Fixed Income Views

June 2023

OUR VIEW AT A GLANCE

Key takeaways

- **The charts**: Yield curves remain inverted with 2-year rates above longer maturities. Credit spreads have tightened from recent peaks. Real yields are in positive territory, showing the comeback of the asset class.
- **Our view**: Strong economic data have taken the market by surprise since the beginning of the year. The Fed is likely to pause further interest rate hikes, but other Central Banks are not done yet. Sticky core inflation needs monitoring.
- **Our positioning**: Inverted yield curves support our preference for shorter dated bonds. We have increased our exposure to longer duration bonds in the US as the Fed approaches its terminal rate. We are still cautious in EUR and CHF Fixed Income.

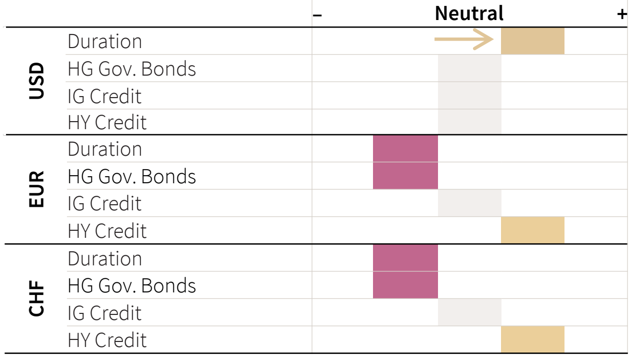
OUR MARKET VIEW

The cyclical risks markets had to deal with in 2022 had been fading, even as geopolitical risks (Ukraine, and heightened China-US tension) remained elevated. Inflation was subsiding slowly and patchily, and economic growth was looking resilient.

Developed economies' terms of trade continue to improve as energy costs – particularly natural gas prices – continue to fall, and China's re-opening also promises support for growth. Yet, if a monetary seizure is avoided – as we think it will be – the economic prospects for the rest of the year may not have deteriorated significantly. The flip side of this of course is that core inflation will indeed remain sticky – as the monthly data are suggesting.

The renewed sell-off in bonds has unearthed value in US longer-dated bonds, even as we see the level of short-term interest rates priced into markets being a little too low, and we are lengthening the duration of our fixed income positions in US portfolios. In European portfolios, valuations have still not reached levels at which we are happy closing our long-standing underweight positions in bonds generally, and in longer-dated bonds in particular.

FIXED INCOME ALLOCATION

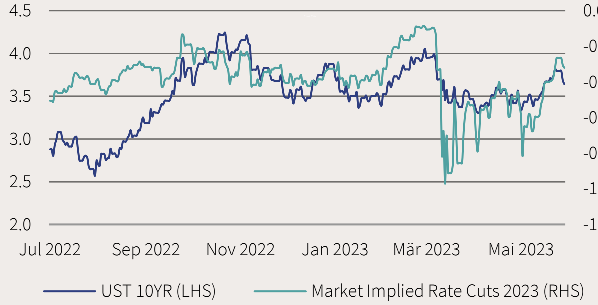


US: In US portfolios, we stay neutral on the asset class and credit quality, but now move longer on duration.

EU: In European portfolios, we stay underweight on the asset class. We stay underweight duration and have a continuing preference for the speculative grade (high yield) segment.

CH: In Swiss portfolios, we stay underweight on the asset class. We prefer credits over government bonds due to the still attractive spread pick up.

CHART OF THE MONTH: US-Treasury yield & market implied rate cuts for 2023 from peak



The charts: Driven by a more hawkish Fed outlook, the yield for a 10-year US-Treasury bond increased from below 3% up to 3,9% in May 2023.

Our view: Rate cuts for 2023 are almost outpriced compared to very aggressive expectations of rate cuts of 100 bps. a couple of weeks ago. We changed our view for US duration from neutral to slightly overweight due to the more attractive entry level for the long end of the curve.

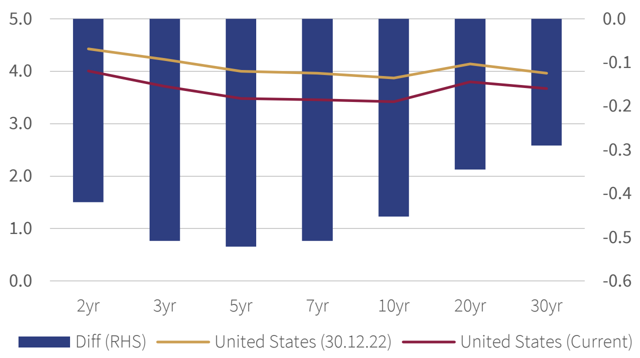
All data source: Bloomberg, as of 31.05.2023

USD Fixed Income Market

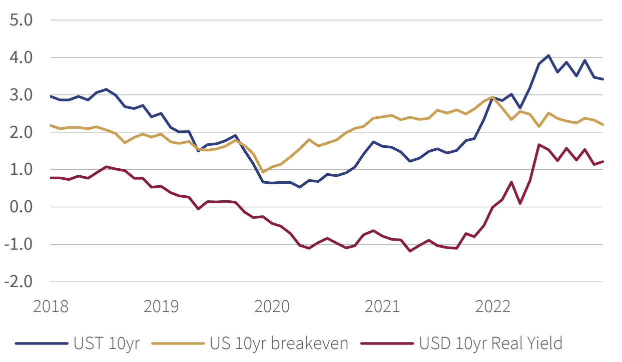
Key takeaways

- **The charts:** The USD remains inverted with 2-year rates above longer maturities. Credit spreads have tightened from recent peaks. Yet, USD real yields are in positive territory, showing the comeback of the asset class.
- **Our view:** Strong economic data have taken the market by surprise since the beginning of the year. Resilient labour figures coupled with sticky service inflation has driven the Fed to hike to 5.25%. This is likely the last hike but recent strength in data put one last hike later this summer on the table again.
- **Our positioning:** As the Fed approaches its terminal rate, we have increased our exposure to longer duration bonds from neutral to slightly overweight.

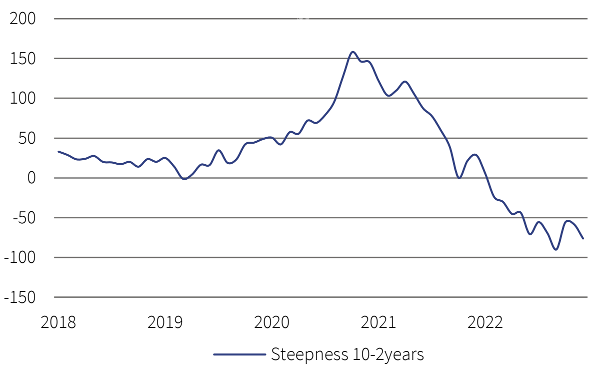
YIELD CURVE EVOLUTION (%)



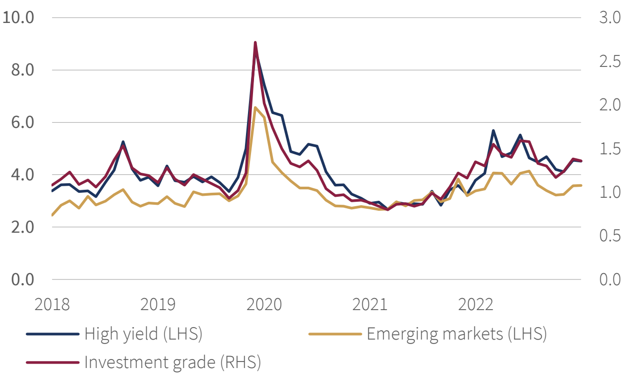
10-YEAR YIELD BREAKDOWN (%)



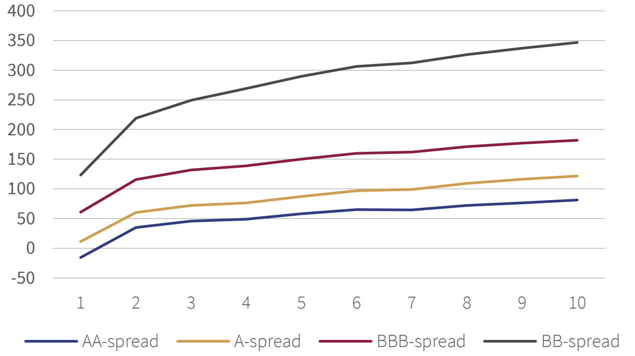
YIELD CURVE STEEPNESS 10-2 YEARS (BPS.)



CREDIT SPREADS EVOLUTION (%)



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



CREDIT LONG-TERM VIEW

◆ -3 MONTHS ◆ LAST ◆ AVG

	Last	Cheap Min	Exp. Max
US IG Credit Spread Deviation FV	-32	-54	51
IG OAS (Gov) Spread •	138	272	80
HY OAS (Gov) Spread •	459	880	268
Corporates BB/BBB-Spread •	146	54	306
IG Curve Slope (10-2yrs)	-10	-11	291
HY Curve Slope (10-2yrs)	-153	-336	117
EM Sovereign USD Spread •	353	657	213
EM Local Currency Yield •	4.2	5.8	3.0

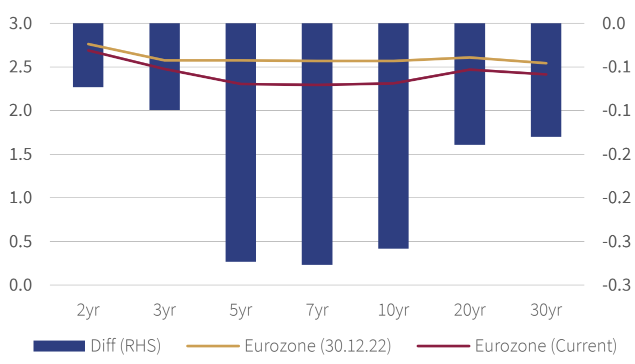
All data source: Bloomberg, as of 31.05.2023

EUR Fixed Income Market

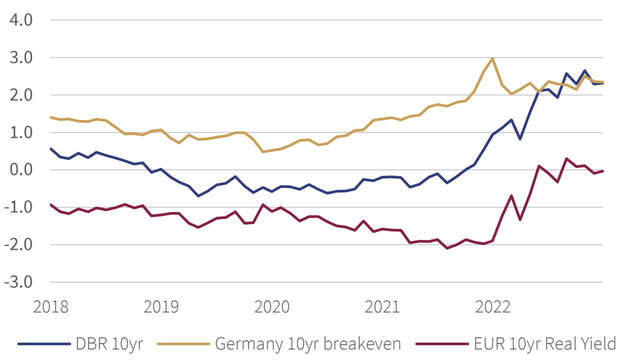
Key takeaways

- **The charts:** The EUR yield curve remains inverted with 2-year rates above longer maturities up to 10 years. Real yields just crossed to positive territory. Credit spreads have tightened from recent peaks.
- **Our view:** Recession expectations in Europe subsided thanks to China's re-opening and a mild winter, driving the ECB to take a more hawkish stance. ECB started its quantitative tightening in March and APP re-investments will end in July.
- **Our positioning:** The ECB started its tightening later than the Fed. As a result, terminal rates are still some time away and our duration is hence shorter. Different to the US, we remain tactically slightly bullish on high yield.

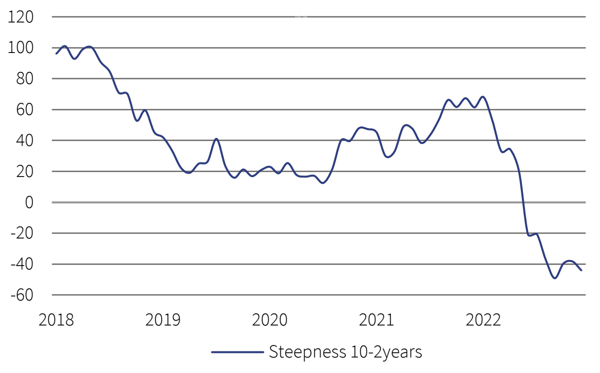
YIELD CURVE EVOLUTION (%)



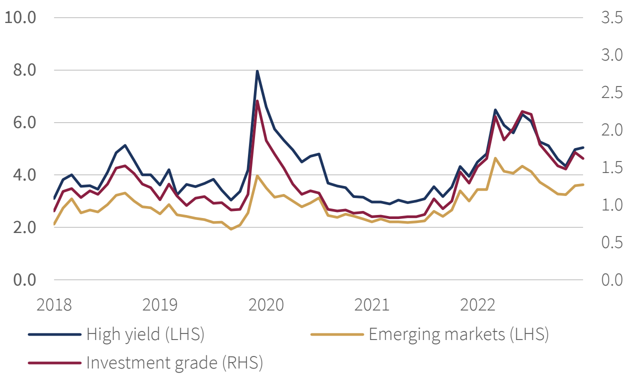
10-YEAR YIELD BREAKDOWN (%)



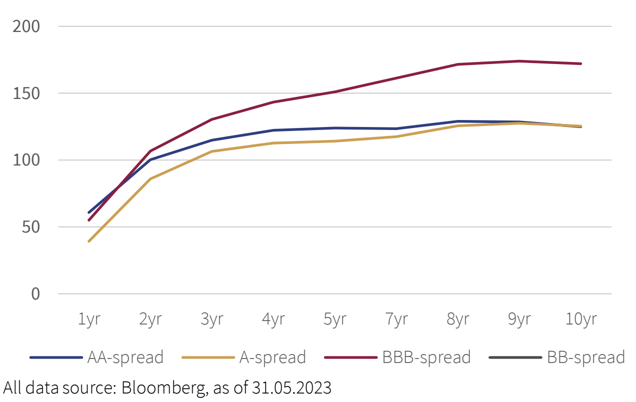
YIELD CURVE STEEPNESS 10-2 YEARS (BPS.)



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	-27	-40		109
IG OAS (Gov) Spread	171	74		239
HY OAS (Gov) Spread	496	247		796
Corporates BB/BBB-Spread	166	82		306
IG Curve Slope (10-2yrs)	24	10		80
HY Curve Slope (10-2yrs)	54	-11		98
Corp. Non-Fin. Hybrid/Senior Spread	2.2	2.8		1.0

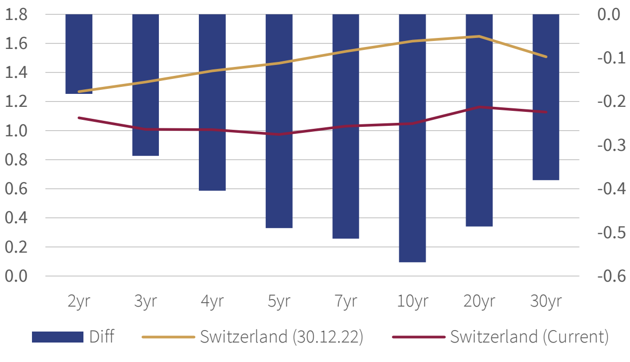
All data source: Bloomberg, as of 31.05.2023

CHF & GBP Fixed Income Market

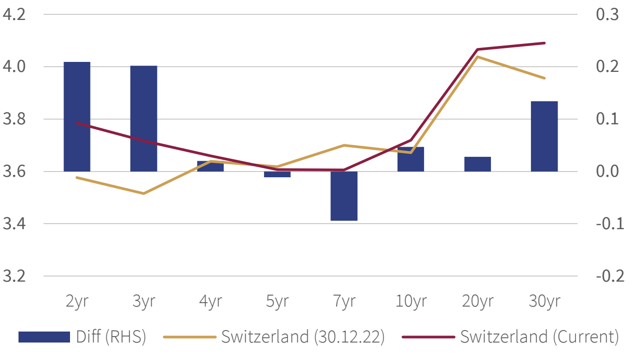
Key takeaways

- **Our view (CHF):** Unlike the USD or EUR, the CHF yield curve is relatively flat and less inverted. Spreads have tightened but are still above average and therefore attractive. Due to the hawkish trajectory, we remain cautious about duration of Swiss bonds, with a preference for high quality bonds from IG-corporates.
- **Our view (GBP):** Both real and nominal yields rose in the UK. This re-pricing of rates was driven largely by expectations that the BoE has not finished hiking, as inflation remains uncomfortably high in the UK. Constructive economic data provided comfort to the credit markets and spreads tightened from peaks. Within our framework we have a preference for SSAs and high quality short dated corporate bonds.

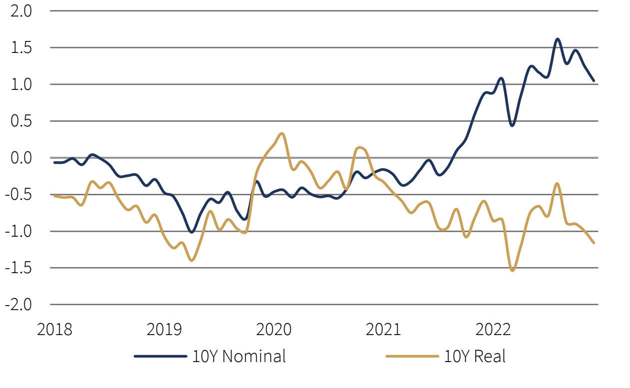
YIELD CURVE EVOLUTION (CHF, %)



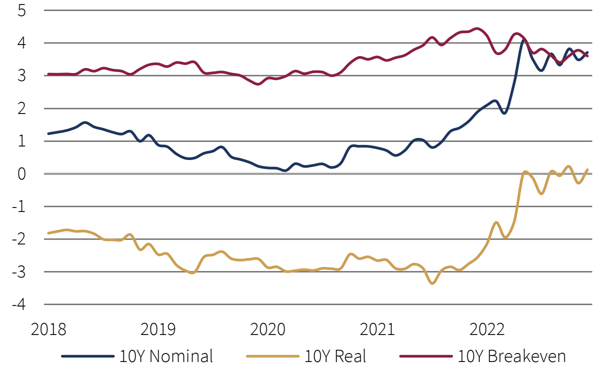
YIELD CURVE EVOLUTION (GBP, %)



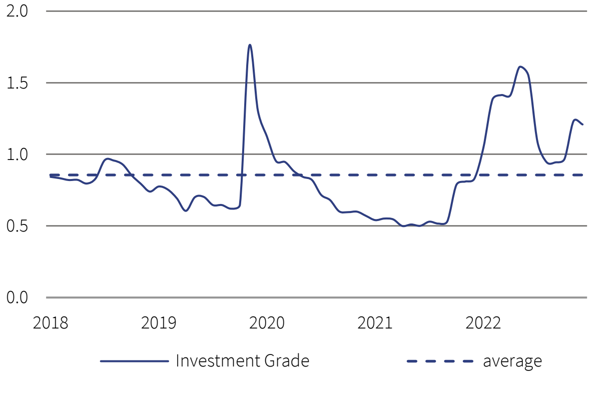
10-YEAR YIELD BREAKDOWN (CHF, RY on core CPI)



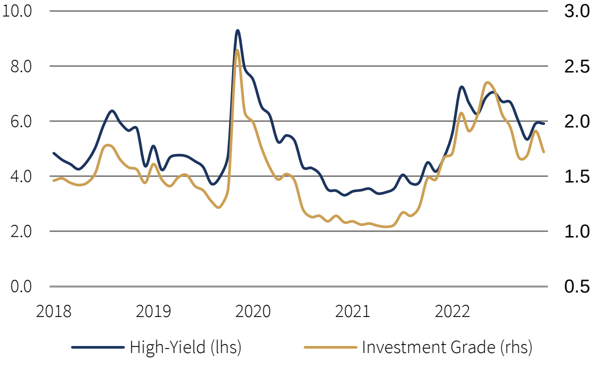
10-YEAR YIELD BREAKDOWN (GBP, %)



CREDIT SPREADS EVOLUTION (CHF, %)



CREDIT SPREADS EVOLUTION (GBP, %)



All data source: Bloomberg, as of 31.05.2023

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