

Fixed Income: Return of the Sovereigns

After an eventful year, Fixed Income is still in a state of flux. Where should you be looking now?

Where Are We Now

A Positive Regime for Sovereigns

Sub-trend growth and tame inflation present a favourable **cyclical** backdrop for central banks to cut rates which is positive for sovereign debt. Divergent economic prospects will likely mean higher volatility but also offers **opportunities to build or extend duration**.

Our Rate Cut Predictions for 2025

3x
25bps
For Fed

4x
25bps
For ECB

5x
25bps
For BoE

Critical Slow-Moving Factors

Investors need to weigh up two opposing **structural** forces in the coming years — **lower trend growth rates** due to demographics (positive for bonds) and **rising deficit and debt levels** (negative for bonds).

Impact of Opposing Forces on Bond Yields

Rising Deficit & Debt Levels
Negative Impact



Bond Yields



Lower Trend Growth Rates
Positive Impact

Where to Look

Sovereign Bonds in Advanced Economies

The sizeable backup in yields in late 2024 (despite slowing growth) offers investors **relatively generous yields** in many European and other non-US sovereign debt markets. US Treasury yields are attractive but a **re-pricing of Fed rate cuts** is the likely catalyst to unlock greater gains here.

Investment Grade and High Yield Credit

With spreads near historic lows, significant compression is unlikely for either IG or high yield credit. Capturing current yields is a reasonable goal, but an **active, systematic approach** may add alpha, as the credit cycle evolves.

Emerging Market Debt

Hard currency EM debt stands to benefit from a favourable US Treasury view. While attractive, the picture is more nuanced for local currency debt given divergent monetary policies. Further US rate cuts and a weaker US dollar can help unlock value in this segment.

How to Play It

Advanced Economy Sovereigns

Repricing may offer investors an opportunity to manage or extend duration if needed.

Investment Grade Credit

An active systematic approach has merit for credit investors looking to add alpha in this environment.

Emerging Market Debt

EM Hard: Can benefit from favourable US Treasury outlook.

EM Local: Nuanced but a weaker US dollar would be strong catalyst for outperformance.

Sustainable Investing Allocation

A sustainable investing allocation can be considered as part of your investing strategy.

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