Fixed Income asset class overview

November 2023

November saw a major rally in markets, buoyed by fresh hopes of a soft landing and potential central bank cuts on the horizon. Notably, the Bloomberg Global Bond Aggregate Index had its best month since the height of the Global Financial Crisis in 2008, rising by 5.0%.

Month in review

November's rally was initially triggered by dovish tones from the Federal Open Market Committee (FOMC) meeting at the start of the month. This was then supported by economic data throughout the month. Europe saw a similar story, with supportive data and a European Central Bank (ECB) cut being fully priced in by April 2024. Energy prices saw a fair decline, with Brent Crude down 5.2%.

Inflation continued to ease, which helped fuel the rally. However, we are not out the woods. Median inflation is still too high and wages continue to add to the inflationary pressure. We may see some Federal Reserve (Fed) push-back given that the rally has loosened financial conditions slightly, which is not what Fed Chair Jerome Powell wants at the moment. Although there have been indications of a policy 'pivot', the rhetoric is still indicating a pause in rates for the time being.

It was a strong month for investment grade (IG) as spreads (-20 bps) and rates (10-year Treasury yield -60 bps) both fell. November was one of the best months for the Global IG Index since its inception in 1997. BBBs and longer-dated names performed best. Cyclicals outperformed non-cyclicals and financials generally did better than corporates. All-in yields remain historically high. Euro IG offers a yield of 4.1%, sterling IG 5.9% and US IG 5.7%.

High yield (HY) had a strong month as well on hopes of a soft landing and looser central bank policy. The lower sovereign bond yields and tightening of spreads led to the global HY market returning +4.1% in the month and bringing HY returns to +8.7% year-to-date. US HY outperformed (+4.5%), followed by emerging market (EM) HY (+4.0%) and European HY (+2.9%). Global floating rate notes (FRN) returned +1.8% thanks to tightening spreads (-50 bps) and the carry the asset class currently offers.

It was a similar story in EM with the fall in rates supporting returns, helped by spread levels tightening across the board. The November rally accounts for approximately 60% of year-to-date returns. IG hard currency (HC) sovereigns returned +5.7% and their HY counterparts +5.9%. Local currency (LC) sovereigns were up +5.3% over the month and HC corporates +3.6%. The HC sovereign outperformance bucked the year-to-date trend of LC outperformance. The frontier-centric NEXGEM Index has returned +15.9% year-to-date. The Argentinian peso performed most strongly in FX following Javier Milei's win in the Argentinian presidential election.

Developed market sovereigns

November saw a major rally as hopes for a soft landing and a pivot towards a dovish stance by central banks gathered pace as a consequence of data released in the month. The soft landing scenario gained support and drove the rally in sovereign bonds: US Treasuries rose 3.6% in November, their best monthly performance since August 2019. Bunds gained 2.6% and gilts 2.9%.

In the US, Moody's shifted its Aaa credit rating of the US from a stable to a negative outlook, citing increased downside fiscal risks. S&P and Fitch ratings are already a notch lower at AA+, so its move may be seen as a step towards catching up to the other rating agencies.

The US CPI report for October surprised to the downside. Headline inflation was roughly unchanged at +0.04% and core inflation (excluding food and energy) rose by just 0.23%. US PPI surprised to the downside too. Monthly headline PPI was at -0.5% versus +0.1% expected and the measure excluding food, energy and trade was only +0.1% versus +0.2% expected. US GDP for Q3 was revised upwards, showing annualised growth of 5.2% (from 4.9%). Inflation and growth numbers meant that over November, markets raised their expectations of Fed rate cuts to fully price in a cut by the May 2024 meeting.

The US retail sales print for October saw a slightly smaller 0.1% contraction than the -0.3% expected, with the September number revised up two-tenths to +0.9%, but with August revised down.

In the eurozone, an interest rate cut is now fully priced in by the market by April. The good news continued to the end of the month as eurozone inflation for November cooled more than expected to 2.4%. This in turn supported European fixed income as Bunds rose 2.6%.

In the UK, latest employment data showed that total wage growth was running at 7.9% in the three months to September, down from 8.2% in the three months to August. Furthermore, vacancies fell to 957k in the three months to October, the lowest in over two years. UK GDP expanded at an annual rate of 0.6% in Q3. This reading matched the second quarter's growth and came in above the market expectation of 0.5%.

In Japan, Bank of Japan (BoJ) Governor Kazuo Ueda said that the central bank is gradually making progress towards its inflation target, but this is still insufficient to justify a pivot away from its ultra-loose policy.

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	4.3	3.6	0.4
Bunds	2.4	2.6	1.7
Gilts	4.2	2.9	-1.6

Source: Bloomberg, 30 November 2023

Inflation

The disinflation trend is alive and well; US inflation came in better than expected in the middle of the month. Headline CPI for the 12 months ending in October was 3.2% versus 3.3% expected. Core inflation was 4.0% versus expectations of 4.1%. The market rose significantly on the news, perhaps highlighting that investors were far too bearish on both equities and bonds.

The rally in bond yields and equity markets continued during the course of the month, leading to the month ending as a very strong one. This rally has the potential to continue, in our view, particularly as we enter the last month of the year, which is usually good for markets. The background is supportive: inflation is falling, a recession has not yet materialised, volatility is dropping and there are still plenty of bearish investors who may close their short positions.

There are a couple of things that could derail this rally:

- Inflation: investors are becoming increasingly comfortable with the idea of disinflation, leaving more room for negative surprises. This month's report was good, but not amazing. Median inflation is still too high and wages are not yet consistent with a 2% inflation target. While inflation is moving in the right direction, we do not think it will happen as fast as people are starting to believe. Money velocity is still rising and that will likely delay a swift return to target.
- Fed push-back: while the Fed is unlikely to hike rates, it might push back on any hope for early cuts. The rally in financial assets will result in a loosening of financial conditions, and that is inconsistent with what Powell wants. For now, the Fed thinks monetary policy has to remain tight as the inflation battle is not over: wage pressure remains high and consumers' inflation expectations have risen considerably in recent weeks.

However, there were some (very) tentative signs of a shift in tone from central bankers, with the market taking comments from the Fed Governor Christopher Waller towards the end of the month as signalling a pivot could come in 2024. It is hard to have a strong directional view on central banks over the coming months – they are sticking to their 'pause for now' rhetoric overall.

This was a good inflation report, which reinforces the disinflation narrative. Inflation is definitely moving into the right direction as money supply has been constrained. However, there is a possibility that things might not move as fast as people are starting to expect. We believe it is important to enjoy the rally for now, but patience is necessary.

Investment grade credit

November was a really strong month for credit, as both spreads and rates fell. The positive momentum was driven by some macroeconomic data which reinforced the view that a soft landing is not just achievable, but a possibility. 10-year Treasury yields fell by 60 basis points (bps), while spreads on the Global IG Index compressed by circa 20 bps. This was by far one of the best months for the Global IG Index since its inception in 1997. The only time the index had a better month was in 2009 as it was recovering from the sharp repricing which happened during the Great Financial Crisis.

High beta names generally outperformed. Cyclicals outperformed non-cyclicals and financials generally outperformed industrials. BBBs and longer-dated names were the top performers. Across regions, the US generally outperformed, while Europe slightly lagged behind, arguably driven by some softer economic data.

Despite the fall in both rates and spreads, overall yields remain historically high. Currently the EUR IG index offers an yield of 4.1%, the GBP IG index has an yield of 5.9%, while the US market is at 5.7%.

Going forward

In our view, the macroeconomic environment is currently very supportive for financial assets: inflation is falling, while recession fears are fading. Growth is showing signs of easing, but that is happening very slowly as consumers continue to spend, supported by a robust labour market. Markets clearly enjoy this environment, particularly as it could give central banks cause to stop hiking rates, while it increases the probability of some rate cuts next year.

In the short term, the rally seen in November has the possibility to continue, particularly as we enter the last part of the year, which is usually good for markets. It is usually a period when liquidity is lower, while more money needs to be invested. This creates a technical tailwind for financial assets and it is the reason why this period of the year is often associated with a 'Santa rally'. Add to that the fact that many investors had extremely bearish positions, both in government bonds as well as in riskier assets. As sentiment is changing, many of those investors will likely have to adjust their bets, which could further support the rally.

Longer term, however, the picture looks less rosy. The more good news is priced in by the market, the lower expected returns become, while chances for negative surprises increase.

While credit valuations still remain historically reasonable, the margin for error is diminishing; in our view, investors should become more selective in this environment and avoid taking excessive risk.

IG investors, however, could take comfort from the fact that rates are higher today and can offset rises in spreads in case the situation were to deteriorate. Moreover, companies' balance sheets within IG remain generally healthy, while refinancing risk is low as many of these companies managed to take advantage of the previously low yield environment to lock in attractive rates on their debt.

Past performance is not a guide to future performance.

Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	111	5.6	4.2
Euro IG	145	2.3	5.1
UK IG	146	3.5	4.6

Source: Bloomberg, 30 November 2023

High yield credit

November was a strong month for HY markets as hopes for a soft landing and a looser central bank policy gathered momentum. Lower sovereign bond yields and tighter spreads helped the global HY market deliver +4.1% during the month, taking year-to-date USD performance to a strong +8.7%. US HY was the main outperformer (+4.5%), followed by EM HY (+4.0%) and Europe (+2.9%). Global HY FRN returned +1.8% in November thanks to tightening spreads (-50 bps) and healthy carry from the asset class. November takes year-to-date HY FRN dollar returns to +12.1%, a truly remarkable result in a year marked by growing macroeconomic uncertainty and continued calls for the end of the cycle. All HY sectors were up last month, with the best performing being broadcasting, banks and homebuilders.

Current views

- We are generally cautious on valuations at current spread levels – in our view, spreads may tighten slightly from now to year-end given strong technicals, but they may mean-revert in the new year.
- We believe the 'higher for longer' narrative on interest rates has merit and, coupled with persistent inflation, suggests earnings deterioration and wider spreads going forward.
- Technical elements such as supply/demand imbalance and attractive 'all-in' yields need to be respected; we do not want to get too underweight as a result.
- We believe fundamentals are still reasonably supportive for now, but macroeconomic deterioration is anticipated. This could probably be worse in Europe than the US.
- Earnings have disappointed in some key sectors, such as chemicals, which is a cyclical sector with inputs into the broader economy and tends to be considered as a leading indicator.
- We expect default rates to increase modestly, but it will likely be issuer-specific events, not a wholesale spike in defaults. Consensus is for a 3.5% default rate cycle, which is more elevated than currently, but is not severe.
- We are generally concentrating on defensive trades (eg, non-cyclicals v cyclicals, up-in-quality, actively underweight real estate, etc.)

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	384	4.5	9.4
Euro HY	442	2.9	9.3

Source: Bloomberg, 30 November 2023

Emerging market bonds

November saw a broad rally on the back of core rates, which ultimately extended into spreads, with levels tightening across the board. November's rally has made up most of the year-to-date returns, accounting for around 60%. The rally was broadly supported by the rates move following lower-than-expected CPI data in the US. The US curve is now pricing in 100 bps of rate cuts, with spreads now back to the tightest levels of the year.

The investment grade and high yield portions of the hard currency sovereign index returned 5.6% and 5.9%, respectively, and signals the closest the two portions of the market have been this year.

The hard currency sovereign market was the strongest performing during November, bucking the trend for local currency sovereign outperformance, although year-to-date performance still favours the local portion. With the hard currency sovereign performance standing at 0.39% year-to-date last month, the November rally has provided welcome respite from a potentially flat year. The frontier-centric NEXGEM Index has now returned 15.9% year-to-date, with 5.6% of that coming from November. In the hard currency markets, Latin America led the way in terms of performance, but it was the Middle East and Africa that saw the largest returns in the local currency space off the back of material rate moves. In the FX space, the Argentinian peso saw the greatest total return following Milei's election victory and turn to more orthodox statement and policies, with dollarisation and cutting trades with the likes of Brazil seemingly off the table for now.

The emerging market corporate debt market underperformed the sovereign space but still delivered 3.6% over the month with US rate moves, and spread tightening, contributing 2.5% and 1%.The high yield and investment grade portion of the market performed in line with one another although spreads tightened more significantly in HY than IG (-23 bps and -11 bps, respectively). By region, Asia was strong on Macau gaming, China property, and strong returns in Indonesia and Thailand. Latin America also performed very well with Argentina up 6.8% on Milei's presidential win, which stands to be a positive for most corporates. Colombia saw spreads tighten significantly and Mexico performed strongly on higher duration. EM Europe lagged the broader rally: Turkey and Ukraine returned +1.9 and +1.3%, respectively. The Middle East also lagged, but Israel bounced back from last month, posting total returns of +5.6%.

Read more about our thoughts on ESG developments in Asian banks and governance standards in emerging markets in our latest blogs.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	5.3	9.2
Hard currency government	413	5.7	6.1
Hard currency corporate	326	3.6	5.8

Source: Bloomberg, 30 November 2023

Currencies

It was a very different month for the dollar versus the previous month, with most assets rallying apart from the greenback. In November, even most of the worst top 10 spot returns (out of the expanded majors) were still positive against the dollar. Sterling and the euro were fairly strong.

The yen had a different month too, showing decent strength. Last month, the yen had been weaker despite some expectations that yield curve control policy would be eased.

It was a strong month for most EM local currencies, helped by the weaker dollar.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	3.9	4.5
GBP/EUR	0.9	2.6
EUR/USD	3.0	1.7

Source: Bloomberg, 30 November 2023

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

The views expressed in this document should not be taken as a recommendation, advice or forecast.