MUFG Asset Management

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Monthly Macro View

- If US inflation were 2% and rates at what the Fed appear to think is neutral (a real 0.75% to 1.0%) with the US economy growing at trend, then rates would be at 2.75 to 3.0%. Forwards into late 2026 have rates at the top end of that. So, a perfect landing; inflation at target and growth at trend. In fact, such an outcome is not unreasonable. There are not so many pressures pushing the economy in either direction away from that outlook. Yet as we have recently seen with Australia, an economy which is expected to reach trend can see markets shift very quickly even if there is no dramatic change in the outlook.

- The downside to the US look to be a Fed which is too worried about inflation and cuts too late, an expensive equity market finding out its optimism is misplaced and (related) an IT sector which starts to think its very heavy investment levels are not going to generate the expected returns. The upside is an economy that is a little stronger than expected with inflation remaining more persistent, the gloomy consumer deciding the truth is not as bad as their feeling, the tariff effect being more long-lived than expected as domestic demand sees a boost from more inward investment, and wages being boosted by the purge on immigration which firms can accommodate through higher prices. At the moment the employment data is favouring the former, but services inflation is remaining persistent and the uncertainty that has hit hiring could dissipate quite rapidly.

- The rest of the world isn't really adding anything else to a narrative of around target inflation and rates going to neutral. China remains burdened with real estate problems, Europe is fundamentally weak but likely supported by a fiscal boost, albeit a challenge emerging from a Chinese thrust to compensate for poor domestic demand though greater exports. Emerging nations seemingly are also going to struggle with competition from China and need to re-orient their economies from export driven to domestic demand as globalisation steps back. There is nothing that interrupts a broadly 'steady as she goes' theme.

- Fiscal issues remain a burden on markets. Oddly, looking at one-year short rate forward markets and current ten-year rates yield curves in most markets are quite similar at around ninety basis points (in line with the long-term average). The fiscally responsible Australia is the same as the others, calling into question the extent to which fiscal pressures are discounted in markets. In the UK the government bought time with the budget but probably bought short term relief at the cost of longer-term trouble (raised taxes to spend, but the taxes coming later, in an election period and some reliance on unrealisable 'efficiency' savings). Germany is trying to get through pension reform, but politics is not enabling sensible and equitable solutions leading to resentment and feeding into moves toward the AFD by the disgruntled. France remains a mess. The US is ignoring its soaring deficit projections. Markets don't care until one day they do.

- The other significant issues remain the rise of populism/authoritarianism, the end of multilateralism and the advent of AI. Thus far populism has not caused very significant market deviations but is does raise the risks of severe outcomes if persistent policies which ignore economic good sense are indulged in. The end of multilateralism also causes economic inefficiencies and a reordering of economic resource allocation globally, but this is a long burn issue. AI is the great hope via growth but also the great concern in potential economic disruption as well as the risk of a short-term over-enthusiasm leading to a pull-back which would be growth negative.

- We think markets are likely to remain calm, with economic activity being unexciting. Steeper yield curves suggest some sense in taking longer duration to take up the increased carry available. Reinforcing this is that in our view downside risks loom larger than the upside ones. Therefore, we look to be modestly long duration. Our emphasis remains on the higher yielding markets and in particular the UK and Australia.

- On the major currencies we remain largely neutral given the political risks and possible changes abrupt changes in policies. Tariffs should push the dollar up, but other policies are poor for the economy.

- On spread we remain on the positive side of neutral. Fundamentals are robust and any softness in economies is largely down to government actions rather than excessive optimism causing distortions in either the consumer or business space. Our positioning is slight given historically tight spreads, the fiscal backdrop with populism preventing sensible policies being pursued and with the risks of populists gaining power and embarking on damaging (potentially very damaging) policies.

Portfolio Positioning

- Rates and Duration

  Anticipating continued slowdown in US macroeconomic growth. Longer-term operations are built primarily around NZ, Australia, the US, and Poland. While Australian and NZ interest rates rose due to economic indicators suggesting inflation in Australia, these figures seem somewhat out of step considering inflation and economic headwinds in other countries. Furthermore, given that political and fiscal risks are healthier than in developed Western nations, we expect a cap on interest rate rises in both countries. While maintaining the duration spread for both countries, we will adopt a conservative approach going forward due to the risk of yen carry unwinding following a Bank of Japan rate hike. For both NZ and Australia, we will use cross-hedging to operate with longer duration without taking currency positions.

  We anticipate that US employment will deteriorate among large corporations over the next few months, making the risk of an economic slowdown more apparent. Meanwhile, the stock market bubble is now widely acknowledged. Historically, collapses rarely occur at such consensus points. We are building a portfolio designed to withstand the carry trade even if the bubble persists. We aim for a duration-heavy strategy targeting a lower bound of around 3.6% for the US 10-year yield. We plan to allocate bonds to countries with potential for lower interest rates relative to the US, such as NZ, Australia, and Poland.

- Currencies

  Our core strategy involves a euro underweight, Norwegian krone, Swedish krona, and Polish zloty overweight, a Chinese yuan underweight, US dollar overweight, and Mexican peso overweight.

  We are currently considering shifting some weight from Norway to Poland, reflecting the potential end of the Ukraine war. For non-government bonds, conservative management focused on high-quality state bonds, government-related bonds, and financials. We would look to increase positions during spread widening.

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