Fixed Income Views

December 2023

OUR VIEW AT A GLANCE

Key takeaways

- **The charts**: In November, global bond markets achieved their second-best (+5%) monthly performance (in USD) since inception of the Bloomberg Global Aggregate Bond Index in 1994.
- **Our view**: Yields (even for eurozone bonds) are offering plausibly positive returns to maturity, even if inflation does not return sustainably all the way to target. With central banks halting the rate hike cycle, the risk-reward for fixed income has become much more attractive again.
- **Our positioning**: In July, we closed our long-standing bond underweight in European and Swiss portfolios which aligns our fixed income positioning more closely with that in the US. We are now moving to an overweight position in fixed income duration within European and Swiss portfolios too.

OUR MARKET VIEW

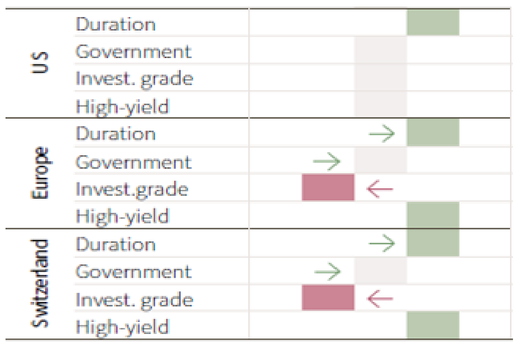
The dreadful events in the Middle East continue to have little impact on the global economy and financial markets. The business cycle, by contrast, does matter directly, and there the news has been broadly favourable to both bonds and stocks in the last month. The picture continues to be an intriguing mix of economic resilience and declining inflation.

In the third calendar quarter, the two biggest economies – the US and China – grew at an annualised pace of around 5%, and even the weaker European economies again avoided a significant setback.

Despite this economic resilience, the trends in developed world inflation are looking benign, and in the last month significantly more so. Headline rates have improved most dramatically – the eurozone's is now back down to 2.4%, less than half a percentage point above target – and core rates are also now more visibly falling too.

The more decisive declines in headline and core inflation rates suggest that we are indeed slowly turning the interest rate corner. We remain neutral Fixed Income – though this is itself the most positive we've been on bonds in a decade. Within fixed income, however, we are making a small change to align European and Swiss portfolios more closely with USD portfolios.

FIXED INCOME ALLOCATION

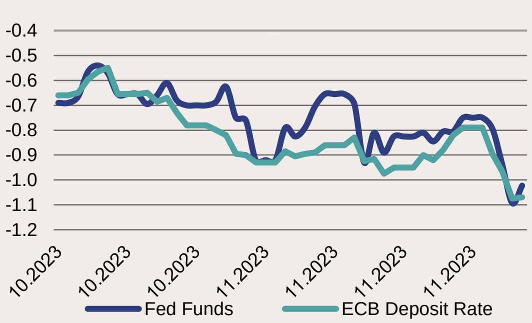


US: No changes.

EU: We have raised our view on duration to "overweight". We have also raised our outlook on government bonds to "neutral" and reduced IG Credit to "underweight".

CH: We have raised our view on duration to "overweight". We have also raised our outlook on government bonds to "neutral" and reduced IG Credit to "underweight".

CHART OF THE MONTH: Expectations for key interest rates in 2024 for the FED and the ECB



The charts: Key interest rate cuts priced into the capital market for key interest rates in 2024 for the FED and the ECB.

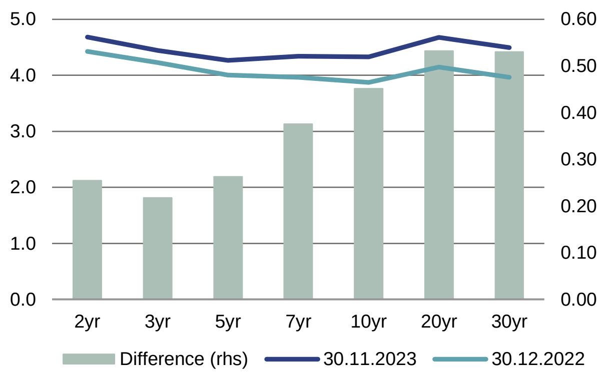
Our view: Expectations for key interest rates in the US and Europe have recently significantly declined. Compared to the previous month, there is an expectation of 1-2 additional interest rate cuts for the coming year. The central banks' dovish stance is driven by the declining inflation rates in the USA and Europe, bringing the central banks` target of 2% closer and providing them with the scope to cut interest rates.

USD Fixed Income Market

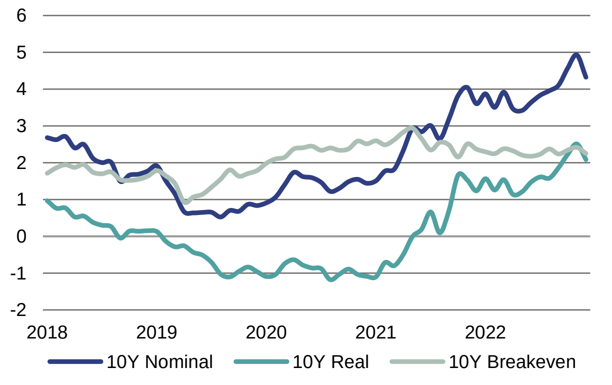
Key takeaways

- **The charts:** The bond markets in the US recorded their highest monthly rise since 1985. The rally in fixed-interest securities was particularly triggered by weaker inflation data and the associated expectations that the FED would lower the key interest rate earlier and more decisively in the coming year.
- **Our view:** The US economy is expanding at an above-trend pace, while inflation is declining. This could provide the FED with some flexibility later next year. Historically, a plateau in interest rates has been positive for bonds.
- **Our positioning:** We upgraded our positioning to a neutral bond position with a slight overweight in US duration during summer. We are open to the possibility of increasing our exposure, contingent on the growth and policy outlook.

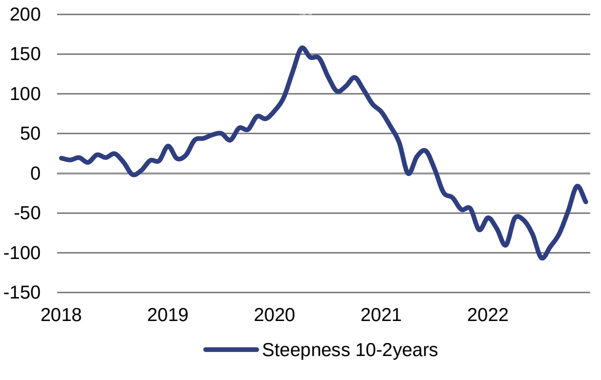
YIELD CURVE EVOLUTION (%)



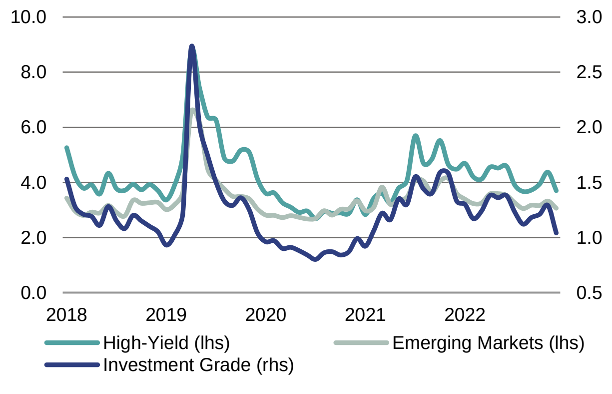
10-YEAR YIELD BREAKDOWN (%)



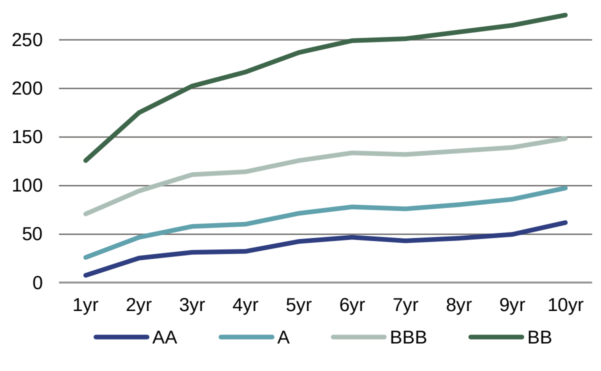
YIELD CURVE STEEPNESS 10-2 YEARS (BPS.)



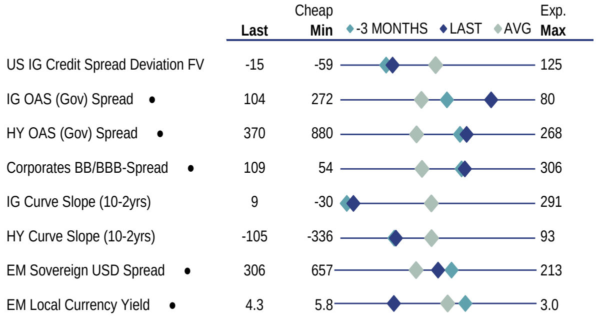
CREDIT SPREADS EVOLUTION (%)



CREDIT CURVE (Spread vs. government bonds in basis points)



CREDIT LONG-TERM VIEW



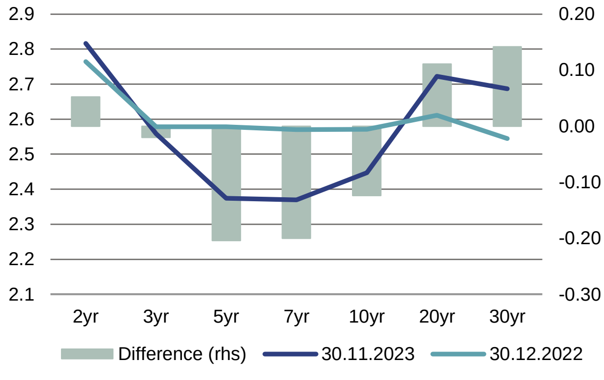
All data source: Bloomberg, as of 30.11.2023

EUR Fixed Income Market

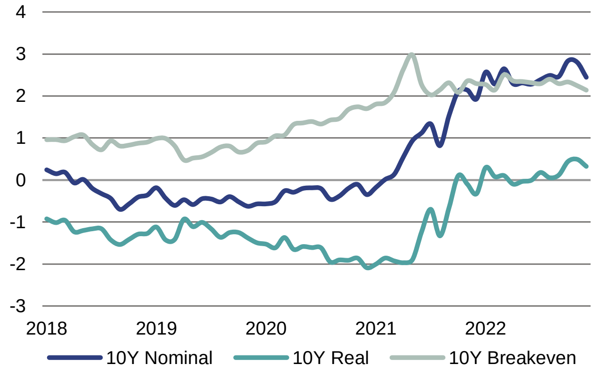
Key takeaways

- **The charts:** The sharp price losses experienced in October were fully recovered last month, and yields on medium-term bonds have even fallen since the beginning of the year. Real yields remain high due to the fall in break-even inflation rates.
- **Our view:** Inflation in the eurozone fell to 2.4% in November; bringing it closer to the ECB's price target. This reinforces our view that the central bank has concluded its cycle of interest rate hikes.
- **Our positioning:** We are now moving to an overweight position in fixed income duration within European portfolios. While retaining our overweight in speculative grade bonds in European portfolios, we are reducing our weightings in investment grade credit instead, in favour of government bonds.

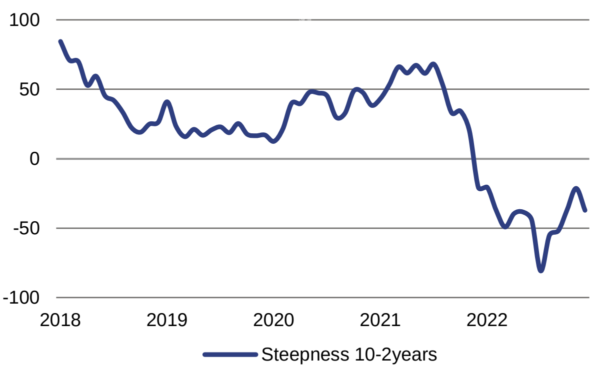
YIELD CURVE EVOLUTION (%)



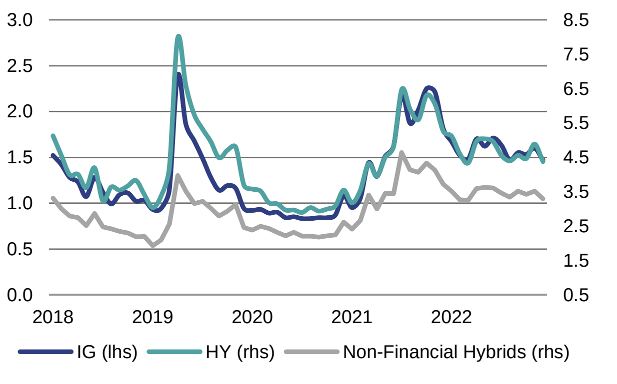
10-YEAR YIELD BREAKDOWN (%)



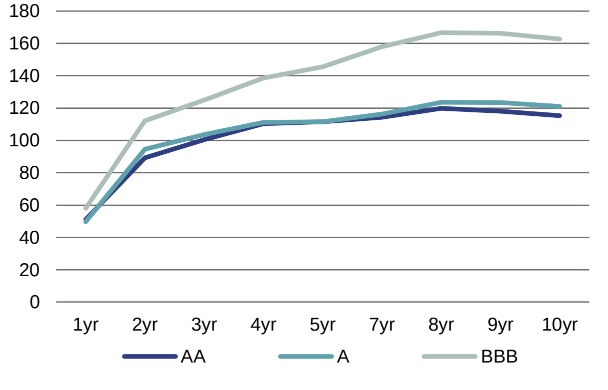
YIELD CURVE STEEPNESS 10-2 YEARS (BPS.)



CREDIT SPREADS EVOLUTION (%)



CREDIT CURVE (Spread vs. government bonds in basis points)



CREDIT LONG-TERM VIEW

	Last	Cheap Min	◆LAST ◆-3 MONTHS ◆AVG	Exp. Max
EUR IG Credit Spread Deviation FV	-41	-12		112
IG OAS (Gov) Spread	147	239		74
HY OAS (Gov) Spread	438	796		247
Corporates BB/BBB-Spread	134	82		306
IG Curve Slope (10-2yrs)	21	10		80
HY Curve Slope (10-2yrs)	58	-11		98
Corp. Non-Fin. Hybrid/Senior Spread	2.0	2.8		1.0

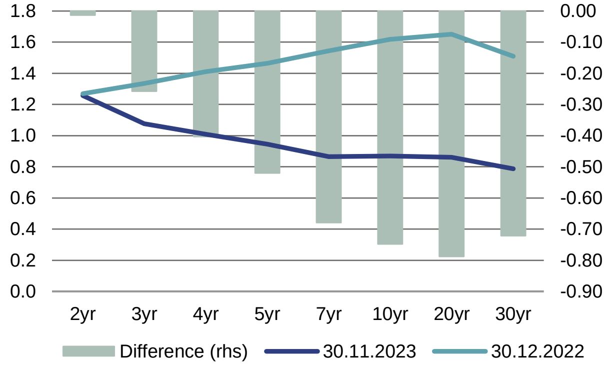
All data source: Bloomberg, as of 30.11.2023.

CHF & GBP Fixed Income Market

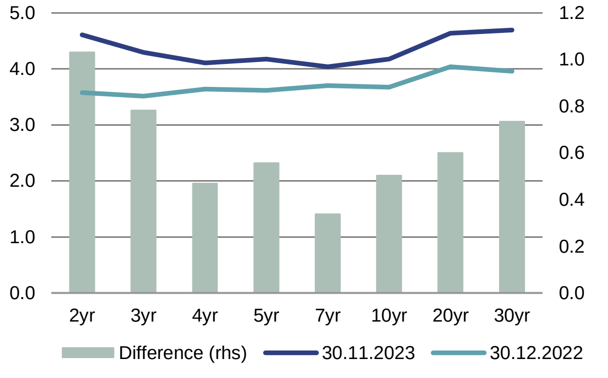
Key takeaways

- **Our view (CHF):** After surprising the market with a rate pause in September, most market economists believe that the SNB's policy rate have reached their peak. Similar-to the Eurozone, we have upgraded duration in CHF portfolios to overweight. Within fixed income, we are reducing weightings in investment-grade credit in favour of government bonds.
- **Our view (GBP):** The UK fixed income market delivered solid returns in November, driven by a fall in yields on government bonds where longer dated bond yields fell more significantly than shorter dated ones. Credit markets also had a strong month, alongside other risk markets, buoyed by falling inflation and a seemingly resilient economy. Our preference remains with higher-quality issuers going into next year.

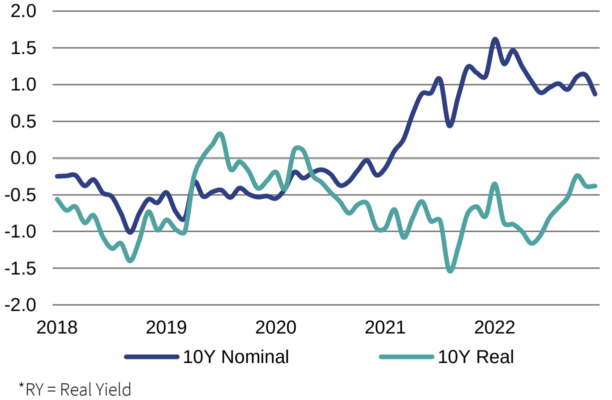
YIELD CURVE EVOLUTION (CHF, %)



YIELD CURVE EVOLUTION (GBP, %)

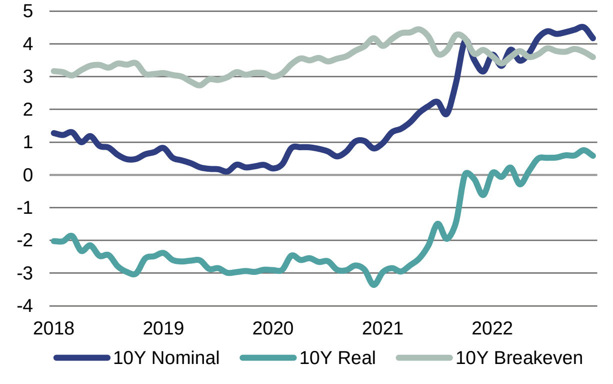


10-YEAR YIELD BREAKDOWN (CHF, RY* on core CPI)

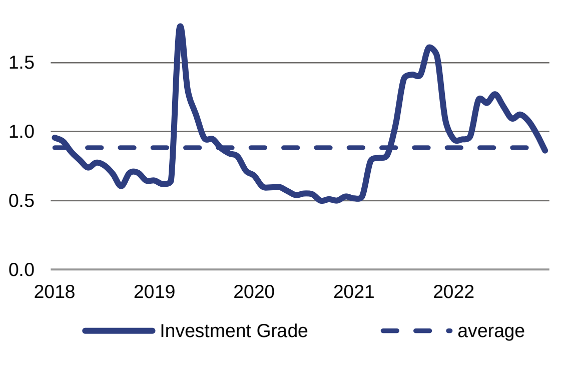


*RY = Real Yield

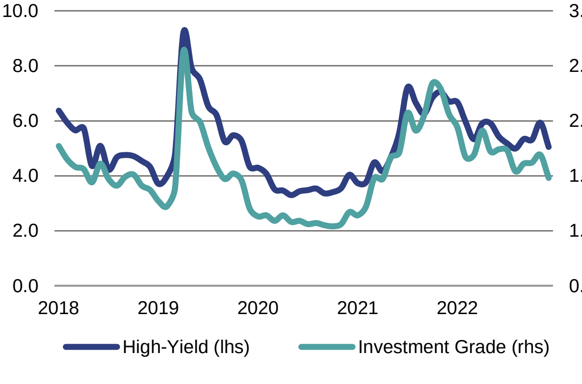
10-YEAR YIELD BREAKDOWN (GBP, %)



CREDIT SPREADS EVOLUTION (CHF, %)



CREDIT SPREADS EVOLUTION (GBP, %)



All data source: Bloomberg, as of 30.11.2023

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