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Monthly Macro View

- 'Something is rotten in the state of Denmark.' Obviously, I don't mean Denmark. The political strangeness in the US continues unabated; removing the head of Venezuela but further entrenching the existing regime and all for oil which is poor quality and in a country too dangerous for the oil giants to want to invest in, claiming an American citizen was legitimately shot dead by ICE agents when the evidence suggest that was untrue, attacking again the Federal Reserve. Yet the economy plods on. We need to keep an eye on the politics since it is deeply disturbing and likely to have serious long-term implications but for the moment the economic data is what is impacting rates rather than what might happen over a longer time horizon.

- The numbers look fine overall, bar concerns about the details in employment. Inflation is elevated due to tariffs, but thus far the pass-through has been lower than expected and the impact should fade over time thus lowering pressures on rates. That assumes the economy is not strong enough to entrench the higher levels, but this seems not to be the case. The consumer should be reasonably healthy, real wages are positive, and tax cuts are coming through. Investment spending should be supported by the OBBA (One Big Beautiful Bill Act – that the world's premier economy has to name serious legislation in that way!!). The question is low consumer confidence and the low hiring rates in the employment data. Assuming employment holds up then fixed income markets should see a couple of rate cuts this year as inflation gradually come down and longer rates may not move much given fiscal risks but should perform better than cash on carry with the risks being more on somewhat lower than higher rates.

- The rest of the world is likely to price itself off this. The EU should see decent economic growth but remains constrained in the longer run by structural issues. That argues short rates stable and probably somewhat higher long rates unless there are signs of less fiscal pressure. The UK has inflation that has proved more tenacious than elsewhere, but we think the economy is under more pressure than most believe, and that the UK bond market should outperform this year. The Australian economy is healthy, but we don't think yield should be higher than in the US, especially since debt scenarios very heavily favour the former. China has structural issues of over saving and this leads to a vast current account surplus. This rest of the world has to absorb this which leads to lower inflation and lower interest rates. Japan is currently in a sweet spot with interest rates below inflation thus leading to a shrinking debt/GDP ratio. However, the equilibrium here is fragile and should that dynamic reverse focus will be on fiscal sustainability.

- Risks remain. Equity prices are elevated, and the promise of AI needs to come through to justify them. The geopolitical background is fragile with the US threatening Greenland and at best neutral with regard to Russia. Europe is to some extent on its own and badly prepared for such which is leading to severe tensions between generous welfare support and planning for an ageing population with the need for a much stronger military and more significant global voice. Events may not wait on them. The strange worship of populism is an ever-present worry given its negative impact on economies over time when such parties gain power.

- Spread is likely, given calm economic waters, to provide carry over the coming year. However, spreads are historically tight and leverage is rising, bank regulation is being pulled back and shocks by definition are unexpected and typically negative. Positioning if long will be modest to ensure an ability to add to positions if spread moves out.

Portfolio Positioning

- Rates and Duration

  Maintaining overall longer duration anticipating continued US macroeconomic slowdown and maintaining underweight (UW) USD-related currencies versus EUR-related currencies. While the ECB has now effectively completed its cutting cycle, structural drivers continue to push term premia higher and QT continues to shrink the balance sheet with no further rate cuts meaningfully priced at the front end. Fiscal dynamics are central here.

  Market volatility in UK gilt yields remains notable, highlighted by a late-Q3 global bond sell-off and domestic supply pressures that pushed UK long-term yields to multi-decade highs, though they eased back in early Q4 amid improving inflation data and receding fiscal worries. Even so, long-term gilts continue to offer value as domestic inflation moderates from its peak and monetary policy leans cautious-dovish at the margin. The UK's term premium stands out as relatively high despite contained long-run inflation expectations and with a focus on fiscal consolidation alongside the BoE's cautious approach, this bolsters the case for a long-duration stance.

  In the JGB market, the trend toward flattening is expected to continue, as the BOJ is anticipated to continue rate hikes. Against this backdrop, buying of ultra-long-term bonds by Japanese pension funds and life insurers is anticipated. Furthermore, given the possibility that the BOJ will maintain a relatively hawkish stance, we believe it remains appropriate to maintain a bias toward a flatter yield curve.

  Longer duration positions built primarily in NZ, Australia, US, and Poland. Continuing to assume Australian and New Zealand economic and inflation trends remain below market expectations. Considering their political and fiscal risks are healthier than those of Western developed nations, interest rate rises in both countries are also expected to be contained. Maintain or slightly extend duration ranges for both countries. For both NZ and Australia, employ cross-hedging to manage duration without taking currency positions.

  US employment is expected to deteriorate among large corporations from February to March, making the risk of an economic slowdown apparent. Meanwhile, as the stock market bubble is now widely acknowledged, its collapse is anticipated to take time. Focus on building a portfolio resilient to carry losses even if the bubble persists. Maintain a longer duration policy with a US 10-year yield target of around 3.6% as the lower bound.

- Currencies

  Underweight USD-area currencies while overweighting countries in advantageous positions in trade wars and geopolitics. The core strategy involves underweighting the euro, overweighting Norway, Sweden, and Poland; underweighting China, overweighting the US; and overweighting Mexico.

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