MUFG Asset Management

Global Fixed Income Monthly

GARY HUTCHINGS
HEAD OF INVESTMENT

JULY 2025

Mitsubishi UFJ Asset Management (UK) Ltd.
A member of MUFG, a global financial group

1. Monthly Macro View

- Fiscal issues remain a burden on markets. There are two problems: the levels and the political backdrop. The levels are high but, in most cases, sustainable. The political backdrop is concerning. Wealthy countries can operate with high debt levels because, well, they are wealthy but also because markets see a reasonably well-educated population making sensible choices to elect politicians who will do sensible things. Sensible things include controlling debt levels, such as was seen after WW2 in the UK for example. The rise of populism is challenging this narrative. In the US an economy which is at full employment, has a large deficit and high debt to GDP is cutting health spending on the poor (economically damaging) and introducing tariffs (economically damaging and rather the cutting this large deficit is cutting taxes for the very rich. In the UK pressures for spending made the government change their fiscal rules and leave little spare room even with the new rules. With a populist party, Reform, gaining supporters it is very difficult to take hard decisions. In many Euro countries similar issues apply. Markets will rightly remain concerned unless they can have confidence debt levels will be tackled.

- Trump is clearly a vital factor in markets, so here is a brief summary. Trump promotes economically illiterate policies, he does so in a chaotic fashion and he appears to want to follow the autocratic playbook as demonstrated by Victor Orban in Hungary. Examples are tariffs, budget policies, ignoring the standing of Congress in spending, firing of civil servants who are not sycophantic, attacks on the judiciary, making it easy to remove naturalised citizens and a host of smaller acts. The impact on markets is greater volatility given there is no idea what is going to be thrown out next or whether it will last and less faith in what had been the bedrock of confidence in the US (the Constitution, the Rule of Law, belief in science, rational policy making) causing risk premia to rise.

- All of this plays into the idea of steeper yield curves. In addition, some of the arguments behind secular stagnation have gone; globalisation is significantly diminished, stronger banking regulations are being toned down, the rise in spending on defence and climate change are boosting demands for capital. Some remain: primarily lower productivity and ageing populations. This pushes up rates relative to the pre-Covid norm but not as high presumably as before the GFC. So we should be looking for rates somewhere in between these two levels but with a steeper yield curve structure.

- We still believe there is some value in bond markets and more in the higher yielding markets. Australia at the longer end we think has value given the far better fiscal position than elsewhere. We still think the UK is cheap because most other countries seem to be in similar predicaments but have much lower yields. We think the EU is poor relative value given the fiscal pressures it faces as well as the existential threats from high debt levels and the growth in nationalism. In the short term, however, the economic outlook is poor making the short to intermediate ends somewhat attractive.

- On the major currencies we remain largely neutral given the political risks and possible changes abrupt changes in policies.

- On spread we remain slightly positive. 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. We would look to add on spreads moving above their long-term average level

2. Portfolio Positioning

- Rates and Duration

  In addition to the potential spillover effects of tariffs on the U.S. macroeconomy, we are beginning to observe adverse economic impacts from high interest rates, such as rising delinquency rates in certain commercial real estate sectors. In scenarios where credit spreads widen due to concerns about economic slowdown, we aim to increase credit weights focused on high-quality financial bonds. We remain comfortable with our mild long duration position in the US, believing that the effect of a near term slowdown in the US economy will crystallise before the medium-term inflationary picture becomes clear (whether sustained or temporary).

In Europe, we concur with the market's pricing of ECB rate cuts but longer term we maintain a short position on long term rates as potential and actual funding pressures should keep risk premia relatively high.

For the UK, market volatility in gilt yields remains notable, highlighted by a sharp sell-off amid renewed fiscal-policy uncertainty. Even so, long-term gilts continue to offer value as domestic inflation moderates and monetary policy tilts dovish.

We expect the Bank of Japan to resume its normalization process in the second half of this year once the turmoil caused by Trump's tariffs subsides, but in the short term, we anticipate that upward pressure on Japanese government bond yields will ease. Therefore, we are considering locking in profits on short DUR positions.

- Currencies

Focus on the economic ripple effects of the Trump administration's economic measures and changes in money flows associated with geopolitical risks.

While the Iran-Israel conflict has temporarily reached a ceasefire agreement, it has not been fundamentally resolved, so the conflict may continue to simmer. On the other hand, the impact of tariffs may spread to the U.S. macroeconomy through the summer, so while the dollar may remain weak, we anticipate volatile developments due to the potential resurgence of geopolitical risks.

We maintain a neutral stance on dollar-denominated currencies against euro-denominated currencies, while remaining watchful of global developments.

Important Information