Fixed Income asset class overview

April 2025

April was a tumultuous month in financial markets, with significant volatility following the announcement of import tariffs by the US. The month started with President Trump's 'Liberation Day' announcement of a set of tariffs that were broader and harsher than expected. The turmoil saw the 30-year US Treasury yield surpass 5% intraday and the volatility VIX index closing above 50, something only seen at the height of the Global Financial Crisis (GFC) and during the initial COVID turmoil.

Month in review

By late April, calm began to return to markets after President Trump announced a 90-day extension to the tariffs for all countries except for China, and US officials began to negotiate deals with other countries.

Separately, US headline and core inflation rates declined for March, printing below expectations at 2.4% and 2.8% year on year respectively. Despite the likelihood of inflation re-accelerating over the next few months, markets are pricing in four US interest rate cuts by the end of the year.

Against the overall volatile backdrop, global investment grade (IG) credit spreads ended the month 13 bps wider. However, this was only part of the story; after 'Liberation Day', spreads widened significantly, by 23 bps – from 97 bps to 120 bps – in just a few days. The 90-day extension to the majority of tariffs (excluding China), and the relaxation on areas such as electronics and smartphones, indicated the US administration's willingness to avoid spooking markets any further. This led to a recovery in spreads, such that overall performance for global IG corporate bonds was positive, due to the downward move in government bond yields.

In high yield (HY), the global index returned -0.1% in a rollercoaster month that saw the fastest HY sell-off since the banking turmoil of 2023, followed by an equally rapid recovery in the last week of the month. Global HY floating rate notes (FRNs, -0.7%) underperformed fixed HY markets, mainly due to their lack of duration (particularly versus European HY, where lower rates did help performance) and a slower recovery in HY FRN spreads. Across regions, emerging market (EM) HY underperformed (-0.9%) versus European HY (0.3%) and US HY (0.0%) given a slower recovery in spread. Tariff and policy volatility continues to weigh down EM sentiment, while Europe has benefited from greater confidence in future fiscal policy leading to better-than-anticipated growth.

EM debt returned 0.9% in April, driven by strong gains in local currency (LC) sovereigns (3.2%), which continued to benefit from a weaker US dollar and rate cuts. Hard currency (HC) sovereign (-0.2%) and corporate debt (-0.4%) underperformed amid spread widening, particularly in HY names. The underperformance reflected renewed US tariff risks and country-specific events in Argentina, Ecuador, and Venezuela, despite support from falling US Treasury yields.

Inflation

US inflation continues to be lower than feared. In March, inflation actually transitioned into deflation, as prices declined by -0.1% month-over-month, partly driven by the reduction in energy prices. However, even outside of the energy sector, prices generally decelerated. Core inflation, which excludes volatile components such as energy and food, was significantly lower than anticipated, suggesting a broader-based deceleration in inflation. Currently, the headline CPI is 2.4% year-over-year, while core inflation is 2.8%. Arguably, the most encouraging news from the March report came from the so-called super core inflation, which declined significantly in the month. This is the inflation component the Federal Reserve (Fed) is most worried about, as it includes categories predominantly influenced by wages, thereby posing a potential risk for a price-wage spiral.

Under normal circumstances, such a favourable inflation print would likely provide substantial relief to both the Fed and market participants. However, its positive implications were largely overlooked due to the prevailing volatility and uncertainty surrounding tariffs at present. As mentioned in the past, we believe these concerns may be somewhat overstated. Tariffs will undeniably increase the prices of certain goods and exert some upward pressure on overall inflation, however we should not focus solely on one specific aspect of the inflation narrative. Instead, we should adopt a broader perspective to better understand overall inflation dynamics.

Below are three things worth bearing in mind when evaluating the potential impact of tariffs on inflation:

1. Goods inflation constitutes less than 20% of US inflation: The US economy has evolved significantly over the years,

transitioning from a goods-based economy to a service-driven economy. Consequently, spending patterns have shifted, with consumers spending considerably more on services than on goods. This transformation is reflected in the CPI calculation, where the goods component accounts for less than 20%. Although tariffs will directly impact goods prices, their effect on services, the largest portion of the inflation basket, is more complex. Crucially, as we previously highlighted, if tariffs are implemented in an environment of relatively low money supply, consumers will be forced to reduce their consumption, potentially causing price declines in other areas. In the coming months, we can anticipate an acceleration in core goods inflation driven by tariffs, but it is essential to monitor services inflation, as it constitutes the largest segment of the consumer prices basket and may continue to decline.

2. Oil prices could offset much of the tariff impact: While much attention has recently been directed towards tariffs, the decline in oil prices has not gained the attention it deserves, in our opinion. The price of oil has gone through a key support level and is now approximately 30% lower than it was one year ago. If oil prices remain low or decrease further, we believe they could compensate for most of the price increases resulting from tariffs. This is a critical factor to monitor closely.

3. Elasticity of demand determines the inflationary impact: Tariffs function as a tax shared between consumers and producers. If producers absorb the cost, it will not be inflationary, merely leading to a reduction in their profit margins. However, if companies pass the cost onto consumers, it will be inflationary. Whether the consumer or producer bears the cost largely depends on the elasticity of the demand curve. If demand for a product is highly elastic, meaning consumers can easily switch to alternatives, producers will bear most of the cost. Conversely, if demand is highly inelastic (for essential goods, for example), consumers will bear the cost as prices rise. Hence, it is important not to assume that an increase in tariffs will lead to a proportionate increase in prices. The issue is far more nuanced.

In summary, while the recent US inflation report was encouraging, market attention remains fixated on the looming impact of tariffs. Over the next few months, we will gain a clearer understanding of the their influence on inflation. Although tariffs will undoubtedly exert some upward pressure on inflation, particularly in the short term, it is essential to remain focused on the overall picture and put their impact into proper perspective.

Developed market sovereigns

April was a tumultuous month in financial markets. However, outside of tariff-driven volatility, data from the US continued to point away from a recession, even though the surveys looked much weaker. For instance, the weekly initial jobless claims didn't show a deterioration, and the flash composite purchasing managers' index (PMI) for April was still at 51.2, above the 50 mark that separates expansion from contraction. And despite the likelihood of inflation re-accelerating over the next few months, markets are pricing in four US rate cuts by the end of the year.

In the eurozone, the European Central Bank (ECB) cut rates by 25 bps, bringing the deposit rate to 2.25%. The monetary policy statement viewed the disinflationary process as "well on track" and noted that the "outlook for growth has deteriorated owing to rising trade tensions." Increasing confidence about the prospect of lower interest rates provided support for European government bond markets. In total return terms, bunds (2.0%) entirely pared back their losses from March, posting their strongest monthly performance since November.

Eurozone flash composite PMI fell to 50.1 in April, driven by a decline in the services index (49.7), while the manufacturing PMI remained relatively unchanged at 48.7, despite the US implementing a 10% tariff (and 25% on autos) in early April. The manufacturing PMI was supported by lower energy prices and expectations for fiscal stimulus, which helped to offset the trade-related headwinds. The eurozone consumer confidence index also dropped, confirming that trade tensions and the unresolved conflict in Ukraine are weighing on economic sentiment.

In the UK, government bond yields were very volatile over the course of April but ultimately ended the month lower, seeing gilt prices up 1.7% in April. An encouraging decline in March inflation, coupled with weaker activity data, is likely paving the way for the next Bank of England rate cut in May. April's flash PMIs showed a deterioration in economic momentum. The composite index moved into contractionary territory (48.2), with both global and domestic headwinds arising from a combination of trade uncertainty and higher domestic taxes.

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	3.6
Bunds	2.4	2.0	0.2
Gilts	4.4	1.7	2.2

Source: Bloomberg, 30 April 2025

Investment grade credit

April was an eventful month for IG corporate bonds, characterised by notable volatility as geopolitical tensions, economic uncertainties, and changes in investor sentiment took centre stage.

The US tariffs announcement triggered immediate retaliatory tariffs from China, sparking a global sell-off in risk assets. Equities dipped, and credit spreads widened in response. Government bonds behaved interestingly, initially rallying before selling off sharply, resulting in steeper yield curves and the 30-year Treasury yield briefly surpassing 5% intraday. The bond market reaction may have been an influencing force behind Trump stepping back from the aggressive stance, or perhaps his doing so was simply part of the plan all along.

While tariffs dominated most news headlines over the month, there were a number of economic data releases to help signal how economies are performing. Hard data from the US offered some reassurance against recession fears, however a number of sentiment surveys have weakened significantly since Trump's arrival into the White House.

Amid the overall volatile backdrop, global IG credit spreads ended the month 13 bps wider, after a much bigger widening immediately after the tariff announcement. The 90-day pause on the majority of tariffs (excluding China), and the relaxation on areas such as electronics and smartphones, indicated the US administration's willingness to avoid spooking markets any further. This led to a recovery in spreads such that overall performance for IG corporate bonds was positive, due to the downward move in government bond yields.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	109	0.0	2.3
Euro IG	111	0.9	1.1
UK IG	120	1.3	1.8

Source: Bloomberg, 30 April 2025

High yield credit

The Global HY Index returned -0.1% in a rollercoaster month that saw the fastest HY sell-off since the banking turmoil of 2023, followed by an equally rapid recovery in the last week of the month, while global HY FRNs underperformed fixed HY markets.

Having widened as much as 100-150 bps during early April tariff announcements, HY spreads managed to retrace c. 80% of that widening by the end of the month. Having said that, at current levels of 394 bps (US HY), 380 bps (EU HY) and 538 bps (HY FRN), HY spreads remain 50-100 bps wider since the start of the year, reflecting a deterioration in US growth prospects ahead.

Across regions EM HY underperformed (-0.9%) versus Europe HY (0.3%) and US HY (0.0%) given a slower recovery in spread (only c.50% retracement). Tariff and policy volatility continues to weigh down EM sentiment while Europe has benefited from greater confidence in future fiscal policy leading to better-than-anticipated growth.

Across ratings, lower-quality CCCs outperformed in the US, while single B rated bonds did better in Europe. Across sectors, media, healthcare and basic industry outperformed in the US, while utilities, insurance and banks lagged. Similar themes were in play in Europe with defensive sectors generally holding up better.

What we think from here

Our cautious stance on risk proved helpful going into the tariff sell-off that caught many off guard as reflected by the sharp market reaction. The HY strategies remain slightly on the defensive side, with a small underweight risk. While spreads do look arguably more interesting today versus the start of the year, they are not yet compelling enough to materially add risk given delayed policy/tariff uncertainties.

With still elevated uncertainty and volatility, bottom-up fundamental research is essential to reassess where risks and opportunities lie, and when to re-engage with the market. As an active manager, our focus over coming weeks will be to work with our global analyst team to identify those dislocations and opportunities at sector and single name level.

As spreads and yields moved higher in April, we believe some value has returned to HY as an asset class, particularly for investors looking to capture healthy yield with lower interest rate risk.

High single-digit yields: Yields of circa 7.9% (US HY) and 5.9% (EU HY) provide healthy coupon income and comfortable cushion to absorb potential bad news.

Low duration: HY markets have shorter durations compared to other fixed income instruments (IG or government bonds). This reduces their sensitivity to swings in interest rates helping mitigate capital loss.

Expectation of benign default cycle: Although interest rates remain historically elevated and economic growth is slowing, distress levels have been dampened by interest rates starting to trend lower and active refinancings taking place. Distress ratios are still consistent with a sub 3% default rate for the next 12-18 months, absent a major macro and/or tariff-shock.

HY fundamentals have come under some pressure, but generally remain robust, particularly when it comes to net leverage (not increasing due to lack of M&A activity) and interest coverage ratio (still above levels at which analysts would typically become concerned).

An active approach is always essential in HY investing, but especially so in times of elevated uncertainty and market volatility. Careful analysis prior to investing in HY credits is crucial to ensure the credit spread appropriately compensates for the risks undertaken.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	394	0.0	0.9
Euro HY	380	0.3	1.1

Source: Bloomberg, 30 April 2025

Emerging market bonds

Despite the month starting off with Trump enforcing tariffs that went beyond most people's expectations, sending markets into a tailspin and setting off a significant shift in trade relationships with the US, the emerging market debt (EMD) market (as measured by the blended benchmark) ended April higher. Of course, this was driven by the local currency (LC) market, which has continued to be a standout performer in the year to date. Breaking down the return of that particular index, we see a fairly even split of performance coming from currency and rates, with the former benefiting from a weakening dollar and the latter benefiting from growing expectations for interest rate cuts by central banks.

The hard currency (HC) sovereign and corporate debt markets also benefited from the rates effect, but credit spreads drove their underperformance, particularly in the high yield space. Notwithstanding this, the spread on the hard currency sovereign and corporate index only ended up being wider by 17 bps and 28 bps, respectively. While most of the spread widening could be attributed to the broad sell-off following the initial tariff announcement, there had been a number of country-specific stories during the month including Argentina, Ecuador, and Venezuela.

High yield names underperformed off the back of spread widening, but also due to the decline in oil prices seen during the month, which has hurt oil exporting nations.

Looking forward, we expect a lot of uncertainty stemming from US policy with the added complexity of countries clamouring to renegotiate trade deals, treaties, and concessions with the US to avoid tariffs that go above the 10% baseline currently in place and ideally removing that altogether. The 90-day grace period does provide some respite, but a lot can happen during that time and Trump's untethered unpredictability is a factor for the world to consider.

During the month, the International Monetary Fund (IMF) revised its growth forecasts in a broadly downward trajectory, with the US being the hardest hit in this regard. EM also saw a decrease, but the premia versus developed markets remains, with the impact being broadly driven by concerns over global growth. With growth being hit and inflation continuing its downward trajectory in EM, there will likely be additional room for the EM central banks to cut rates.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	3.2	7.7
Hard currency government	369	-0.2	2.0
Hard currency corporate	294	-0.4	2.0

Source: Bloomberg, 30 April 2025

Currencies

The tariff announcement drove a weaker USD in April, with the DXY index down 4.6%, bringing the year-to-date return to -8.0%, effectively negating the returns seen in 2024. The announced tariffs were widespread, indiscriminate, and based upon unorthodox methodology, with allies of the US not being spared treatment typically reserved for adversaries. With this, major questions are now being asked about the Trump administration, the US trade policy, and its general trustworthiness. Even with the 90-day respite, tariffs are still set to be well above historic norms.

The very broad USD weakening reflects a diminished attractiveness of US assets, given the significant uncertainty that it faces in terms of growth, trade, and inflation. The question now is whether the US can avoid a scenario whereby growth is muted while inflation ticks up, which would not be unrealistic considering the broader impact tariffs will have, leaving the economy in a state of stagflation.

The depreciation was broad, with the dollar weakening against all G10 currencies and most major currencies. There were a few exceptions, such as the South African rand, Turkish lira, and Argentine peso, albeit these were driven by country-specific factors, such as Argentina once again allowing the currency to float freely -- a step taken to ensure the country could receive $20 billion of funding from the IMF.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	3.2	6.5
GBP/EUR	-1.5	-2.6
EUR/USD	4.7	9.4

Source: Bloomberg, 30 April 2025

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.

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