Fixed Income asset class overview

November 2024

The main event of the month was the US presidential election on 5 November, resulting in a victory for Donald Trump, as well as Republican control of the House of Representatives and the Senate, allowing for the president-elect to more easily roll out his policy plans.

Month in review

Whilst the US election dominated attention, there were also significant political developments in France, where there was growing speculation about the government's survival as it looked to pass a budget that sought to deal with the bulging public debt. This saw French assets continue to underperform, with the CAC 40 down -1.5% in total return terms in November. The Franco-German 10 year yield spread widened by 7 basis points (bps) over the month to 81 bps.

Another theme that continued during November was growing scepticism that the Federal Reserve (Fed) would cut interest rates rapidly over the year ahead. This came as Fed Chair Jerome Powell said that the economy 'is not sending any signals that we need to be in a hurry to lower rates'. Later in the month, October's core personal consumption expenditure figure (PCE) figure came in at a seven-month high -- a monthly pace of 0.3%. As a result, there was growing concern that inflation was proving sticky above the Fed's target. The two-year US inflation swap moved up 10 bps over the month to 2.56%.

November saw US investment grade (IG) spreads tightening, driven by stronger economic data and positive market sentiment, resulting in a 1.2% return. In contrast, European IG spreads widened slightly due to weaker economic data and political instability, particularly in France, but still managed a 1.6% return. Sterling IG spreads tightened, with a 1.7% return. Overall, global IG spreads tightened, reflecting regional divergences, but maintaining stability amid significant geopolitical and economic developments.

Global high yield (HY) markets returned 0.9% in November, with US HY leading at 1.1%, driven by post-election optimism. European HY and emerging market (EM) HY returned 0.5% and 0.6% respectively, constrained by trade and growth uncertainties. HY floating rate notes (FRNs) continued their positive trend over the month, returning 0.6%. US HY spreads tightened to 272 bps, while European spreads ended at 347 bps, wider than in the previous month but still tighter than at the start of the year. Despite a slowdown in US primary market activity due to election-related caution, the global HY market has returned approximately 9.1% in the year to the end of November.

Emerging markets debt (EMD) had mixed returns in November. Local currency (LC) EMD sovereigns returned -0.6% over the month (-0.5% year to date), while hard currency (HC) EMD sovereigns returned 1.2% (8.0% YTD). HC EMD corporates returned 0.6% (8.2% YTD). Performance was influenced by the US election and reactions to a second Trump term, with LC EMD negatively impacted by a strengthening dollar. HC returns were driven by interest rates and credit spreads, with HY outperforming IG, showing YTD returns of 13.7% and 1.6%, respectively. Despite positive growth and inflation dynamics in many EMs, sentiment remains cautious post-election, with geopolitical developments such as the Israel-Hezbollah ceasefire stabilising oil prices.

Inflation

Inflationary pressures around the globe remain subdued with most countries now at, or close to, their target. In the US, inflation came in as expected, offering very little excitement. Core goods continue to show deflation, while rents remain extremely sticky, albeit trending in the right direction. Meanwhile, the Fed's closely monitored 'supercore' index also remains on a sticky downward trajectory, reflecting dynamics in its primary driver: wages.

So the inflation narrative is becoming boring again, leading both investors and the Fed to shift their focus increasingly towards the labour market. But can newly-elected Donald Trump "Make Inflation Great Again"? Can his immigration policies and tariffs push prices upward? Contrary to popular belief, we don't believe that is the case.

Regarding immigration, many argue that deporting illegal immigrants will be inflationary, citing their role in providing cheap labour. However, this is a supply side argument, which mostly ignores the demand part: immigrants don't only supply labour, they also create demand by consuming goods and services. Given the scale of recent immigration to the US, the demand effect has been very significant. A large-scale deportation would suddenly remove a substantial portion of that demand, and this, in the short term, would likely exert downward pressure on inflation.

Now on to tariffs. Conventional wisdom suggests tariffs are highly inflationary, but that's not necessarily the case. Here are a couple of things to consider:

1. Currency adjustment: higher tariffs could be offset by an appreciating dollar. A stronger dollar reduces the cost of imported goods, counteracting the price increases caused by tariffs.

2. Relative versus absolute prices: tariffs affect relative prices, not the overall price level. Without an increase in money supply, any rise in tariff-affected prices will likely be offset by declines elsewhere. For example, suppose tariffs drive up the cost of specific goods, and the dollar doesn't strengthen enough to counterbalance this. In that scenario, consumers would spend more on tariff-affected goods but, if their overall amount of money doesn't change, they will have less left to spend on services. Such reallocation of spending could push goods prices up but pull services prices down, leaving overall inflation largely unchanged.

In summary, Trump might make the inflation narrative interesting, but not necessarily greater again. Although money supply growth has begun to reaccelerate, it remains historically low for now, keeping inflationary pressures in check. Inflation's trajectory will depend more on monetary dynamics than on immigration or trade policies, in our view.

Developed market sovereigns

The US presidential election on 5 November was the main event of the month, and it resulted in victory for Donald Trump, as well as Republican control of the House of Representatives and the Senate. That backdrop saw higher US Treasury yields and a stronger dollar. European sovereign bonds advanced as investors priced in faster rate cuts from the European Central Bank (ECB). The 10-year Bund yield moved from 2.4% to 2.1% in the month, as the German inflation reading came in beneath expectations.

In the US, ongoing strength in US economic data was the general trend. The ISM services purchasing managers' index (PMI) for October also came in at 56.0, the highest since July 2022, while the weekly initial jobless claims continued to move lower and the Conference Board's consumer confidence measure for November moved up to the highest level since July 2023.

As a result of Trump's victory and stronger data there was growing scepticism that the Fed would cut interest rates rapidly over the year ahead. Besides, Fed Chair Powell said the economy "is not sending any signals that we need to be in a hurry to lower rates".

Then later in the month, data also showed core PCE at a seven month high in October, coming in at a monthly pace of 0.3%. As a result, there was growing concern that inflation was proving sticky above the Fed's target. The 2-year US inflation swap moved up 10 bps to 2.56%.

In the eurozone, there were also significant political developments in France, where there was growing speculation about the government's survival as it tried to pass a budget seeking to keep a lid on the country's bulging public debt. As a result, French sovereign debt continued to underperform.

In Germany, the political parties agreed to hold an early federal election on 23 February. Chancellor Olaf Scholz will table a confidence vote on 16 December, enabling the President to hold early elections.

Meanwhile, the final services and composite PMIs for October in the eurozone saw some upgrades from the earlier flash prints. Germany's latest Ifo business climate indicator for November ticked down a bit more than expected to 85.7 (versus 86.1 expected).

In the UK, the Bank of England (BoE) also delivered, as expected, a 25 bps interest rate cut in November, taking its policy rate down to 4.75%. Its latest forecasts also included the impact of the government's Autumn budget, which announced higher borrowing plans for the years ahead. Looking forward, the BoE signalled that rates would continue to move lower, with Governor Andrew Bailey stating that "a gradual approach to removing policy restraint remains appropriate". Currently, consensus expects the BoE to leave rates on hold at the next meeting, before delivering another cut at the subsequent decision in February, and eventually moving to a terminal rate of 3.25%.

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	0.8	2.2
Bunds	2.1	2.4	2.1
Gilts	4.2	1.6	-1.2

Source: Bloomberg, 30 November 2024

Investment grade credit

November was a busy month for financial markets, not least due to the US election, which will heavily shape economic performance, the geopolitical landscape and in turn, financial markets, over the next four years. With opinion polls, betting markets, and financial markets all divided on the winner, it was a surprise when Trump won so comfortably. Not only did he win the popular vote, but

Republicans also took the House and the Senate, giving Trump plenty of room to implement his ideas and policies.

The initial market reaction was as expected. Risk assets in the US shot up, with the S&P 500 rising 4.3%, the Dow Jones up 6.4%, and the NASDAQ gaining 3.5% from the election to the end of November. The dollar also strengthened by 2.2% over the same period.

The trading of inflation expectations was interesting with markets trying to gauge the likelihood of tariffs and how inflationary they could potentially be. Short-term breakevens rose, while longer-term expectations softened. The Fed's policy path adjusted higher, partly due to stronger US economic data. For instance, weekly initial jobless claims continued to decline, with the four-week moving average reaching 217k by the end of the month, the lowest since May.

Europe is continuing to show signs of weakness, with softer economic data putting pressure on the ECB to deliver a sizable cut at the next policy decision meeting. This situation has not been helped by political quarrels.

Despite a month filled with elections, economic data, and geopolitical events, credit markets remained relatively stable. The most notable point was the divergence across regions. Global IG spreads tightened, with USD outperforming due to the election result and stronger economic data, while euro spreads widened due to weaker economic data and political instability. Sterling spreads were flat. Absolute returns were positive across the board – the US IG index returned 1.2%, European IG corporates returned 1.6%, and sterling IG returned 1.7%.

Looking ahead, Scott Bessent, nominated by Trump for the role of US Treasury Secretary, could be important for the US monetary policy path. One of Bessent's proposed policies looks to increase oil production to keep inflation down, which should allow the Fed to continue lowering rates. This, combined with extending tax cuts, could boost demand and consumption, but might concern bond investors. If tariffs are implemented seamlessly without harming growth, it could mitigate some concerns about bond market issuance and deficits. The sequencing and details of these policies will be crucial. If tariffs are introduced first and alone, inflation could rise and growth could fall, creating uncertainty about the Fed's response.

The divergence between economies is also noteworthy. Any doubts about US exceptionalism are diminishing. The eurozone, particularly Germany, appears to be weakening significantly. There is a strong possibility that the ECB might shift from a restrictive stance aimed at reducing services inflation to a more accommodative stance. This could happen even before we hear anything from Trump about European tariff policy, which might further worsen the outlook.

In the UK, there are increasing signs of a labour market slowdown, however the jury remains out on the reliability of the data. The budget revealed another "let's aim to grow into our debt" announcement, but there doesn't seem to be much growth policy yet, other than a significant tax increase to fund higher government spending. We need to see what shape the investment will take to gain more clarity. The challenges are:

1. The increase in national insurance might soften the labour market further, which won't help growth.

2. A slowdown is almost inevitable, and the government has already spent most of what it raised in taxes, leaving little headroom. This raises the risk of more tax increases (or spending cuts).

3. Borrowing £300 billion via gilts each year for the next five years means there's a lot of issuance to come.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	82	1.2	4.6
Euro IG	106	1.6	5.1
UK IG	107	1.7	2.5

Source: Bloomberg, 30 November 2024

High yield credit

November was a positive month for Global HY markets which returned 0.9%, albeit with mixed performance regionally. While US HY spreads rallied, benefiting from the US election risk-on boost, both European and EM spreads were held back by the resulting trade and growth uncertainty. As a result, US HY was the main outperformer, returning 1.1% during the month, ahead of European HY (up 0.5%) and EM HY (up 0.6%).

HY FRNs benefited from their lower spread beta and were partly insulated from adverse moves in spread. The asset class returned 0.6% in November, continuing its positive return streak in 2024.

Spreads continue to grind tighter in the US, ending the month at 272 bps and well inside 10-year tight levels. European spreads remain wide of the US at 347 bps at month-end, but still historically rich and tighter versus the start of the year. In the meantime, demand for HY credit remains exceptionally strong and is showing few signs of softening, given the combination of good yields and solid recent performance.

US primary activity slowed down during the month as issuers stayed on the sidelines, processing the election outcome and avoiding rate volatility.

YTD, the global HY market has returned 9.1%, which is quite exceptional in a year that started off with recession worries, elevated funding costs and steep maturity walls for many high yield issuers.

Going forward:

We believe opportunities in the high yield market remain, even at current valuations. Here's why :

• **All-in yields are historically attractive:** while spreads are relatively low, yields on HY bonds are still higher than in previous years. Historically, yield has been a better proxy for future return than spread has been. With today's yield-to-worst of around 7.0%, there is arguably potential for the asset class to generate reasonable returns in 2025, in our opinion.

• **Greater confidence in the economy:** recent economic performance has shown continued strength, with corporate profits and consumer spending remaining largely resilient in the face of high interest rates. This environment suggests a benign default cycle going forward, also evidenced by diminishing levels of market distress.

• **HY fundamentals look resilient despite macroeconomic uncertainty:** Improved growth expectations are likely to further support fundamental metrics. It's worth noting that the interest coverage ratio (which measures a company's ability to pay off its debt), while dropping as companies have refinanced at higher rates, remains well above levels at which analysts would typically become concerned about companies' ability to pay.

• **Strong market technical remains supportive for HY spread:** While HY spreads may be rich, all-in yields are still historically attractive, creating an equilibrium between buyers of yield and sellers of spread. Importantly, the high yield market continues to shrink as issuers seek capital elsewhere (private markets, loans market), which further reduces supply against ongoing robust demand backdrop.

• **Strong case for active management:** Rich valuations and rising pockets of spread dispersion provide a strong case for active management in high yield. We believe an approach that focuses on fundamental credit research and thorough credit selection is essential to navigate high yield markets in 2025.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	272	1.1	8.7
Euro HY	347	0.5	8.2

Source: Bloomberg, 30 November 2024

Emerging market bonds

Whilst November was a volatile month, mostly dictated by the US election and markets trying to gauge what a second term of Trump means for the global picture, returns were broadly positive although the local currency portion of the market was negative as it continues to be weighed under a strengthening dollar. During November, rates and spreads drove hard currency returns in both sovereign and corporate markets, although the ever-present theme this year of HY outperforming IG continued, with YTD returns now standing at 13.7% and 1.6%, respectively.

Despite positive growth and inflation dynamics within many EMs, bolstered by the Fed's initiation of its interest rate cutting cycle, sentiment remains subdued following the US election. Geopolitics will also be under the microscope, but we have already seen a ceasefire agreement reached between Israel and Hezbollah, which has helped improve sentiment whilst grounding oil prices, which had begun to rise following the escalation of Russia's war on Ukraine.

The uncertainty that Trump brings to the global stage is already in full view. His inauguration isn't until January, but he has already ramped up rhetoric on tariffs on goods from Mexico, Canada, and China, only to renege on Mexico a day later following talks with Mexico's president, Claudia Scheinbaum. This highlights what we saw from Trump in his first term insofar as he will ramp up threats, but with the aim of getting a good deal. In this case, he climbed down on Mexico tariffs once Scheinbaum promised to do more on illegal migration, which she instantly delivered on by stopping several 'migrant caravans' before they had reached the US border.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	-0.6	-0.5
Hard currency government	340	1.2	8.0
Hard currency corporate	250	0.6	8.2

Source: Bloomberg, 30 November 2024

Currencies

A strengthening dollar on the back of Trump's election victory, which has seemingly set expectations for higher-than-expected inflation and interest rates, dominated the currency scene in November. With that said, we are of the view that there is reason to believe the impact may not be as severe as first thought. But because of this, there hasn't been much room for currencies to appreciate relative to the dollar during November. Most developed markets' currencies (aside from the yen and Norwegian krona) weakened, and only a couple in the emerging markets space appreciated (the Peruvian sol and the Colombian peso).

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	-1.3	0.0
GBP/EUR	1.6	4.4
EUR/USD	-2.8	-4.2

Source: Bloomberg, 30 November 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.