Global Fixed Income Monthly

GARY HUTCHINGS
HEAD OF INVESTMENT

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

1. Monthly Macro View

- Trump has been active and revolutionary on a number of fronts making the investment environment challenging. The break from almost a century of what Western economies have stood for, the chaotic or incoherent thought processes and the strange policies which appear designed to make his voters poorer make the path toward a stable longer term investment position challenging.

- There are too many events to be able to describe them all and so an attempt will be made to synthesize the main areas.

- Tariffs. As applied they make no economic sense, simply bad for everyone.

- Fiscal policy. The US fiscal position is poor. The current budget plans will make it worse. The oddest thing is that tariffs and planned spending cuts hit Republican Red States the hardest. The benefits are basically aimed at the top one per cent. Under Reagan this was defined as trickle-down economics. This has now been researched and understood as being incorrect: it doesn't work. Trump has supplied no argument for making the majority of his voters poorer, but they don't appear at the moment to mind.

- Undermining the structure of the American State and society. Ignoring due process, attacks on universities, DOGE having access to data and systems for purposes that remain unclear, removal of senior civil servants, rewarding loyalty above competence, appointing essentially a witch doctor to be in charge of Health, ignoring serious security breaches, insulting and threatening to invade allies, removing the military lawyers responsible for ensuring the military obeys the law, threatening and removing judges and concerns about personal enrichment.

- Where do points three to five leave us on markets? Tariffs: raise prices and reduce economic activity (cyclical and secular). The question is the balance between them. Prices are very likely to be well above the Fed's target both this year (above three per cent) and next (high two per cent). The impact on demand is likely enhanced by the constant changes creating more business uncertainty. It seems likely that the demand shock and subsequent rise in unemployment will keep the Fed on hold and then subsequently cutting rates. Yet historically tariffs have not caused recessions and the US fundamentals were very good under Biden, so a downturn enhanced by built up distortions is not likely. We are therefore somewhat positive on rates but not overwhelmingly so. At the same time the fiscal background is likely to keep the yield curve steep and the spend may boost investment spending but with money going to the wealthiest it is unlikely to boost consumption spending much.

- The longer-term factors are causing a weaker dollar as US exceptionalism is being challenged. It remains the case, though, that the great productivity hope remains AI where the US clearly retains its lead. The attacks on education and science are unlikely to cause that situation to reverse quickly.

- The risk to a settled view is also that Trump starts to fail. His popularity rating is already low and that is before the economic hit. Large protests are taking place against his policies. The poor might at some stage understand that he is making them poorer. A very large reversal in his popularity could well cause a number of Republican politicians to turn against him and alter once again the political landscape.

- Of note, of course, is that the causes of the rise of Trump are not solely American. In the UK the right-wing Reform Party have surged in popularity and throughout the EU the populist right continue to prosper. The underlying causes of people simply feeling poorer (lower productivity since 2005) and significant pressures on society going forward (high debt/GDP ratios, climate change costs and defence spending pushing out more pleasurable resource allocation, ageing populations, unaffordable housing, inequality, migration pressures) are not going away any time soon. There are high levels of risk that populists gain power and introduce policies that markets will find difficult to absorb. That should cause yield curves to be steep. We continue to favour countries with higher yields.

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

  Although the market has calmed down for now, the tariff war itself is still ongoing, and we remain vigilant. We expect the tariff war to lead to a deterioration in real economic indicators around June to July. However, it is too early to factor in an economic downturn, and we are maintaining a longer-term stance centred on the United States, targeting a US 10-year yield of around 3.6%, which reflects the previous economic downturn.

  Non-government bonds will be increased in line with rising market volatility. We have added credit-worthy government-related bonds and financial bonds whose spreads have widened due to increased volatility. We have raised the non-government bond weight from 12% to around 15%.

- Currencies

  Following Trump's announcement of reciprocal l tariffs, the dollar lost credibility, leading to a triple dip in US equities, foreign exchange, and bonds, and subsequently triggering a global position adjustment. The loss of US Treasurys' risk hedging function raised the possibility of a financial crisis. Such a market environment could damage our portfolio and we have constructed our overweight/underweight positions based on political and economic advantages among currencies with strong trade correlations. Cconsidering drawdown risk, we have implemented some risk adjustment .

  We maintain our overweight positions in Poland, Sweden, and Norway - these are key countries amid the expansion of European military spending but cointribuite an attractive risk profile. We remain underweigh China underweight versus the U.S. and adjust our exposure through cross-hedging in line with risk sentiment.

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