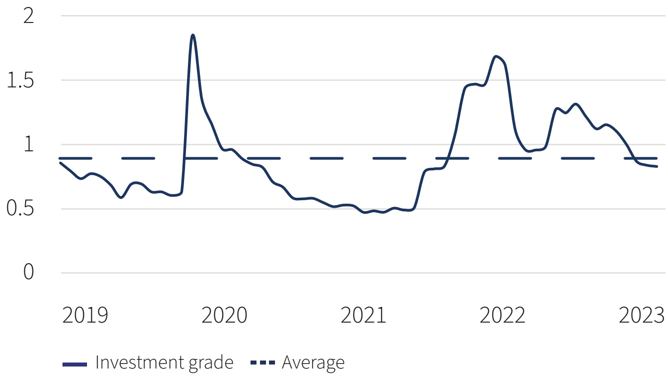
Correction after the 2023 year-end rally



All data source: Bloomberg, 28.02.19 – 29.02.24. 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 (%)

Spreads on corporate bonds narrow further



All data source: Bloomberg, 28.02.19 – 29.02.24. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

Compared to US and EUR yields, the Swiss 10-year government bond yield moved sideways in February but has risen by 15 bps since the year's start. Markets expect the SNB to start rate cuts in June, with two more expected in September and December, aiming for a terminal policy rate of 1%. However, the SNB adopts a prudent approach, awaiting confirmation that domestic price pressures no longer pose inflationary risks. However, January's inflation figures, which were 50 basis points lower than the SNB's Q1 target of 1.8%, cast doubt on the central bank's forecast.

Wealth Insights

At the heart of Wealth Insights lies a wide set of timely and insightful publications and podcasts.

For more information, please visit our page at www.rothschildandco.com/insights