

Fixed Income asset class overview

September 2025

The Federal Reserve (Fed) delivered their first rate cut of 2025 in September, following an underwhelming August jobs report that showed payrolls were up just +22k, while the unemployment rate moved up to its highest level since late 2021, at 4.3%. The 25bps cut lowered the target range for the federal funds rate to 4.00-4.25%. The Fed also pointed to further rate cuts ahead, with the median dot plot pencilling in 50bps more cuts by the end of 2025. The move to cut rates helped to support US Treasuries, with 10-year Treasuries ending the month up 1.2%.

Month in review

In Europe, fiscal fears put long-end bonds under pressure, particularly in France. Prime Minister François Bayrou lost the confidence vote on fiscal reform on 8 September, and France saw a credit rating downgrade by Fitch from AA- to A+. This saw the gap between the 10-year French and German bond yields reach their widest levels since January 2025.

Against this backdrop, investment grade (IG) spreads moved 5bps tighter in September. There were no clear drivers, September was a mixed data month in which spreads compressed across all regions. US dollar spreads tightened by 4 bps and remain the tightest at 76 bps. Euro spreads finished September at 78 bps and Sterling spreads moved from 91 to 84 bps. IG spreads remain tight when looking at last five, 10 and 30-year valuations.

Global high yield (HY) markets continued their positive run, delivering 0.7% in September, taking year-to-date (YTD) performance to 6.8%. Global HY floating rate notes (FRNs) also had a good month returning 0.3%, led by carry (income) with a little help from tightening credit spreads. US HY outperformed European HY again. The Fed's rate cut was interpreted as supportive for credit risk and the balance of easier policy and resilient macroeconomic conditions kept credit spreads tighten further. Following September's rally, US and European HY spreads have converged around 280 bps, both near the tightest levels in the cycle.

Emerging market (EM) debt posted solid gains in September, with hard currency sovereigns up 1.8% and corporate bonds +1.0%, supported by spread compression and falling US Treasury yields. Local currency debt returned 1.4%, driven by currency appreciation and attractive carry. A significant portion of performance, which had been driven by spread compression, was spearheaded by high yield names -- a key theme for most of the year. Currencies continue to perform well despite the US dollar being flat in the month, with Latin American currencies continuing to benefit from increasing investor demand.

Inflation

US consumer price index (CPI) inflation came in line with expectations, increasing to 2.9% year-on-year (YoY), while core inflation, which excludes the most volatile items, remained stable at 3.1%. The prevailing narrative remains largely unchanged. Although tariffs are gradually influencing consumer prices, their overall impact on inflation has been less severe than many initially anticipated.

The effects of tariffs are evident in the core goods category, which continues to experience YoY increases. However, inflation in core services, which constitute a larger and more significant portion of the inflation basket, has been on a downward trajectory, helping to moderate overall price rises.

This trend will likely persist for some time. Tariffs have yet to fully permeate the economy, suggesting continued upward pressure on core goods. Conversely, the downward adjustment in services inflation appears incomplete. The two key drivers of services inflation, wages and rents, indicate further potential weakness. The labour market is softening more rapidly than many expected, likely leading to lower wages -- a crucial factor for supercore inflation (services excluding rents). Additionally, the housing market continues to show signs of weakness, with house price growth, typically a precursor to rent changes by approximately 18 months, having declined significantly.

If we take a step back and look at money supply, which we believe is what ultimately influences the overall prices level, we can get a better picture of overall inflationary pressures. The growth in the money supply is accelerating, although it is starting from a very low base, essentially returning to pre-COVID levels, which were consistent with achieving the 2% inflation target. Nevertheless, if the growth in the money supply continues to accelerate, it should raise a red flag and could alter the inflation outlook for the coming years.

However, there is also another important variable to consider: velocity (the rate at which money circulates within the economy). An abundance of money is ineffective if it does not circulate, as prices will not rise. Velocity is particularly crucial to consider today, as the economy appears to be losing momentum. Should a recession occur, velocity is likely to decrease, potentially offsetting inflationary pressures and resulting in lower inflation.

In conclusion, the inflation situation remains largely unchanged. Looking ahead, an increase in money supply could suggest rising inflationary pressures next year. However, an economic slowdown, accompanied by a decline in velocity, might exert a more significant influence, leading to reduced inflation. The key factor moving forward will not be tariffs, but rather the broader economic conditions, particularly whether the economy is indeed slowing and if job losses continue to increase.

Developed market sovereigns

September 2025 delivered sharply contrasting economic signals across the globe. In the US, August brought virtually no net job growth even as inflation nudged slightly higher. Markets took this as confirmation of a slowdown, prompting the Fed's first rate cut of the cycle.

In the eurozone, inflation hovered around the European Central Bank's (ECB) 2% target, allowing policymakers to pause further easing, with a hawkish bias. Growth indicators remained tepid, underscoring a flat, but not collapsing economy. The UK saw inflation hold at a painful 3.8% – highest among G7 economies – which forced the Bank of England to hold off on more rate cuts after its summer easing. In Japan, inflation finally eased to a 10-month low (around 2.7%).

In the US, the JOLTS report for July (released on 4 September) showed US job openings fell to 7.18 million – a 10-month low. In a stark sign of slowdown, nonfarm payrolls rose by only 22,000 in August – dramatically below consensus (75k) and the weakest monthly gain in years. The unemployment rate ticked up to 4.3% (from 4.2%).

August CPI inched up slightly, while on the same day, initial jobless claims spiked higher than anticipated, reaching their highest level in months. The surge in weekly layoffs grabbed the market's attention and Fed futures swiftly priced in a deeper easing path (about 0.75% of rate cuts by year-end, up from 0.68% prior).

Finally, the Fed cut rates by 25bps (to a 4.00–4.25% range), its first rate cut of 2025. Powell framed it as a "risk management cut", noting rising unemployment risks. Notably, the Fed's updated projections showed slightly more easing ahead (75bps of total 2025 cuts versus 50bps

before). The Fed highlighted that future moves will depend on the evolution of data (labour, growth and inflation).

Eurozone business activity contracted in August. The final eurozone services PMI slipped to 50.5, with Germany's services PMI downgraded to 49.3, back into contraction territory. Manufacturing PMIs remained weak as well.

The Bank of England (BoE) kept the Bank Rate at 4%, after having cut by 25bps in August. The decision to pause was driven by the lack of improvement in inflation. BoE Governor Dr. Swati Dhingra and the monetary policy committee (MPC) emphasized that while the UK economy is fragile (with very slow growth and rising unemployment), inflation remains far above target.

Past performance is not a guide to future performance.

Government bond total returns (in local currency)

	10-year yield %	Total return % (1m)	Total return % (ytd)
Treasuries	4.2	0.9	5.4
Bunds	2.7	0.2	-0.9
Gilts	4.7	0.7	1.9

Source: Bloomberg, 30 September 2025

Investment grade credit

Against this backdrop, global IG credit spreads moved 5bps tighter, closing the month at 77 bps. There were no clear drivers, as September was a mixed data month in which spreads compressed across all regions.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	76	1.4	7.0
Euro IG	78	0.4	2.8
UK IG	84	0.9	4.3

Source: Bloomberg, 30 September 2025

High yield credit

In September, US HY outperformed Europe again. The Fed's 25bps interest rate cut was interpreted as supportive for credit risk and the balance of easier policy and resilient macroeconomic kept credit spreads tightening.

Spreads remained tight across most regions with European spreads seeing a little upward pressure. Current levels remain very tight, pricing an almost perfect scenario of continued low defaults, stable growth and supportive central bank policy. We maintain a cautious risk position given current valuations look unconvincing, even though we may still see moderate spread compression with the deployment of built-up cash over the summer.

Post-summer, primary markets re-opened and secondary market liquidity was decent; spread tightening through the month reflects persistent demand for carry despite macroeconomic cross-currents (rate path uncertainty, tariffs). With spreads at relatively unconvincing levels, we favour selectivity over beta. We continue to focus on disciplined stock selection and defensive carry, keeping dry powder for any primary-market concessions as issuance momentum builds into October.

Outlook

- **Attractive all-in yields:** HY bonds offer attractive all-in yields, around 5-6%, providing strong carry despite tight spreads. In a carry-driven environment, this supports potential high single-digit returns, aided by broadly supportive central bank policies.
- **Benign default expectations:** defaults remain low, projected below 3% over 12–18 months, with the recent uptick limited to isolated distressed exchanges. The focus is on avoiding security-specific risks -- which is where our analyst team adds value.
- **Supportive market technicals:** this is a supportive market, in our view, with low net supply and strong demand from ETFs and coupon reinvestments. Despite higher volatility due to macroeconomic and trade concerns, the supply-demand imbalance continues to support spreads. US HY bonds, with yields near 6.5%, are likely to attract yield-focused investors.
- **HY FRNs** retain an edge even in rate-cutting cycles thanks to lower volatility — historically capturing the most upside with less downside — plus senior secured status that boosts recovery (60–80%) in defaults. They offer competitive yields despite minimal duration, appealing to income-focused investors. Their low correlation with sovereign and IG credit adds diversification, making them a resilient allocation for income and stability.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	280	0.8	7.1
Euro HY	283	0.5	4.9

Source: Bloomberg, 31 August 2025

Emerging market bonds

September saw a continuation in the very broad-based rally seen in the market with only a couple of countries (Senegal and Argentina) experiencing negative returns.

The Fed has now begun its rate-cutting cycle, which historically provides a meaningful tailwind for EM debt. A softer US dollar is supportive of local currency returns, and as investors seek to diversify away from US assets, EM debt is increasingly viewed as a relatively stable refuge. EM fundamentals remain robust across both sovereign and corporate sectors, with many economies benefiting from contained inflation and the easing of monetary policy. While the prospect of new tariffs has led to downward revisions in global growth forecasts, EMs are still expected to outpace their developed counterparts, and we remain constructive on EM fundamentals.

Although spreads continue to compress, yields remain elevated, offering an appealing entry point for those rotating out of other parts of the market. A compelling feature of the asset class is its ability to deliver yields comparable to, or even exceeding, those found in HY markets, while maintaining superior credit quality. With approximately half of the market rated IG and a high degree of diversification, we believe EM debt is well-positioned to attract investor interest. Importantly, we do not expect any sovereign defaults over the medium term, and with risks in developed and emerging markets converging, EMs look increasingly attractive, in our view.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	1.4	15.4
Hard currency government	288	1.8	10.7
Hard currency corporate	234	1.0	7.3

Source: Bloomberg, 30 September 2025

Currencies

The US dollar whipsawed in September, but ended the month flat as measured by the dollar index. Despite the dollar finding a period of respite during the year, it is still down 9.9%. During September there was a very wide variation in currencies that strengthened, and weakened, against the US dollar, with Latam currencies performing particularly well.

G10 currencies were mixed, with the British pound, Canadian dollar, and New Zealand dollar among the worst performing, with the latter driven by weakening domestic data as well as markets pricing in an aggressive easing cycle.

While the Argentine peso ended the month marginally weaker, it could have been a lot worse had the US not stepped in to provide assurances that they would intervene if required during Argentina's period of weakness, which saw assets sharply sell off following concerns that dwindling reserves would impact the country's ability to pay back debt in hard currencies. At one point, the Argentine peso was down 8.9% on a spot basis, but recovered end the month broadly flat.

The Colombian peso and Brazilian real were among the strongest during the month owing to continued interest in the carry trade as well as improving sentiment within the region. The Russian rouble depreciated among growing calls for additional sanctions, but still remains one of the strongest currencies on a year-to-date basis (c.40% vs USD).

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	-0.4	7.4
GBP/EUR	-0.8	-5.2
EUR/USD	0.4	13.3

Source: Bloomberg, 30 September 2025

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