For Investment Professionals only.

Fixed Income asset class overview

April 2024 (Data as at 31 March 2024)

While inflation has largely been heading towards the Federal Reserve's (Fed) 2% target over the last year, January and February's inflation prints may suggest that progress has been stalling. Headline CPI came in at a six-month high of 0.4% for February, with the year-on-year measure ticking up to 3.2%.

Month and quarter in review

Despite higher inflation data for January and February, Fed Chair Powell appeared decidedly not worried, regarding the figures instead as bumps in the road in the ongoing journey to disinflation. That said, following some more hawkish data towards the end of the month, Powell noted that "we don't need to be in a hurry to cut", so it remains to be seen whether the Fed modifies its tone over the coming weeks.

Higher inflation numbers, combined with the positive growth data (with the US economy shown to have grown 3.4% in the fourth quarter of 2024, according to data released by the Bureau of Economic Analysis on 28 March) have provided a major boost to the S&P 500 Index (+10.6% year to date, according to Refinitiv data), saw high yield credit spreads tightening, and oil prices rising (Brent crude +13.6% on the quarter to $87.48/bbl, according to data from Deutsche Bank's quarterly review), it was a much weaker quarter for sovereign bonds. US Treasuries, German bunds and UK gilts were all seen to struggle over the quarter as inflation remained persistent, and central banks pushed out the timing of rate cuts versus the start of the year. As per the ICE BofA indices, US Treasuries (-0.9%), German bunds (-1.4%), and UK gilts (-1.7%) were all seen to struggle over the quarter as inflation remained persistent, and central banks pushed out the timing of rate cuts versus the start of the year. Despite the weaker period overall, March did see a more positive backdrop for sovereign bonds, albeit the end of the month saw more of a sell-off in response to further hawkish data.

June now appears to be the most likely timing for a first rate cut by the Fed; the implied number of US rate cuts in 2024 has reduced to no more than three, from six to seven cuts priced in at the end of 2023. March saw two other significant milestones: firstly, the Bank of Japan ended its negative interest rate policy, and secondly, the Swiss National Bank was the first G10 central bank to cut rates this cycle, with a 25 bps cut in its policy rate to 1.50%.

The first quarter of 2024 saw investment grade (IG) corporate bond new issuance reach record levels. Spreads continued to tighten in March, supported by the Fed's decision to maintain three rate cuts this year – despite the recent increase in inflationary pressures. As in prior months, the asset class continues to provide historically elevated levels of yield, with the EUR IG index at 3.8%, and the GBP and USD indices at 5.4%.

March saw solid performance from the high yield (HY) market, with global HY delivering 1.1% during the month, taking year-to-date (YTD) returns to 2.0%. Most sectors delivered solid performance in the month, aside from telecommunications and cable, which were down 2% and 0.1% respectively. It was the busiest quarter for HY issuance in over two years; however, the pace moderated during March and is expected to continue along this trajectory going forward.

In emerging markets (EM), local currency underperformed hard currency (HC) in March, with HC sovereigns delivering the strongest performance with 2.1% MTD (2.0% YTD). Spreads continued to tighten across the spectrum, with corporates and IG names looking particularly tight. The market was broadly risk-on in nature, but was somewhat reined in as expectations for US rate cuts were pared back, with 80-90 bps now priced into the market for the rest of the year.

Inflation

Market participants were expecting hawkish rhetoric from Fed Chair Jerome Powell, given the recent high inflation numbers. However, towards the end of the month Powell and the committee decided to pleasantly surprise the market by adopting a more dovish tone at March's Federal Open Market Committee (FOMC) meeting.

Here are the two key takeaways from Powell's speech:

1) Fed officials believe that the recent high inflation readings were mostly noise and will not alter the overall trajectory. Consequently, the FOMC maintained its outlook for three rate cuts this year.

2) Tapering Quantitative Tightening (QT): Powell hinted that the Fed could soon slow down the pace of QT, thus further easing monetary policy.

Overall, this was a dovish FOMC meeting and clearly more dovish than expected by the market. As a result, both bonds and stocks rallied.

However, it was somewhat surprising to us that this dovish rhetoric was accompanied by a rather hawkish macroeconomic outlook. As usual, the FOMC updated its Summary of Economic Projections (SEP), which provides information on committee members' projections for key economic variables. Expectations were revised upwards. The committee now anticipates higher growth in 2024, with GDP growth now expected to be 2.4% compared to the previously expected 1.4%, and higher core inflation (2.6% versus the previous expectation of 2.4%), along with a lower unemployment rate (4.0% versus the initially expected 4.1%).

To conclude, the dovish rhetoric from the FOMC appears to contrast with its hawkish economic projections. If its projections prove accurate, it may be challenging for them to actually implement monetary policy easing.

Developed market sovereigns

The first quarter of 2024 was supportive for risk assets and a quarter in which developed market (DM) sovereigns generally suffered against a backdrop of persistent inflation, weaker growth and expectations of rate cuts being pushed out further into the year. However, March was a much better month for sovereigns, reversing some of the losses suffered in January and February. The DM heavy Bloomberg Global Aggregate Treasuries was up 0.8% over the month. As such, we believe there remains opportunity in the asset class.

In the US, the theme of pushing back expectations of Fed rate cuts continued in March. Although traditionally other major central banks wait for the Fed to make the first move, the market is now pricing in a move from the European Central Bank (ECB) and Bank of England (BoE) first. The annual core PCE deflator print (the Fed's preferred inflation measure) for February slowed to 2.8%. It is expected that the Fed will want to see the annual core PCE deflator drop to +2.5% before commencing rate cutting. The US Treasury index posted a positive return of 0.6% in March after weakness in January and February.

The eurozone saw a mixture of dovish and hawkish central bank speak during the month, although a 25 bps cut from the ECB at the June meeting is priced in. March inflation prints will hold the key as to whether the ECB act in line with market expectations given its very public data-dependent approach. Euro area sovereign bonds also saw a positive return on the month, returning 0.9% after a losing start to the first two months of the year.

In the UK, there was a positive surprise in the CPI numbers for February, with headline CPI decreasing to 3.4% year-on-year from 4.0% in January and core CPI falling to 4.8% from 5.1%. On the back of this, the market increased the chance of rate cuts this year. There is increasing optimism that the BoE may cut by June, but this is not yet fully priced in. Gilts were the best performing DM sovereign, returning +1.7% after a disappointing start to 2024.

The Bank of Japan (BOJ) ended an eight-year period of negative interest rate policy with its first rate hike in nearly two decades. The target policy rate has increased from -0.1% to a 0.0-0.1% range. Two-year Japanese Government Bond (JGB) yields reached 0.18%, their highest quarterly close since 2011. Despite this significant move from the BOJ, the central bank said it foresaw that accommodative financial conditions will be maintained for the time being.

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	0.6	-0.9
Bunds	2.3	0.9	-1.4
Gilts	3.9	1.7	-1.7

Source: Bloomberg, 31 March 2024

Investment grade credit

Spreads continued to tighten, supported by the Fed's decision to maintain three rate cuts this year, despite the recent increase in inflationary pressures. Additionally, positive growth contributes to the strength of the credit market as the risk of defaults remains limited. Consequently, IG indices generally performed well in March, benefiting from tighter spreads and stable or lower interest rates. The USD and EUR IG indices experienced a gain of 1.2%, while the GBP index saw an increase of 1.8%.

Throughout the month, higher-beta names continued to outperform, and credit curves flattened. Among ratings, BBBs generally outperformed higher quality categories, while cyclicals outperformed non-cyclicals. The Global Investment Grade index currently offers a spread of 99 bps, slightly lower compared to the previous month. The asset class continues to provide historically elevated levels of yield. Presently, the EUR IG index offers a yield of 3.8%, while the GBP and USD IG indices have yields of 5.4%.

Going forward

The macroeconomic environment remains supportive for the asset class. Inflationary pressures are slowly easing, while economies are growing, albeit at a slower pace. Yields remain historically high, and rate cuts are now expected in 2024, which should be supportive for fixed income investments in general.

Moreover, it is important to highlight some key features that make this asset class attractive today:

1. Market sophistication: The investment landscape has become more sophisticated, leading to lower transaction costs. This increased market efficiency has particularly benefited investors in IG securities.

2. Growing opportunities: Over the last few years, the IG investable universe has grown significantly, presenting investors with a much larger pool of opportunities to explore.

3. Improved credit quality: The quality of global high-grade credit has shown notable improvements in recent years. There have been more upgrades than downgrades, highlighting the general strength of companies' balance sheets. Notably, the proportion of bonds rated single A has increased, potentially making them a significant component of IG indices. About three years ago, approximately 51% of the Global IG index was rated BBB, while around 39% were rated single A. Currently safe single A bonds are close to becoming the biggest part of IG indices for the first time in about 10 years.

4. Valuations: The extra compensation for investing in corporate bonds (spread) has diminished in recent months. This in turn should lead investors to adopt a more cautious approach and favour higher-quality companies, such as those in the IG universe. Furthermore, the overall yield offered by this asset class remains historically appealing.

5. Natural diversification: The IG market further benefits from its natural diversification, as it combines duration and credit risk. If economies were to enter a recession, the duration component of this asset class would help performance as rates would have to decline. On the other hand, if economies were to continue to grow, spreads will likely remain supported, thereby supporting returns for IG bonds.

In summary, while spreads may not appear historically attractive, the positive macroeconomic environment, combined with the aforementioned features, makes this asset class particularly attractive for investors, in our view. We believe active investors can continue to capitalise on market dislocations, mitigating the impact of tighter spreads and potentially achieving better performance.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	93	1.2	-0.1
Euro IG	112	1.2	0.4
UK IG	117	1.8	0.1

Source: Bloomberg, 31 March 2024

High yield credit

March saw a solid performance from the HY market on moderating supply and steady rates. Global HY markets delivered 1.1% in March, taking YTD returns to 2.0%. European HY underperformed (returning only 0.4%) dragged by Altice France and other notable blowups. The CCC cohort was especially hard hit returning -4.0%.

US HY spreads took another leg tighter closing at 312 bps. EU HY spreads were 362 at the end of March. These values are now very close to the 10-year lows of 2022 (301 bps). Spread compression was helped by a continued strong technical element.

Higher quality BBs benefited from falling rate volatility and outperformed during the month. The CCC-rated cohort was exposed to greater volatility (especially in Europe) and now looks attractive on a relative value basis.

Most sectors delivered solid performance except from beaten-up telecommunications and cable, which were down 2% and 0.1% respectively.

Supply moderated somewhat in March, but the first quarter of 2024 remains the busiest quarter in more than two years. Many companies have taken advantage of the slight leg down in rates to refinance upcoming 2025/2026 maturities. We would expect the pace of issuance to moderate going forward.

Current views

- HY spreads remain unexciting, but all-in yields are still attractive with scope for absolute returns and carry. With moderate rate cuts, contained spreads and a mild default environment, the asset class could still deliver high single digit returns over 12 months, in our opinion.
- HY markets continue to see inflows and issuance is light versus previous years. As such, to us the market technical remains positive and should help contain/support spreads, even at current tight levels.
- We believe fundamentals are still resilient, as many lower-quality credits managed to refinance either via private credit or in the loan market. Potential future rate cuts will also help many sectors and issuers, such as real estate.

- Active management is more important than ever as security and country-specific risks are rising, such as the Altice France (SFR Group) episode, whose owner is trying to engineer a restructure (including bond haircuts) threatening bondholders with taking proceeds from asset disposal outside of the group.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	312	1.2	1.5
Euro HY	362	0.4	1.7

Source: Bloomberg, 31 March 2024

Emerging market bonds

The local currency market underperformed hard currency markets in March, with hard currency sovereigns being the strongest performer. Spreads continue to grind tighter across the spectrum, with corporates and IG names looking particularly tight. Only triple C rated bonds continue to trade wider than pre-Covid levels. The market was broadly risk-on in nature, but expectations for US rate cuts were pared back, with 80-90 bps now priced in for the rest of the year.

Hard currency sovereign bonds continue to outperform, which has been the case for all of 2024. Another trend that is repeating is the HY portion continuing to outperform IG. MTD, HY and IG returned 0.5% and 2.4% respectively, and YTD the returns are even more disparate at 4.75% and -1.2%. Further supporting market performance and being driven by a broader spread tightening trend, the frontier-centric NEXGEM Index returned 3.5% over the month.

YTD, the hard currency portions of the market are now in positive territory, with the decline in January now compensated for. Latin America dominated performance in the hard currency sovereign space in March. Local currency bonds, however, are still slightly negative, with FX continuing to weigh on performance as the USD continued to strengthen. From a local currency point of view, the Middle East region is the biggest underperformer, while Asia was the strongest. This, again, has been a trend for most of the year.

Investments in bonds are affected by interest rates, inflation and credit ratings. It is possible that bond issuers will not pay interest or return the capital. All of these events can reduce the value of bonds held by funds.

High yield bonds usually carry greater risk that the bond issuers may not be able to pay interest or return the capital

Investing in emerging markets involves a greater risk of loss due to greater political, tax, economic, foreign exchange, liquidity and regulatory risks, among other factors. There may be difficulties in buying, selling, safekeeping or valuing investments in such countries.

The corporate bond market delivered positive returns on the back of spread tightening in HY credits, with the HY portion of the market returning 1.2% versus IG returns of 0.9%. Within corporates, the best performing sectors were real estate, oil & gas, and utilities, with financials, infrastructure, and metals & mining being the underperformers. Further supporting the HY performance narrative, regions that typically have lower-rated corporate issuers such as Africa and Latin America were the stronger performing ones, with Ghana and Ecuador names being notable performers. Conversely, the Gulf Cooperation Council (GCC) region lagged, reflecting its IG status and very tight spread levels.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	0.0	-2.1
Hard currency government	351	2.1	2.0
Hard currency corporate	276	1.0	2.3

Source: Bloomberg, 31 March 2024

Currencies

The US dollar strengthened as Fed interest rate cuts failed to materialise.

Despite the BOJ ending its negative interest rate policy, the Japanese yen weakened against the dollar as the Bank of Japan maintained a dovish tone.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	0.0	-0.8
GBP/EUR	0.2	1.4
EUR/USD	-0.1	-2.3

Source: Bloomberg, 31 March 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.

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