Fixed Income asset class overview

June 2025

The second quarter of 2025 saw volatility across markets as investors grappled with tariff policy uncertainty and war in the Middle East. In both cases, investors' fears eased as situations stabilised. In particular, there weren't obvious signs over the quarter of tariffs impacting inflation just yet, with the US CPI reports surprising to the downside for April and May. This was seen to be keeping the door open to interest rate cuts this year, and by the end of June, futures were still pricing in 67 bps of cuts by the Federal Reserve's December meeting.

Month in review

In June, the war between Israel and Iran caused significant geopolitical volatility, with Brent crude rising 7.0% on 13 June, its biggest daily increase since 2022. However, its impact on markets was largely muted, with investors largely putting it behind them when a ceasefire was agreed a week and a half later. Overall, it was a good quarter for government bonds, with gilts, euro sovereigns, and US Treasuries all advancing.

The investment grade (IG) market remained well supported through June, with healthy demand meeting a steady, but manageable pace of issuance. Valuations remain tight by historical standards, but we believe absolute yields continue to look attractive to income-focused investors, particularly as central banks edge closer to interest rate cuts.

Global high yield (HY) markets returned 1.6% in June, with global HY floating rate notes (FRNs) returning 0.7%, a result of their lower duration sensitivity (ie, they did not benefit from the modest rate rally that supported fixed rate HY). Besides, global fixed-rate HY spreads tightened, supported by continued risk-on sentiment, easing financial conditions, and resilient corporate earnings. US HY and emerging market (EM) HY outperformed, benefiting from strong earnings and the pricing of a more dovish Fed, while Europe lagged due to a more cautious European Central Bank (ECB) tone and weaker macroeconomic data.

It was another month of strong performance across the EM debt universe, with local currency sovereigns once again leading the way delivering 2.8%, leaving year-to-date performance at 12.3%. While a weakening dollar has helped drive the majority of these returns, interest rates have also played their part. Hard currency sovereigns and corporate bonds returned 2.4% and 1.4% during the month. For both, spread compression drove a portion of the gains, but interest rates delivered the majority.

Inflation

May's US CPI came in softer than expected, with inflation at 0.1% month over month compared to the consensus forecast of 0.2%. This resulted in a year-over-year change in consumer prices of 2.4%. Similarly, the core consumer prices index (CPI), which excludes food and energy prices, posted a month-on-month (MoM) increase of 0.1% versus the anticipated 0.3%, keeping the year-on-year (YoY) rate stable at 2.8%. Widespread fears about an inflation surge driven by tariffs have not yet materialised, marking the fourth consecutive month of lower-than-expected inflation. The US inflation surprise index, as calculated by Citi, highlighting recent sharp downside surprises in inflation readings. This is one of the lowest historical readings for this index.

The core US CPI print was beneath every economist's estimate on Bloomberg, so it was a clear downside surprise that wasn't expected at all. Investors were reassured by the lack of an obvious tariff impact.

Looking at the report, the overall narrative remains largely unchanged. The prices of core goods are continuing their rebound, partly due to the influence of tariffs; however, this increase is being counterbalanced by a declining inflation rate in the services sector. This presents a very different dynamic compared to the period immediately following the COVID-19 pandemic. At that time, prices for both goods and services were rising quickly, driven by a substantial injection of money into the economy. In contrast, money supply today is relatively stable, indicating that an increase in one component of the inflation basket is likely to prompt a decrease in another, as consumers may lack sufficient funds to increase spending across both sectors simultaneously.

Moving across the Atlantic, eurozone inflation has recently surprised to the upside, but this momentum might be reversing as wage growth is likely to return to normal levels soon. The ECB wage growth tracker, historically a reliable indicator of future wage growth, has receded to typical levels. If this proves accurate, wage growth will diminish again, consequently leading to lower core service inflation since wages are its key driver. This means that absent any sudden increases in oil prices due to geopolitical tensions, the inflation momentum in the eurozone may soon shift, potentially causing overall inflation to steadily fall below the 2% target and possibly prompting the ECB to contemplate resuming rate cuts.

In summary, US inflation continues to surprise to the downside, as the anticipated effects of tariffs have failed to materialise. This can be attributed partly to companies opting not to pass the complete burden of tariffs onto consumers, and partly to a stable money supply, which has prompted consumers to modify their spending habits, leading to price declines in sectors unaffected by tariffs.

Developed market sovereigns

The second quarter ended on a positive note with growing optimism around US trade deals, along with continuing anticipation that the Fed would be cutting rates by year-end. This consequently helped spur a notably cross-asset rally.

In data released during June in the US, the ISM manufacturing print for May unexpectedly fell to a six-month low of 48.5 (versus 49.5 expected), adding to investor nerves about the near-term outlook. May headline (+139k versus 147k) and private (140k versus 146k) payrolls were slightly above the 126k consensus expectations, but -95k of net revisions to the two previous months softened the beat. The Fed kept the fed funds rates unchanged at 4.25-4.50%, as widely expected. The updated Summary of Economic Projections (SEP) saw the median dot still projecting 50 bps of cuts by year end, but with a hawkish shift in the distribution as seven officials now expect no cuts this year (up from four in March). The median 2026 and 2027 dots also both moved higher by 25 bps.

In the eurozone, the ECB cut rates by a quarter of a percentage point as expected, taking the deposit rate down to 2%. Significantly, President Lagarde signalled that they had "nearly concluded" the easing cycle, suggesting that policy rates weren't likely to go much lower from here. She also signalled little urgency to cut rates, saying that the current level left them "in a good position to navigate the uncertain conditions that will be coming up." As such, the ECB appears to be saying that it may have now reached the appropriate level of rates although growth and disinflation will have to be monitored. In the UK, the Bank of England (BoE) left the policy rate on hold at 4.25%, as widely expected, but the vote was 6-3 to hold, with the minority preferring a 25 bps cut. Looking forward, they maintained their language about a "gradual and careful approach" to easing policy, and markets continue to price another cut at the August meeting as likely.

In Japan, the Bank of Japan (BoJ) left short-term interest rates at 0.5% as widely expected in a unanimous vote after a two-day policy meeting. More importantly, it announced that it intends to slow the rate at which it reduces its bond purchases next year. Beginning in April 2026, it will decrease its bond purchases by approximately 200 billion yen per quarter, down from the current rate of 400 billion yen per quarter.

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	1.3	3.8
Bunds	2.6	-0.4	-0.6
Gilts	4.5	1.5	2.5

Source: Bloomberg, 30 June 2025

Investment grade credit

The month kicked off with a flurry of key macroeconomic data. In the US, headline CPI rose to 2.4% (from 2.3% in April), while core CPI climbed to 2.8%. In the eurozone, marginally firmer inflation, just under 2% in June, and sub-1% GDP growth increased ECB and market confidence that disinflation is on track. Meanwhile in the UK, the latest headline CPI data eased to 3.4% from 3.5% the previous month, with food and housing costs the primary pressures. Elsewhere, escalating tensions between Israel and Iran at the start of May rattled oil markets, driving Brent and WTI futures up around 6% to 7%. That energy-driven inflation scare reverberated through risk assets. However, Iran's reaction to the US attack on its facilities was deemed by the market as de-escalatory, leading to an easing of supply fears. The result of which was oil prices retracing and stabilising in the $67 to $68 range by month-end, helping to calm inflation anxiety.

With inflation data largely moderating, bond markets rallied. The US 10-year Treasury yield fell by 17 bps over the month as markets increasingly priced in additional easing by the Fed later in the year. In Europe and the UK, calmer inflation and dovish central bank commentary buoyed sovereign yields. Against this backdrop, global IG corporate spreads continued to grind tighter. Year-to-date, global spreads are now flat, with US dollar and sterling markets wider and euro markets tighter.

Overall, the IG market remained well supported through June, with healthy demand meeting a steady but manageable pace of issuance. Valuations remain tight by historical standards, but absolute yields continue to look attractive to income-focused investors, particularly as central banks edge closer to rate cuts.

Volatility remains a persistent undercurrent in markets, with investors weighing a range of unresolved macroeconomic risks. Trade policy remained a key source of uncertainty, particularly with the 90-day tariff pause window drawing closer to expiry and negotiations around new trade agreements still ongoing. At the same time, the monetary policy backdrop continues to evolve slowly. Policy rates remain restrictive, and while the direction of travel is increasingly toward easing, central banks remain cautious. With the economic impact of past tightening still feeding through, growth headwinds are likely to persist into the second half of the year and beyond.

In this environment, flexibility and responsiveness are key. A dynamic approach to credit selection and duration management will be important in navigating policy, politics, and economic developments. We believe that active strategies are best placed to identify value and manage risk through what may be a choppy period ahead.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	86	1.8	4.2
Euro IG	91	0.3	1.8
UK IG	99	1.8	3.5

Source: Bloomberg, 30 June 2025

High yield credit

High yield credit had a positive return and spreads tightened, supported by a continued risk-on sentiment, easing financial conditions, and resilient corporate earnings.

Energy was among the top performing sectors given the spike in oil prices following geopolitical tensions in the Middle East. The sector benefited from spread tightening and positive sentiment, especially after the ceasefire agreement. Telecom and Media continued to perform well due to stable cash flows, low default risk and strong demand for connectivity services. On the other hand, Healthcare and Consumer Discretionary underperformed due to regulatory uncertainty and margin pressures (for the former) and softer retail sales data (for the latter).

Primary markets saw a resurgence, with an estimated US$32 billion in new US HY deals and €24.1 billion in EU HY deals, the busiest month on record. The bulk of issuance was driven by refinancing activity, as companies took advantage of tighter spreads and strong investor demand. We've often noted that the supply/demand dynamic is a strong technical factor compressing credit spreads, but the market clearly had no problem absorbing this supply and climbed tighter. June was also notably active for HY FRN issuance, with nine deals totalling an estimated $6 billion in volume priced globally. This marked one of the strongest issuance months for the HY FRN market, reflecting renewed investor demand for short duration, credit risk assets amid geopolitical volatility and shifting interest rate expectations.

What we think from here:

The HY market enters the second half of 2025 with positive momentum, supported by strong technicals, resilient fundamentals, and attractive carry. However, valuation concerns and geopolitical fragility remain the key risks that could introduce volatility. At current spread levels, there are arguably less obvious opportunities to pick up. However, as an active manager, we focus on alpha and remain confident in the skill of our global analyst team to identify sector and issuer dislocations that may arise from tariff headwinds/tailwinds and any further market volatility.

The opportunity:

- **High single-digit yields**: yields of circa 7.1% (US HY) and 5.5% (EU HY) provide healthy coupon income and act as a comfortable cushion to absorb a potential adverse move in spread.
- **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 to mitigate capital loss in volatile markets.
- **Expectation of a 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 macroeconomic 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 make sure 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	296	1.9	4.5
Euro HY	321	0.5	2.9

Source: Bloomberg, 30 June 2025

Emerging market bonds

It was another month of strong performance across the emerging market debt (EMD) universe, with local currency sovereigns once again leading the way. While news mid-month surrounding US attacks on Iranian nuclear facilities threatened to escalate the ongoing conflict within the Middle East, markets remained relative unaffected during a brief period of uncertainty, which was shortly resolved following a US and Qatar brokered ceasefire between Israel and Iran being agreed, and importantly, adhered to. Even at the height of uncertainty markets still reflected a risk-on mood, with oil initially rising but then moving back to levels prior to the US strikes.

June saw a continuation in the very broad-based rally, with only Senegal experiencing a negative return driven off the back of revelations that the previous administration had accrued off-the-book debt. While US uncertainty continues, we still see plenty of opportunity in emerging market debt and believe the resilience of the market is a positive sign. EM fundamentals remain strong, in our view, with a low default cycle within corporates expected and economies able to benefit from under-control inflation and loosening monetary policy as a result. While expected tariffs have revised growth expectations downwards globally, emerging markets are still expected to outgrow developed markets. A weakening dollar is supportive for local currency returns, with the Fed cutting cycle (once it recommences) historically a material tailwind for emerging market debt. As investors look to reduce their exposure to US assets, emerging market debt is proving to be a relatively safe harbour.

Spreads are continuing to tighten, but yields remain elevated and offer what we see as an attractive entry point for investors who are looking to move out of safer, lower-yielding, assets. A sometimes overlooked, but attractive part of the market is that EMD can offer yields in line with, and sometimes in excess of HY markets, but do so with better credit quality with the market being roughly 50% investment grade. Alongside the very diversified nature of the market, we think this should position the asset class well for investors.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	2.8	12.3
Hard currency government	325	2.4	5.6
Hard currency corporate	266	1.4	4.0

Source: Bloomberg, 30 June 2025

Currencies

The US dollar continued to fall in June, meaning it has now had the worst start to the year since 1973. The dollar index (DXY) is down 10.8% year to date, and 2.4% in June. Global investors continue to question their exposure to the world's reserve currency among an unpredictable administration and continued trade rhetoric from Trump. Fears keep growing over the US fiscal position and Trump's "big, beautiful bill" cutting tax while increasing spending, and therefore increasing the financial burden. Markets have also begun to increase their expectations for lower rates in the US with a view that the Fed may have to cut more aggressively to support the economy. Given the extent of dollar weakness in June, all G10 currencies appreciated relative to it with almost all major currencies following suit. There were some exceptions during the month such as the Hong Kong dollar, Indian rupee, and Turkish lira, with the former needing intervention from the central bank to the tune of $1.0 billion to prop it up.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	2.0	9.7
GBP/EUR	-1.8	-3.6
EUR/USD	3.9	13.8

Source: Bloomberg, 30 June 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.

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