Fixed Income Views

January 2025

Fixed Income Allocation

January was primarily marked by the new political leadership in the US. Speculation about higher deficits drove yields further up at the beginning of the month, but this was replaced by increasing signs of weakening inflation in the USA by the end of the month. The US Federal Reserve left its key interest rate unchanged at the January meeting, while the ECB cut rates by 25 basis points (bps)- - both as expected.

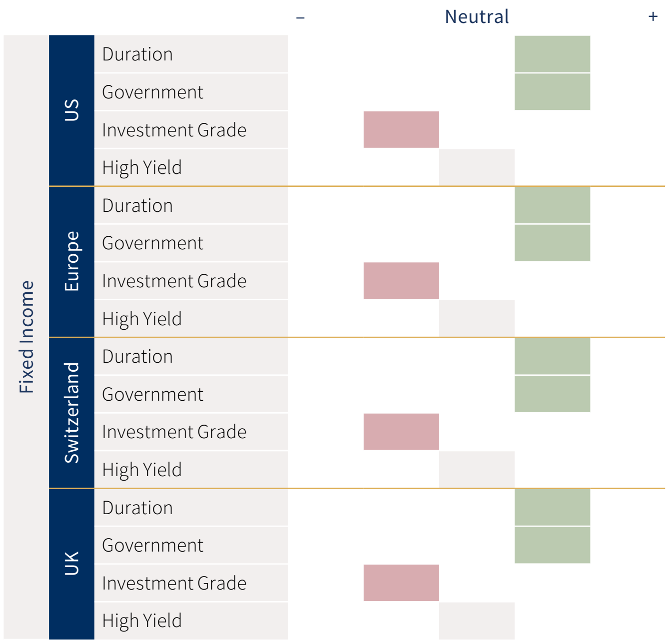
Much uncertainty still surrounds the Trump administration's intentions, capabilities and personnel, with many announcements likely in the days and weeks ahead. Even the impact of additional tariffs may be more nuanced than economists expect, especially since taxes may be falling at the same time, as they did during his first administration.

The business cycle often matters most in the narrow investment context in any case. For now it continues to offer a relatively constructive backdrop, but we do wonder for how much longer than can continue – not so much because of Trump II, but because economies remain historically rather fully utilised, and global inflation risk may resurface as a result in 2025.

With inflation no longer falling steadily, the balance of risks may be tilting back towards some revival. We have always thought it would prove sticky in the 2-4% range. That stickiness has not stopped central banks cutting interest rates so far, but in the US and UK in particular they are showing signs of slowing or pausing their easing – and indeed, might eventually even feel the need to consider hiking rates anew.

Our preference for longer-duration exposure has again hurt at the start of the year, this time in euro-based portfolios as well as dollar-based ones. And, as noted, we do think that inflation risk could revive this year. But yields remain close to longer-term neutral levels, and central bank policy may be more credible this time around, allowing yield curves eventually to flatten once again.

We continue to favour government bonds over credit– not due to concerns about corporate defaults, but rather on valuation considerations (the same reason we trimmed our stock weightings). Credit spreads have not been materially lower since the global financial crisis.



Our positioning

EUR: We still prefer duration over credit risks and have prioritised government bonds over corporate bonds since June. Credit spreads tightened in January and, from historical perspective, are still relatively expansive and priced for a perfection (low inflation, solid growth, and looser monetary policy).

USD: As in Europe we are neutral in our Asset Allocation positioning on bonds and have an overweight positioning in US duration. With the Fed expected to be on hold for the time being, the outlook for monetary policy is neutral. The main reason for our (still) bullish stance on US duration is the change in market expectations for the Fed, which has led to cheaper valuation for US Treasuries.

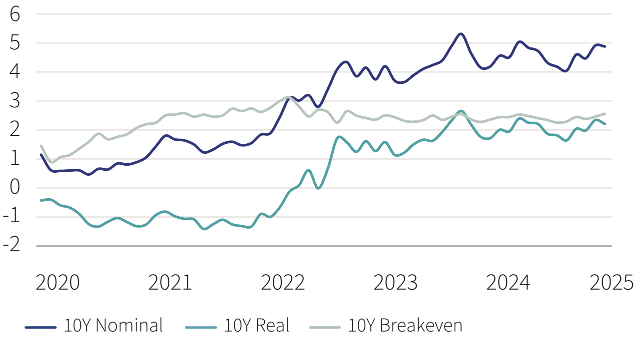
CHF: In Swiss franc-based portfolios, where we felt in December that the SNB's remarkable credibility had driven bond yields back down to negligible levels, we changed our view for Fixed Income from "neutral" to "underweight". This has led to prefer liquidity there. Within Fixed Income, we are neutral on speculative credit, underweight in investment grade, and overweight in government bonds.

Chart Flash

US and Eurozone

US 10-year yield breakdown (%)

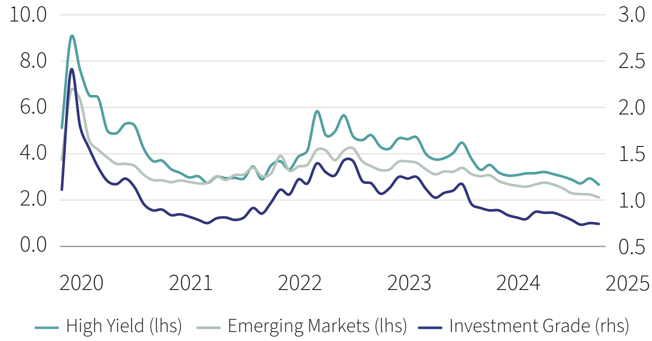
Rollercoaster in January



All data source: Bloomberg, 31.03.2019 - 31.01.2025. 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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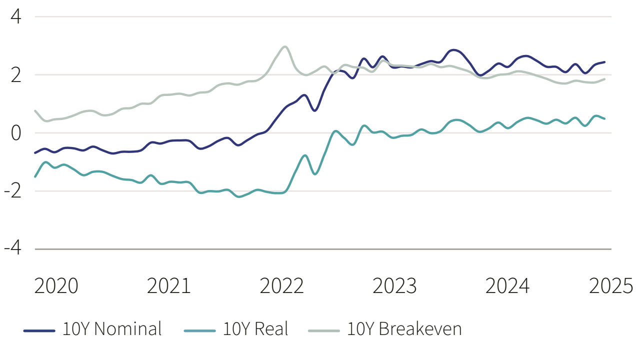
The release of robust payroll data at the beginning of January led to an increase in US Treasury yields. However, the subsequent inflation report reversed this trend, and 10-year Treasury yields ended the month approximately 3 bps lower. The first wave of tariffs imposed after President Trump's inauguration had little impact on the bond market. As anticipated, the Fed maintained interest rates on January 29, with Chairman Powell reaffirming the Fed's cautious approach, leaving near-term policy rate expectations largely unchanged.

EU 10-year yield breakdown (%)

Higher bund yields with higher volatility



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EU credit spreads evolution (%)

Falling credit spreads

All data source: Bloomberg, 31.03.2019 - 31.01.2025. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise.

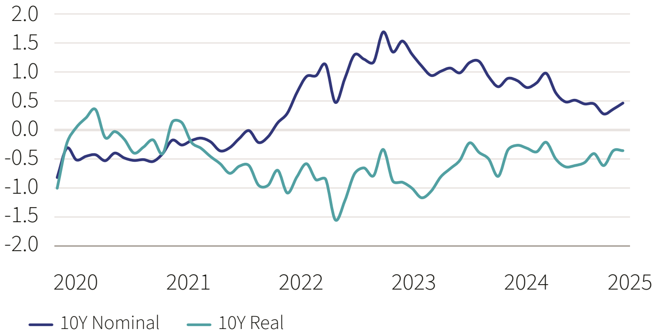
As in the US, Bunds experienced a similar fluctuation due to mixed US data. Throughout January, 10-year Bunds traded above swaps, driven by their relative underperformance and the upcoming German election on February 23. Market sentiment towards France improved in January, with French government bonds seeing unprecedented demand during their first syndicated bond sale in eight months on January 21. Consequently, the spread between French and German government bonds reached a two-month low, reflecting the outperformance of French bonds.

Chart Flash

Switzerland

CH 10-year yield breakdown (%)

Swiss government bonds yields unchanged



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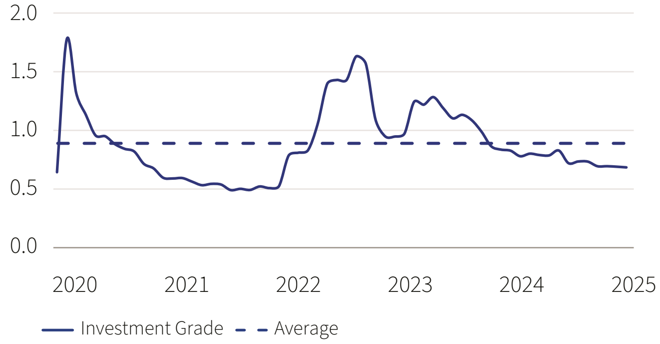
CH credit spreads evolution (%)

Credit spreads lower



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The Swiss National Bank (SNB) unexpectedly cut the deposit rate by 50 bps in December. Markets are pricing in a further 25 bps cut by the SNB in March 2025. With fewer cuts priced in for 2025 compared to the ECB, and the outperformance of longer-dated Swiss government bonds (vs. German government bonds) in 2024, Swiss bonds started the year weaker, and yields rose by 10 basis point in January. Corporate credit spreads moved sideways, with low volatility.

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