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Monthly Macro View

- The war, no war (as far as Congress is told). Goods critical for production pass through the Straits of Hormuz. Close them and the full effect is not immediate; there are still tankers on the sea, there are inventories, some efficiencies can be found and the goods are not completely inelastic (although they are pretty inelastic). As time goes on if the good used to produce things aren't available then markets force you to stop producing. The mechanism is through prices. There are a wide range of estimates on the price of oil, from $150 to $400. Either way, demand has to fall to meet available supply. Governments would be foolish to try to keep energy prices lower than they should be, interest rates would have to take up some of the burden. Result: stagflation. Impact on bond markets; ambiguous, as one can see from central bank framing on whether to 'look through' the inflation impact.

- However, there are certain negatives one can look to that should drive risk premia higher. Inflation will be higher and bond investors will certainly want to be compensated for that. Government deficits will worsen and poorer economic conditions seemingly (and absurdly) currently favour populist political parties who make outcomes more worrisome. Whilst inflation expectations remain well-anchored, inflation has hardly been well contained over the past few years and it would be fair to imagine expectations are being eroded to some extent. High government deficits and populations less tolerant of being told what is good for them by 'elites' corrode faith in central bank independence and inflation targets over the long run. The extraordinary political situation in the US must raise longer term questions about the independence of the Federal Reserve which will matter if you hold a thirty-year bond. The general challenge to science, the efforts to change the standard thinking that has been dominant over the past fifty or so years cannot make one confident that economic norms that bond investors take for granted will remain sacrosanct.

- Turning to the US, it was always strange that someone so different had so little impact on markets. There are obvious efforts to turn the US into an autocracy which are not being much resisted. Internally the impact is profound and externally the relationships that have been dominant since WW2 are being challenged. This is not just Trump but has been a theme slowly running for many years with the current president being a mercurial accelerant. He is also a narcissist who has surrounded himself with sycophants; hardly comforting. Then he started a completely unnecessary war in a vital part of the globe. Yet even here markets have been largely quiescent. US bond yields rose from four per cent but remain within the range seen in 2025. Corporate spreads remain tight and the equity market is up by four per cent. It appears markets are optimistic about a relatively quick end to the war. Logically that seems sensible; the lines are known and so a bargain should be reached. Bar boots on the ground or indulging in war crimes the US faces trying to starve Iran into submission, Iran wants to show it has the power to wreak havoc on the global economy. Many commentators think US optimism about how quickly Iran will crumple is misplaced (they have money, they have storage capacity, they have the ability to slow production and damage to wells is months off), that US safe passage through the straits for ships is not feasible (Iran only has to hit a few of many to stop things dead), that Trump's popularity is suffering badly before the mid-term elections, that oil prices have reached nowhere close to what they will as the supply drain continues and that therefore Iran has the upper hand. Yet finding an off-ramp is difficult, trump's negotiating style is all about pressure and little about compromise and he has neutered the depth of the advisors he has and is relying on a small pool of inexperienced people. There are also well-developed theories of how escalation happens even when it doesn't make much sense. So, market optimism may well be misplaced albeit we constantly need to be aware that war is extremely unpredictable thus making market outcomes much the same.

- There are very many long-term issues swirling around that aren't necessarily immediately impactful but will have important consequences down the road and the best we can do here is briefly list them. Demographics, AI, the shift to a multi-polar world, the moving away from the NATO umbrella in a more dangerous world, rising defence spending, very high debt/GDP ratios when taxation is already high and demands for spending are growing, the failing of anti-trust in the US leading to less competition, national security considerations leading to onshoring, the erosion of democracy. On balance these are also on the whole somewhat negative for bond yields.

- 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, very unsurprisingly, has sold off. However, spreads were very tight before this and have recovered from the highs. There is therefore little reason not to keep a low profile.

Portfolio Positioning

- Rates and Duration

  The Iran conflict is not expected to be resolved anytime soon which leads us to anticipate that energy prices will remain elevated and inflation will rise. While the U.S. macroeconomy is showing resilience for now, we believe the economy will lose momentum due to high energy and commodity prices, increasing the risk of stagflation. Although interest rates will rise when inflation concerns intensify, we expect the rise in long-term rates to halt once equities turn downward, causing the yield curve to flatten. Therefore, our strategy is to manage duration risk while maintaining a slightly longer overall position.

  Specifically, we will keep positions in the European region—which is highly susceptible to inflation—on the shorter side, while maintaining longer positions in markets such as Australia and New Zealand, where the scope for further interest rate hikes is limited.

  Under the economic conditions described above, the distance to default may narrow for certain issuers. Consequently, when spreads widen significantly, we plan to increase our weighting in high-credit-quality issuers.

  We reduced positions in countries expected to face increasing negative impacts from this conflict, while maintaining positions in countries expected to see positive or neutral impacts as much as possible under risk management. Specifically, we reduced the duration and weightings of energy-importing countries such as Poland and other European nations, while maintaining positions in Australia, New Zealand, and Mexico. We also adjusted the ratio of U.S. dollar-denominated currencies to euro-denominated currencies, shifting from a net short dollar position toward a more neutral stance.

  In Euro area, we maintain a neutral stance on short-term rates, broadly in line with current market pricing, which now embeds almost three hikes before early 2027. At its most recent 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.

  In the UK, Market volatility in gilt yields remains notable, now driven primarily by the Iran-related energy shock and reinforced by political/fiscal risk after Labour's heavy local-election losses. Even so, long-term gilts continue to offer value as the medium-term domestic inflation outlook remains one of moderation under the BoE's less adverse scenarios, 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. While political risk, fiscal fragility and near-term inflation uncertainty remain material, the UK's unusually elevated term premium appears to more than compensate for these risks at current levels.

  In the JGB 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. Considering these underlying pressures for yen weakness alongside the recurring risk of intervention, it is appropriate to maintain a generally neutral stance toward the foreign exchange market for the time being.

Important Information