

Global Fixed Income Monthly

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Monthly Macro View

- The war is clearly the area of main uncertainty and concern currently. The US presumably regrets ever starting it, Iran thinks it has leverage and can negotiate very hard and Israel is very keen to continue it. Oil inventories have declined to low levels and oil executives have warned that if the supply disruption continues prices will rise sharply. The economic implications are stagflation, with poorer countries being hit hardest and non-oil producers suffering more than oil exporters. The political implications are poor for Trump who has seen his popularity diminish further (not much helped by his slush fund and his grandiose projects at a time when much of the country is being squeezed by higher gasoline prices). Other countries have seen incumbent parties generally lose votes when economic times get harder, even if that is no fault of their own. Where the war is heading is very uncertain. This makes market forecasts awkward and positioning light.
- Since Covid inflation rates have been higher than targets. Central bankers have been happy to look through this given the one-off nature of the inflation shocks. That has been anchored by inflation expectations. The latest University of Michigan five-year inflation expectation numbers were somewhat worrying in this respect. This is not helped by the US Administration's attacks on US institutions, including the Federal Reserve. Unlike many others that institution is well-insulated but given the pressures risk premia should have increased. In the UK there is a split between those who would focus on the economy relative to those who are more concerned about inflation expectations losing their anchor. The EU remains clear about its mandate and will hike rates to entrench their commitment. Australia has already done this. The US therefore looks weaker than other countries. Beyond this very high debt/GDP ratios, the risk of populist parties gaining or retaining power, populations willing to vote for economically disadvantageous policies, pressures from ageing populations and defence spending on budgets going forward and a move away from globalisation are all risk premia negative.
- Taking into account the very abrupt turn in the nature of the United States remains challenging. The effort to turn it into an autocracy, the attacks on individuals and institutions, the reversing of long-held norms by the Supreme Court, the corruption, the failure of the rule of law, the abandoning of the global democratic alliance system, the concentration of extreme wealth to a level not seen since the late nineteenth century and the turning against science and immigration are clearly profound events. The impact on markets has not been anything like these shifts. The equity market has benefited from AI excitement and the ability of companies with strong moats (i.e. a lack of competition) around them to finance data centres without too much strain. The share of the GDP being to capital has been rising, which is clearly positive for earnings. The ability to increase stock buybacks relative to dividends has also been important given tax considerations as has increased gearing. For bonds most of what is happening should increase risk premia to some degree; it is less certain one can trust the United States to pay one back, the inflation targeting is more likely to be challenged, and debt metrics are not high in populist regimes.
- Currencies are highly dependent on the war. We were long AUD before the war and would continue with that. Otherwise, we have little conviction. The US benefits from being an oil exporter and a safe haven, but it is increasingly isolating itself internationally and is becoming less trusted. Its debt situation is also troubling in that there is no sign any party wants to control it. Its policies are diminishing rather than enhancing its huge fundamental strengths. Finding the alternative, though, remains troubling. That investors are looking, though, is not a good sign.
- Spread remains tight. Healthy corporates, little sign of concentrations of risk and less trust in governments are all likely contributing to this. Disillusionment with AI hopes could damage this, but it is not a main scenario. There is therefore little reason not to keep a low profile.

Portfolio Positioning

- Rates and Duration

We believe that in the US, consumption, particularly among the wealthy, remains robust due to the wealth effect from rising share prices, whilst companies are also performing solidly thanks to premiumisation strategies tailored to this trend. As for share prices, in the midst of the generative AI boom, they are likely to remain firm until events arise that cast doubt on earnings or business sustainability. In such a market, inflation is likely to occur, but there is a high probability of stagflation, where the economy can no longer withstand inflation. Therefore, our policy is to maintain a duration position that is neutral to slightly long, a flattening yield curve position, and a bond allocation centred on resource-rich countries such as Norway and Australia.

To account for speculation regarding a short-term ceasefire agreement in the Middle East and concerns about stagflation arising from prolonged inflation, we maintained a neutral to slightly long duration, a flattening yield curve, and an allocation centred on resource-rich countries. Regarding duration, we adopted a longer position in Australia and New Zealand—which are less susceptible to high energy prices and have relatively limited scope for interest rate rises—whilst maintaining a shorter position in Europe, which is more vulnerable to high energy prices.

In Euro area, we maintain and reinforce a neutral stance on short-term rates, broadly in line with current market pricing, which now almost fully prices a June hike and still embeds additional tightening before early 2027. At its most recent 30 April 2026 meeting, the ECB left its deposit facility rate unchanged at 2.00%, with President Lagarde stressing a data-dependent, meeting-by-meeting approach and warning that the Middle East war has created upside risks to inflation and downside risks to growth; since then, ECB communication has shifted toward a credibility-driven June recalibration as headline inflation has re-accelerated, services inflation has stayed sticky, and underlying pressures have broadened modestly.

In the UK, Market volatility in gilt yields remains notable, driven by the Iran-related energy shock and reinforced by political/fiscal risk. Even so, long-term gilts continue to offer value as medium-term domestic inflation should moderate if the shock fades, and the structural case for rate normalisation remains intact. The Debt Management Office's reduced long-dated issuance continues to provide a technical tailwind, but this is partly offset by still-large overall gilt supply, ongoing QT and weaker fiscal execution after April borrowing overshoot the Office for Budget Responsibility profile. The UK's elevated term premium still appears to compensate for these risks, provided the energy shock remains a relative-price shock rather than a persistent wage-price dynamic.

In the Japanese government bond market, there is a risk of further yield increases. Expectations that the Bank of Japan will continue to normalize monetary policy remain strong, while buying pressure from domestic institutional investors appears to have weakened. In particular, demand from life insurance companies and pension funds is becoming less reliable as a stabilizing factor for the market, given current yield levels and rising volatility in the ultra-long-term sector. As a result, Japanese government bond yields could rise further, particularly if inflation expectations remain firm and the Bank of Japan maintains a relatively hawkish stance.

- Currencies

As previously mentioned, we currently have no strong view on currencies. We are moderately short the Dollar bloc and short Chinese Yuan vs USD. We maintain a modestly bullish view on AUD because of the divergence of monetary policy between Australia and the US.

A comment on the yen, the yen is expected to remain under downward pressure for the time being. Rising crude oil prices are heightening concerns about Japan's trade and current account balances, and the still-wide interest rate differential continues to exert downward pressure on the yen. Although the government intervened in the foreign exchange market as expected, we do not believe this will fundamentally alter the underlying trend of yen weakness in the short term. Rather, the intervention is likely to slow the pace of yen weakness and curb disorderly movements, but it will not completely reverse the trend.

That said, the risk of further intervention remains significant. If the yen's depreciation accelerates again or exhibits disorderly movements, there is a real possibility of additional intervention, which could trigger a sharp but temporary appreciation of the yen.

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