

Global Fixed Income Monthly

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

Monthly Macro View

- 'Jaw-jaw is better than war-war': (attributed to Churchill, but although he said something very similar it was actually Harold MacMillan). Either way given Donald Trump's reference to Starmer being no Churchill would seem to be more appropriately aimed at himself than the UK PM. With no compelling reason to start it there is no compelling reason to continue it, not much idea of the end game and the risk in between of something more disruptive than currently envisaged taking place. Markets have gone moderately risk off, which appears about right and will respond to the (unknowable) news as it comes emerges.
- Bond yields have risen a bit, the dollar has firmed a bit, spreads have moved out a bit and equities have come off a bit. Before all of these markets were settled down into hovering around neutral. The EU was largely there as inflation was about at target and the economy about at trend. The US still had inflation that as a bit too high and an economy that bar frozen employment data looked fine, so markets were looking to see if the employment data would win out and rates were cut. Australia was seeing growth a bit too strong and was shifting rates up. The UK was seeing a weaker economy and building pressure for rate cuts but with inflation that remained a little too high. China remained challenged by poor domestic demand as housing remained troubled and the lack of a social safety net kept consumption cautious. So investment was rather nuanced around these factors.
- The longer term background was populism, demographics, the return of more muscular geopolitics, the huge shift in US attitudes both at home and abroad, the impact of climate change and demographics, the decline in productivity and the hopes (or fears) around AI.
- What has changed? Not a lot and probably not much once this episode is over. Yet although the Middle East is less important than it was it remains hugely relevant. This is not just for oil but also other goods, such as fertilizer and helium. So markets are right to have sold off and as above it is difficult to know how long this will go on for or whether something will happen to make it more consequential for the longer term than currently seems likely.
- We are therefore maintaining positions since nothing has moved enough to make anything compelling. We are monitoring the underlying data to see if it provides further information about the dynamics that mattered before focus turned. We are, of course, looking at the Middle East to see the shifts taking place there to understand if the longer term issues we focus on are affected in any way.
- Spread has moved out but so far not sufficiently to cause us to alter our very modest current positioning.

Portfolio Positioning

- Rates and Duration

While the U.S. macroeconomy maintained resilience, we had anticipated economic deterioration centred on employment. However, the U.S. and Israel's attack on Iran at the end of February shifted market focus to energy prices driven by the potential Iran war. The outlook for the continuation of this war will determine energy prices and impact fiscal and monetary policies globally. Currently, we anticipate a challenging outlook for this conflict. Therefore, we will manage the portfolio by partially reducing the range of longer durations and lowering currency risk. Duration holdings will focus on Australia and New Zealand, economies less susceptible to the economic impact of this conflict.

We maintain an overall longer duration stance anticipating continued U.S. employment slowdown and keep the dollar-related currencies underweight versus euro-related currencies. We expect U.S. long-term and ultra-long-term interest rates to remain resilient due to Trump's high-pressure diplomacy towards other nations.

In the Euro area, we maintain a neutral stance on short-term rates, broadly in line with current market pricing, (approximately one 25bp hike by year-end). Longer term, we retain our short duration stance on long term rates, reinforced this month by the convergence of record supply, inflation repricing, and geopolitical risk premium. While the ECB appears to have completed its cutting cycle and the front end is now pricing the possibility of hikes rather than an extended hold, QT continues to reduce balance-sheet support, reinforcing upward pressure on term premia.

In the UK, market volatility in gilt yields remains notable, now driven primarily by the Iran-related energy shock. Even so, long-term gilts continue to offer value as the medium-term domestic inflation outlook remains one of moderation, and the structural case for rate normalisation is intact once the energy shock dissipates. The DMO's reduced long-dated issuance (£23bn, a 21-year low) and ongoing fiscal consolidation intent provide a technical tailwind. The UK's term premium stands out as relatively high which, combined with contained long-run inflation expectations and the BoE's eventual return to an easing bias once clarity emerges, continues to bolster the case for a long-duration stance.

In the JGB market, expectations of continued policy normalization are likely to keep flattening pressure on the JGB yield curve. Structural demand for ultra-long JGBs from domestic institutional investors, particularly pension funds and life insurers, is therefore likely to persist. In addition, if the Bank of Japan maintains a relatively hawkish policy stance, maintaining a bias toward yield curve flattening strategies remains appropriate.

Therefore, In New Zealand and Australia, we focus on longer-duration management primarily where interest rate decline potential exists. For New Zealand, we employ cross-hedging to manage with longer duration without taking currency positions. For Australia, we focus on the inverse correlation between interest rates and exchange rates, aiming for lower rates while gaining carry income through longer duration and currency overweight positions.

- Currencies

Maintain an overweight (OW) position in USD, Norway, Australia, and Mexico (resource exporters) and an underweight (UW) position in EUR and China (resource importers). We plan to reduce the OW range for Poland.

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