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Fixed Income asset class overview

October 2024

October saw economic data continue to surprise to the upside, easing fears of a sharp economic downturn and leading investors to reduce expectations for rapid rate cuts. This shift was further supported by September's US consumer prices index (CPI), which rose by 0.2% month-over-month and 2.4% year-over-year, slightly higher than expected.

Month in review

Given the strong economic data out of the US, by the end of October futures were pricing a 3.62% interest rate at the December 2025 Federal Reserve meeting, up from 2.95% at the end of September. As rate cut expectations cooled, sovereign bonds came under pressure, with the 10-year US Treasury yield rising from 3.8% to 4.3% over the month.

In the UK, the first Labour government budget in 14 years saw Chancellor of the Exchequer Rachel Reeves announce additional borrowing, raising concerns over long-term growth. The Office for Budget Responsibility now forecasts growth of just 1% this year and 2% next year. The spread of 10-year gilts over bunds widened in October to around 200 bps, the highest since October 2022 under former PM Liz Truss.

Geopolitical tensions also took centre stage in October, as events in the Middle East led to volatile oil prices. While initial escalations raised concerns over oil supply, prices cooled as subsequent actions were more limited than expected. By month-end, Brent crude was up slightly at $73.16/bbl, ending a three-month decline.

In October, global investment grade (IG) credit spreads continued to tighten, despite already trading at historically tight levels. Spreads narrowed by 8 bps globally, with USD, EUR and GBP IG markets all benefiting from attractive yields that kept demand strong. However, this tightening in spreads was offset by a sell-off in government bond yields, resulting in negative total returns across IG markets. US IG was hit hardest with a -2.2% return, while sterling IG corporate bonds returned -1.5% and European IG -0.4%.

Global high yield (HY) returned -0.3% in October, under pressure from the higher government bond yields in the US and UK, although European HY (0.6%) benefited from interest rate stability. Spreads tightened further, with the US reaching a decade-low spread of 280 bps. CCC rated bonds outperformed BBs, and the primary market remained strong in Europe, while the US slowed after September's issuance burst. Year-to-date, global HY returned 8.2%, buoyed by strong technicals and carry, with stable demand supporting returns despite recession concerns.

Emerging market debt (EMD) saw negative returns across all segments in October, with local currency EMD sovereigns down -4.6%, hurt by a strengthening US dollar. Hard currency sovereigns and corporate bonds also fell as gains from spread tightening were outweighed by rising US Treasury yields. EM FX struggled, particularly against a robust dollar, despite positive carry in high rate countries. Although EM spreads tightened, particularly in HY, segments like IG in Asia have grown expensive. Geopolitical events, including Middle East tensions, had minimal impact on regional spreads but influenced oil prices.

Inflation

Inflationary pressures remain subdued, with price increases generally close to the 2% target in developed economies. However, some stickiness persists in the US, where inflation declined less than expected to 2.4% compared to the 2.3% anticipated by most economists. The primary contributors to this stickiness in September were core goods, whose prices finally moved back into positive territory after months of deflation.

Such a prolonged period of deflation in this category was unusual, even by historical standards, and was likely to create some upward pressure eventually. However, this category alone is unlikely to alter the overall inflation trajectory, especially as rent inflation continues to cool off. We saw an unexpected uptick in the numbers in the previous month, but in September rents resumed their downward trend and, as suggested by more timely indicators, are likely to decelerate further.

In summary, goods prices have reaccelerated after a period of prolonged deflation, contributing to the slightly above-expectations inflation print. While core goods could continue to exert upward pressure on prices, they are unlikely to change the overall direction of inflation, which is primarily influenced by rents. They constitute the largest component of the US inflation basket (almost 40% of the CPI), and as long as rents continue to move in the right direction, it is difficult to foresee a significant surge in CPI.

Developed market sovereigns

The mix of better economic data than expected and fiscal policy risks, especially with the US election imminent, made October the worst month for global bonds since September 2022. A more positive economic outlook was rapidly priced in by the market with reduced expectations for Fed interest rate cuts. The 10-year Treasury yield moved from 3.8% to 4.3% in the month.

In the US, the pick-up in economic data was a welcome signal that a sharper downturn was highly unlikely, with the soft landing or the re-acceleration now the favourite scenarios for markets.

September's US ISM Services Index figure reached a 19-month high at 54.9, followed by a much stronger-than-expected jobs report. Nonfarm payrolls jumped by 254,000 for September, with upward revisions to the prior months' figures, while the unemployment rate edged down to 4.1%.

The latest personal consumption expenditures index (PCE) report for September, which is the measure that the Fed officially targets, showed core PCE rose 0.3% on a monthly basis, the highest rise in five months, while the year-on-year rate remained at 2.7% (versus 2.6% expected). Headline PCE was down to just +2.1% on a year-on-year basis, which is the lowest rate since February 2021.

In the eurozone, sovereign bonds performed somewhat better, although they still experienced losses. This followed the European Central Bank's (ECB) decision to cut rates by 25 bps at its October meeting, bringing the deposit rate down to 3.25%. Notably, this marked the first consecutive rate cut in this cycle, as prior cuts in June and September had followed a quarterly rhythm.

Meanwhile, data showed business activity remained sluggish early in Q4, with the euro area's October flash composite PMI at a contractionary 49.7. As a result, euro sovereign bonds saw smaller losses than US Treasuries and UK gilts, supported by expectations of further ECB rate cuts.

We also saw stronger-than-expected GDP and inflation data in Europe. GDP grew by a solid 0.4% quarter-on-quarter (QoQ) in Q3 (versus 0.2% expected), with upside surprises in Germany, France and Spain. On the inflation side, Germany's inflation print for October saw the harmonised index of consumer prices (HICP) measure come in at 2.4% year-on-year (versus 2.1% expected).

In the UK, the market absorbed a post-budget update from the Office for Budget Responsibility revealing that gross financing needs for 2024/25 will be £23 billion higher than projected in April, with an additional cumulative increase of £145 billion over the next four years.

Yields eased by 5 to 10 bps from their session highs before the close, though volatility remained pronounced. The market's takeaway for the Bank of England was that interest rates are likely to stay elevated for longer, with June 2025 pricing climbing by 15.9 bps on the day.

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	-2.5	1.4
Bunds	2.4	-1.3	-0.3
Gilts	4.4	-2.5	-2.8

Source: Bloomberg, 31 October 2024

Investment grade credit

October was a difficult month for fixed income markets, as stronger economic data (especially in the US) caused markets to price out much of the monetary easing it was so keen to price in August. Economic data are causing investor sentiment to swing between extremes of either severe recession or a strong reacceleration. October was certainly a case of the latter. Further to the macroeconomic developments, the day before Halloween brought some unexpected spice to markets — and not just from pumpkin lattes. The UK Budget turned out to be more fiscally expansive than widely expected, with borrowing figures surprising to the upside. A combination of additional future gilt supply and policies deemed to be mildly inflationary drove gilt yields higher.

In the US, October saw a much brighter global outlook as markets bounced back from the summer chaos. The robust data changed expectations for upcoming Fed meetings. At the start of the month, four cuts were priced in over the next three meetings. By the end of the month, this number had decreased to 2.3. Markets are now projecting a terminal rate of approximately 3.5%, expected to be reached by early 2026.

In Europe, sovereign bonds outperformed their counterparts, even though they still lost some ground.

Despite credit spreads trading very tightly, the grind tighter continued through the month. Global IG spreads were 8 bps tighter, fairly consistent across the board with USD, EUR and GBP all benefitting from attractive yields driving continued demand for the asset class. Despite spreads tightening, the sell-off in government bond yields led to negative performance across the board. US IG was the most negative.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	86	-2.2	3.4
Euro IG	105	-0.4	3.4
UK IG	112	-1.5	0.8

Source: Bloomberg, 31 October 2024

High yield credit

The global HY market was returned -0.3% in October with mixed performance regionally. While spreads continued to grind tighter, higher government bond yields in both US and UK weighed on total return. European HY outperformed (+0.6% LOC) thanks to greater stability in rates, while US HY (-0.6%) and EM HY (-0.3%) were dragged down by increased volatility in the US Treasury market.

On the other hand, HY floating rate notes (FRNs) were unaffected by rate moves and saw positive returns of 0.5% during the month, benefitting from carry and stable spreads.

Spreads continue to grind tighter with the US hitting a 10-year tight of 280 bpsduring the month. Spreads in the US ended the month at 288 bps. European spreads continue to be wide of the US, but still tighter than the start of the year. Technicals continue to play a role grinding spreads tighter on still-strong demand and yield buyers stepping in for spread sellers.

Rating-wise, lower quality CCCs continue to lead in October, generating positive returns versus higher quality BBs which underperformed.

In terms of sectors, US weakness was broad-based, with nearly all subsectors generating negative returns for the month. However, Telecoms and Cable outperformed and have swung back to positive returns year-to-date. After selling off aggressively early in the summer, these sectors driven by large cap stacks like Altice USA, Charter and DISH have rallied back.

The primary market was resurgent in Europe although more muted in the US. After the major burst in issuance in September, US issuance slowed down in October where many, if not most issuers, have addressed 2025 (and some of 2026) maturities. In US HY, $23.0 billion worth of deals were priced.

Year-to-date, the global HY market has returned 8.2%, which is quite exceptional in a year that started off with recession worries, elevated funding costs and steep maturity walls for many HY issuers. Going forward, absent a major market/macroeconomic shock, the power of carry alone means the asset class could still generate reasonable returns in our opinion, even during a mild economic slowdown.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	288	-0.6	7.5
Euro HY	324	0.6	7.6

Source: Bloomberg, 31 October 2024

Emerging market bonds

All segments of the market posted negative returns in October, though the drivers of these returns varied across sub-asset classes. In the hard currency space, both sovereign and corporate bonds experienced spread tightening, which contributed positively to returns. However, this was significantly outweighed by movements in US Treasuries leading to overall negative performance. The contrast was particularly pronounced within the hard currency sovereign space. In the local currency space, the level of carry was insufficient to counteract other return drivers, notably the impact of a strengthening US dollar, which appreciated by 3.2% during the month.

Within the hard currency space, spreads tightened by 24 bps at the index level, with IG tightening by 1.5 bps and HY tightening by 50.1 bps. Year-to-date, this translates to spreads tightening by 4 bps for IG and 91 bps for HY. The relatively muted spread tightening in the IG space reflects its proximity to historic lows, although still wider than pre-2008 levels. Given IG's greater sensitivity to US Treasury movements and HY's greater sensitivity to spread movements, the year-to-date performance disparity between IG and HY is significant, at 2.0% versus 11.7%, respectively.

The corporate space exhibited similar dynamics over the month, with spreads and HY outperforming Treasuries and IG. Across sectors, returns were predominantly negative with the exception of Real Estate, which benefited from recent stimulus measures in China that supported real estate names in the country. The local currency market was the worst performer over the month, largely due to the strengthening dollar, which left little room for EM FX to perform well, despite positive carry, particularly in countries with elevated policy rates.

Market

Despite positive growth and inflation dynamics within many emerging markets, bolstered by the Fed's initiation of its rate-cutting cycle, sentiment remained subdued ahead of the upcoming US election. Market odds and polls fluctuated between Donald Trump and Kamala Harris, with prevailing market sentiment suggesting Trump as the frontrunner towards the end of October. Geopolitics continued to factor into markets but the recent escalation in the Middle East did little to change spreads within the region which only marginally widened, reflecting the fact that the conflict is already well priced into markets. The escalation, however, did impact oil prices, which rose initially following Iran's missile strikes but reversed following Israels attacks which were more focussed on military bases.

Throughout the month spreads tightened rendering segments of the market, particularly the IG space in Asia, increasingly expensive. Nonetheless, yields remain elevated relative to historical norms.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	-4.6	0.1
Hard currency government	341	-1.7	6.8
Hard currency corporate	245	-0.9	7.6

Source: Bloomberg, 31 October 2024

Currencies

In October the US dollar experienced a robust resurgence leading to a broad-based weakening of most currencies against the greenback. The dollar index surged by 3.2% over the month, primarily driven by a recalibration of market expectations regarding Fed rate cuts. This market repricing was influenced by two key factors: stronger than expected US economic data and increasing market sentiment favouring a potential Trump re-election. A second term for President Trump has significant implications for fiscal and global trade policies, which are expected to be inflationary. Such policies could constrain the Fed's ability to continue cutting rates, thereby providing further support for a stronger dollar. This dynamic has exerted additional pressure on currencies year-to-date, with only a select few managing to appreciate.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	-3.6	1.3
GBP/EUR	-1.3	2.7
EUR/USD	-2.3	-1.4

Source: Bloomberg, 31 October 2024

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.

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