BROKERAGE
FIDUCIARY
PAYMENTS
PROFESSIONAL BUSINESS SUPPORT

Opportunities in Global Fixed Income Market

Alexander Viner

Head of Portfolio Management
Wise Wolves Group

Historical Returns

	YTD	2023	2022	2021	2020	Since 2000 (annual equivalent)	Annualized Volatility of Returns	Return/ Volatility
US								
USD GS 3-Month Money Market Index	+5,0%	+5,5%	+2,4%	+0,2%	+0,7%			
The Bloomberg US Aggregate Index	+2,2%	+5,5%	-13,0%	-1,5%	+7,5%	+3,9%	4,2	0,93
The Bloomberg US Corporate Bond Index	+3,5%	+8,5%	-15,8%	-1,0%	+9,9%	+5,0%	5,6	0,89
The Bloomberg US Corporate High Yield Bond	+8,3%	+13,4%	-11,2%	+5,3%	+7,1%	+6,6%	5,2	1,26
EU								
GS 3-Month EUR Money Market Index	+3,5%	+3,3%	+0,0%	-0,5%	-0,3%			
The Bloomberg Pan-Euro Aggregate Index	+2,0%	+7,5%	-18,9%	-2,1%	+3,6%	+3,2%	3,9	0,82
The Bloomberg Pan-European Aggregate: Credit Index	+3,6%	+8,3%	-16,4%	-0,8%	+2,8%	+3,4%	3,7	0,92
The Bloomberg Pan-European High Yield Index	+7,9%	+12,8%	-11,1%	+4,2%	+1,8%	+5,8%	6,0	0,96
EM								
The Bloomberg Emerging Markets Hard Currency	+7,3%	+9,1%	-15,3%	-1,7%	+6,5%	+7,0%	5,5	1,28
Bloomberg Emerging Markets High Yield	+14,5%	+13,1%	-12,4%	-3,2%	+4,3%	+8,0%	7,0	1,14
Equity indices								
S&P 500 INDEX	+27,3%	+26,3%	-18,1%	+28,7%	+18,4%	+8,1%	19,8	0,41
STXE 600 (EUR) Pr	+10,4%	+16,6%	-9,9%	+25,8%	-1,4%	+4,6%	18,9	0,24
MSCI ACWI	+20,8%	+22,8%	-17,9%	+19,0%	+16,9%	+6,3%	15,9	0,40

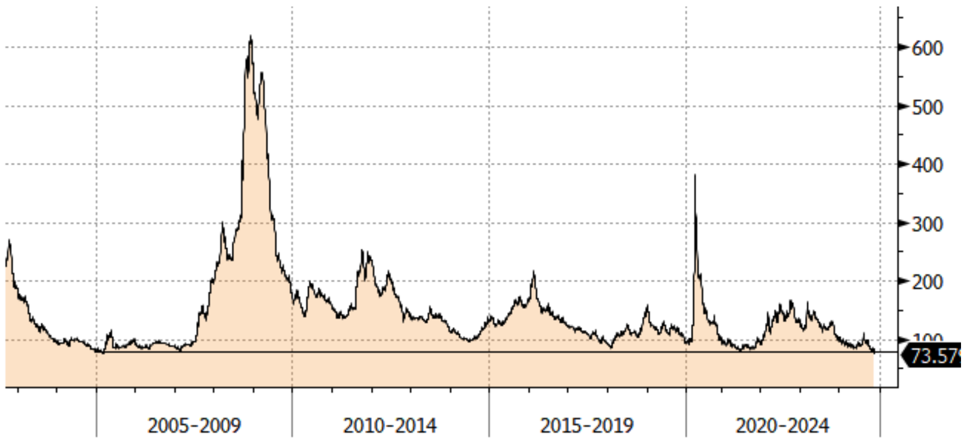
- **Investment-grade bonds**, year-to-date, in both USD and EUR have lagged behind money market and high-yield bonds. Tight spreads at the end of 2023 and aggressive pricing of Treasuries in anticipation of a Fed rate-cutting cycle contributed to this underperformance.
- **High-yield bonds** have outperformed, supported by a strong risk-on environment. Equity market gains were a key driver of high-yield performance, and the relatively short duration of these bonds helped them withstand Treasury market volatility.
- **Emerging market bonds** have also outperformed, benefiting from significant spread tightening. EM high-yield bonds, in particular, delivered strong double-digit returns, with notable contributions from Argentina and African markets.

Current State of the Bond Market

- Bond spreads across all fixed-income sectors are below long-term averages, limiting potential for further tightening and increasing sensitivity to Treasury yield movements and potential spread widening in a risk-off environment.
- Investment-grade bonds offer yields similar to money market rates, making them less attractive for carry. However, their duration exposure may benefit from a rate-cutting cycle.
- Money market rates remain competitive for carry, providing tactical trading optionality and safety amid current volatility.
- Emerging market hard currency bonds (both IG and HY) now have credit characteristics similar to developed market (DM) bonds but offer better yields and carry.

	Currency	Credit rating	Duration	YTW, %	Average coupon, %	Average price	Index Average current yield	OAS over Treasuries	Average OAS since 2020	Average OAS spread since 2000
US										
12M US T-Bill		**AA+**	**0,9**	**4,3**			**4,3%**			
US Aggregate Index	USD	AA2/AA3	6,2	4,7	3,4	91,6	**3,7%**	31	47	58
US Corporate Bond IG Index	USD	A3/BAA1	7,2	5,1	4,3	93,7	**4,5%**	74	120	148
US Corporate HY Bond Index	USD	BA3/B1	3,5	7,1	6,4	96,3	**6,6%**	256	398	496
EU										
12M Germany Bubill		**AAA**	**0,9**	**2,5**			**2,5%**			
Pan-Euro Aggregate Index	EUR	AA3/A1	6,7	3,2	2,2	93,1	**2,4%**	54	62	62
Pan-European IG Corporate Index	EUR	A1/A2	5,5	3,4	2,5	94,7	**2,6%**	87	114	119
Pan-European High Yield Index	EUR	BA3/B1	3,1	6,1	4,9	96,8	**5,1%**	334	426	503
EM										
EM Hard Currency Aggregate Index	USD	BAA2/ BAA3	6,3	6,5	5,0	90,8	**5,5%**	217	312	340
Emerging Markets High Yield index	USD	BA3/B1	5,3	8,4	5,9	87,5	**6,7%**	408	626	544

Historical Spreads



US Corporate IG OAS Spread

US Corporate HY Bond Index OAS Spread

Pan-European IG OAS Spread

Spreads across all fixed-income sectors are at historical lows, limiting potential for further tightening and prospects for capital appreciation. However, in periods of economic stability, such low spreads can persist, allowing investors to achieve reasonable returns through carry strategies and tactical trades.

Long-term Returns

US IG Corporate YTW, Bloomberg

EM Hard Currency Aggregate Index YTW, Bloomberg

EU IG Corporate YTW, Bloomberg

Long-term bond returns are primarily driven by yield to maturity, interest carry, and the compounding effect—not price appreciation. Currently, yields to maturity remain historically attractive—even in a low spread environment—offering compelling opportunities for long-term investors.

FI Sectors Performance During Rate Cut Cycles

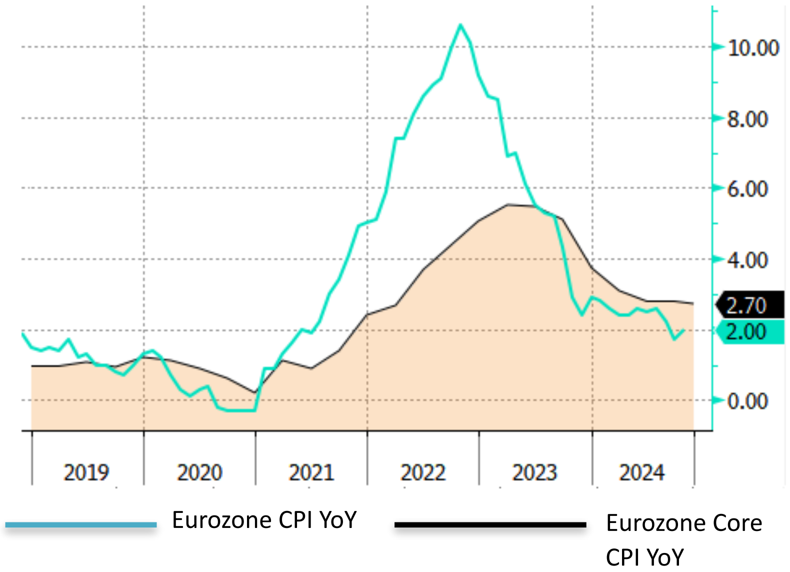
	1995-1997 cycle (Soft landing)	1998-1999 cycle (Asia & Russia defaults)	2001-2004 (Dot-Com Crises)	2007-2015 (GFC)
US				
US Aggregate Index	+5,2%	-0,7%	+6,4%	+4,4%
US Corporate Bond IG Index	+5,4%	-1,3%	+7,9%	+5,6%
US Corporate HY Bond Index	+11,8%	+6,1%	+9,1%	+6,8%
EU				
Pan-Euro Aggregate Index			+5,7%	+5,4%
Pan-European IG Corporate Index			+5,9%	+4,9%
Pan-European High Yield Index			+5,5%	+9,6%
EM				
EM Hard Currency Aggregate Index	+29,2%	+31,4%	+10,4%	+6,6%
Emerging Markets High Yield index	+29,3%	+34,9%	+10,6%	+7,5%
Equity indices				
S&P 500 INDEX	+25,6%	+45,0%	-3,1%	+6,1%
STXE 600 (EUR)	+24,6%	+41,8%	-7,5%	+3,5%
MSCI ACWI	+13,8%	+41,4%	-1,5%	+2,9%

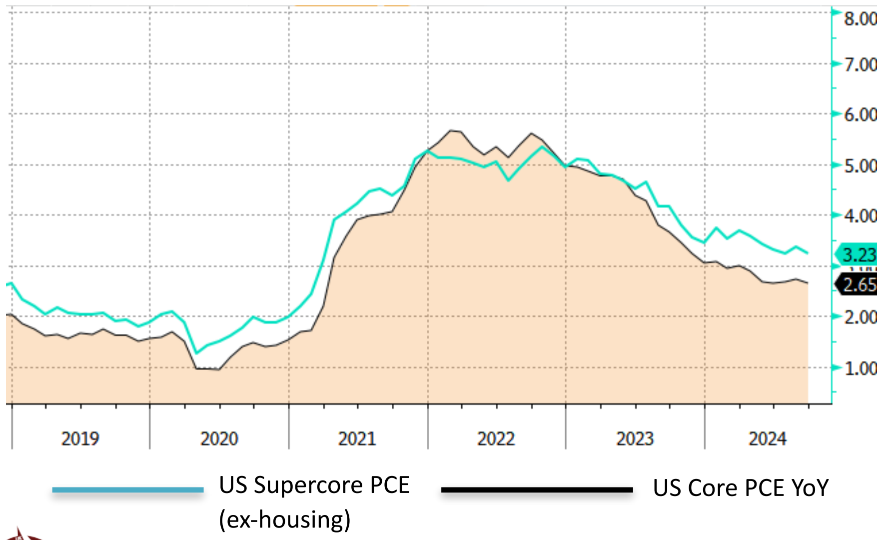
Annualized returns, Bloomberg

- High yield bonds have consistently outperformed investment-grade bonds during rate-cutting cycles. This outperformance is due to monetary easing—which lowers default risk—and the higher carry yields of high yield bonds that boost returns in risk-on environments.

- Emerging market bonds have shown strong performance in recent rate-cut cycles. In the 1990s, EM bonds were a nascent asset class with limited issuers and high spreads, offering significant yield premiums that contributed to their exceptional performance. Over time, EM bonds have become more attractive due to higher carry yields, increased transparency, and improved governance. These factors, combined with ample global liquidity, have allowed EM bonds to outperform equities and developed market bonds, even during periods of crisis.

Economic Factors: Inflation



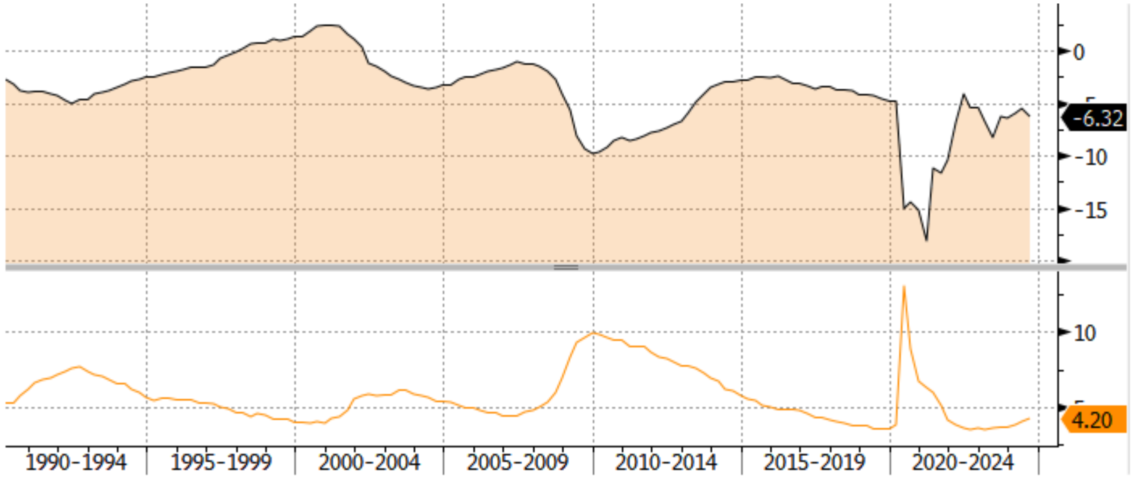


Inflation rates have declined and are nearing the 2% targets set by central banks, though the pace of decline has slowed.

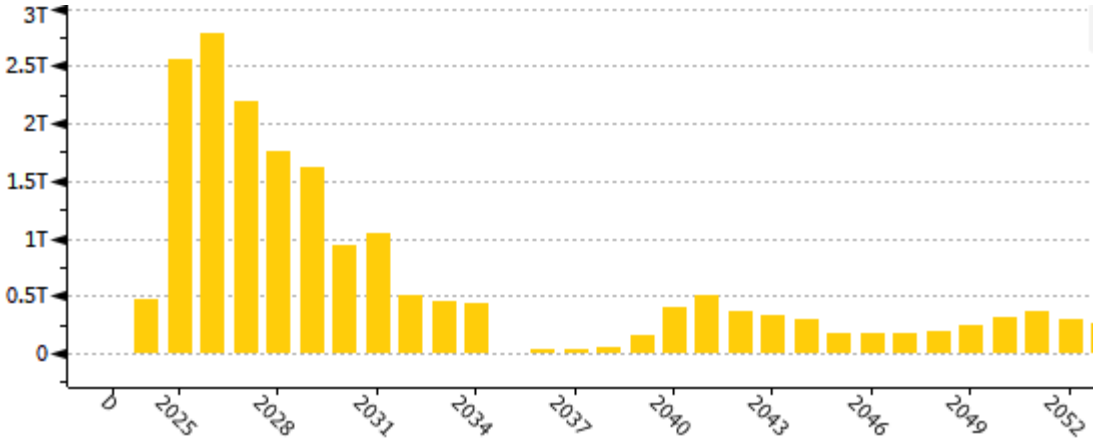
- Headline inflation fell below the ECB's 2% target, but Core CPI remains elevated. Despite sticky Core CPI ECB is widely expected to continue quarterly rate cuts, bringing rates down to 2%.

- **US**: Core PCE—the Fed's preferred inflation measure—has plateaued at 2.6% since May 2024. Additionally, "Supercore" PCE (excluding energy and housing) has remained steady around 3.2–3.3% since June 2024.

US Fiscal Policy – Still Inflationary



US Budget Deficit (upper graph) vs Unemployment rate (bottom graph), Bloomberg



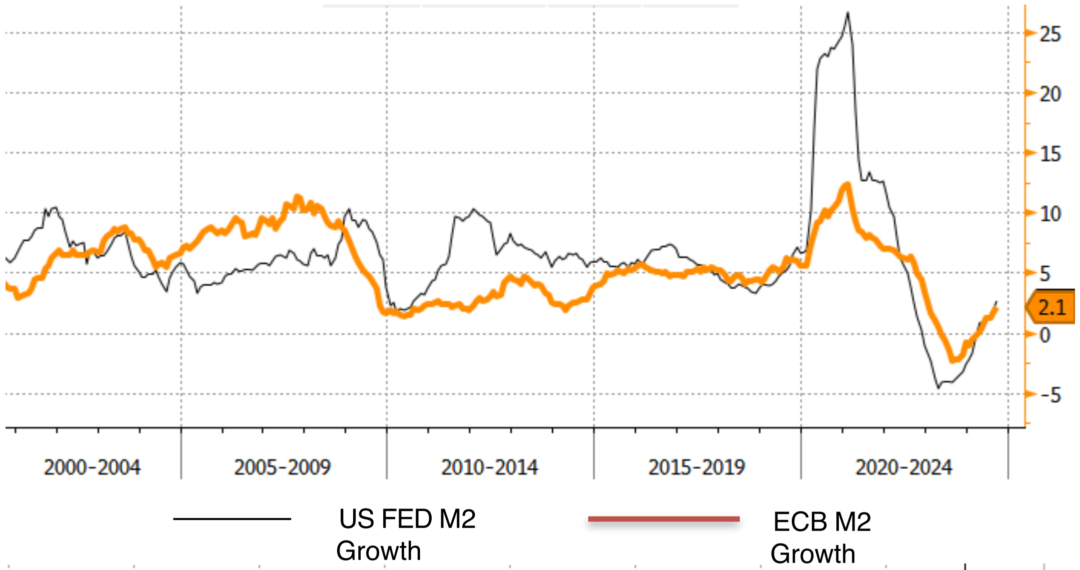
Distribution of US Government debt maturities, Bloomberg

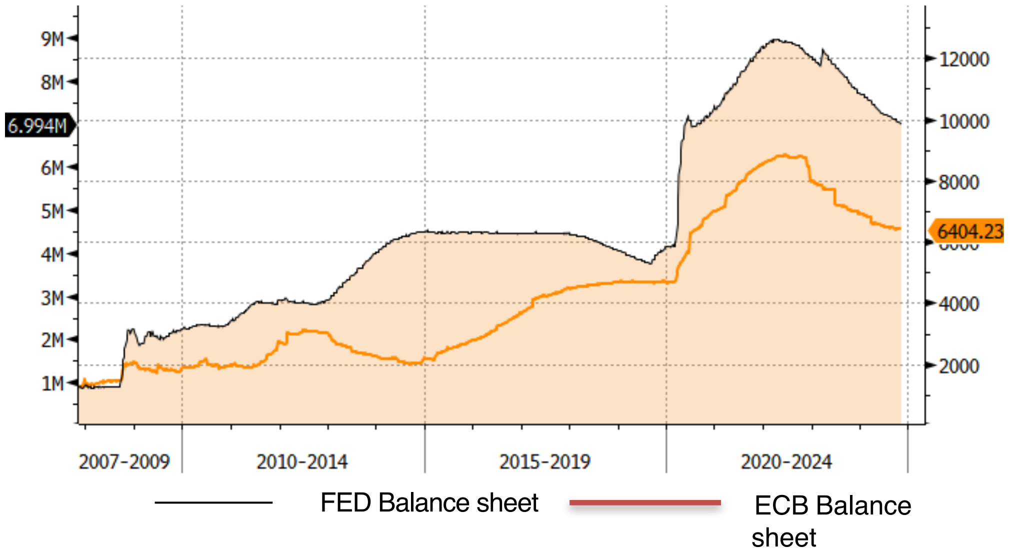
- Expansive U.S. fiscal policies, including the Infrastructure Investment and Jobs Act and the Inflation Reduction Act, have significantly widened the budget deficit, currently around 6.3% of GDP—a level consistently seen only since the period leading up to 2008.

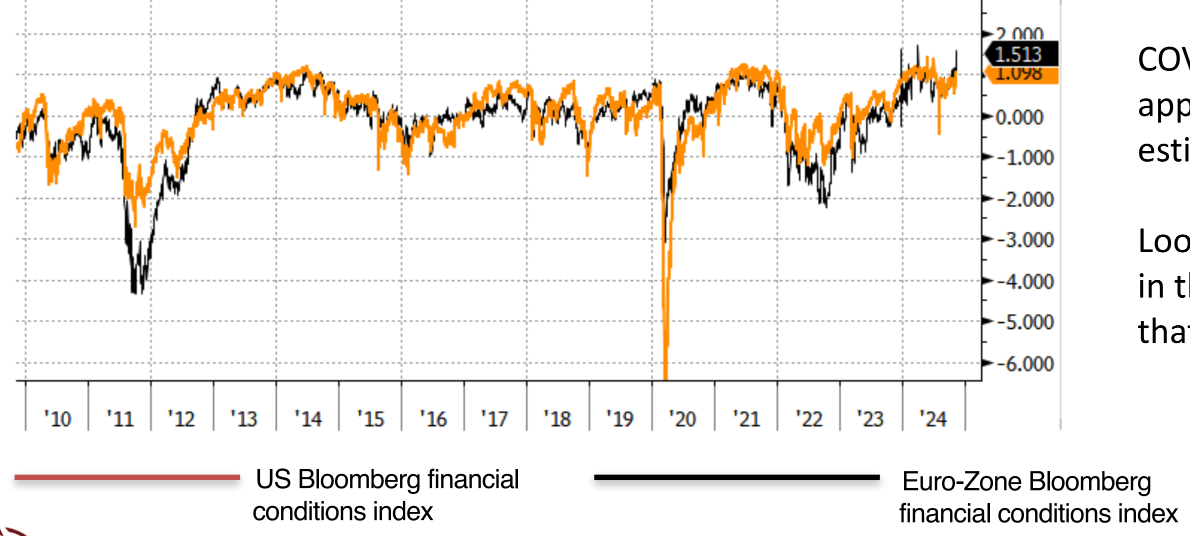
- The bulk of infrastructure investments is planned for 2025–2026. Media reports suggest that the Biden administration may accelerate spending ahead of potential leadership changes, aiming to 'cement his legacy.'

- Between now and 2026, the U.S. needs to refinance over $5.7 trillion in government debt. This substantial increase in government spending, along with the significant refinancing requirement, is expected to expand the supply of U.S. government bonds, potentially putting upward pressure on bond yields and making the market sensitive to any disruption from new bond issuances.

Monetary policy – Still in the Post-COVID Era



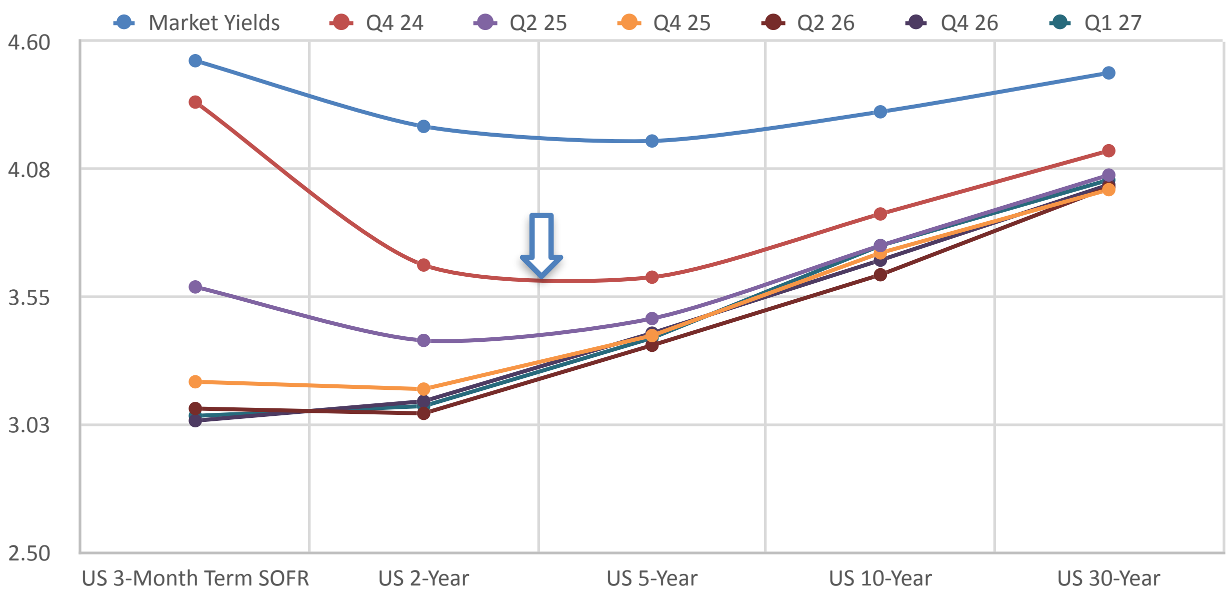




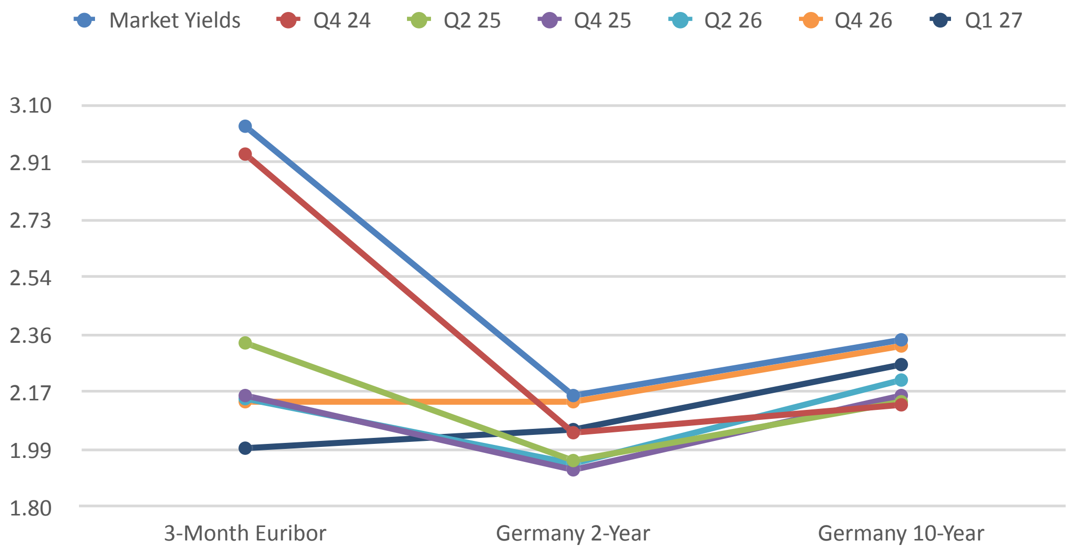
COVID-19 Response: Central banks expanded their balance sheets by approximately $7.5 trillion to support the economy. Despite recent reductions, estimates suggest around $3 trillion in excess liquidity remains.

Loose Financial Conditions: After a brief period of contraction, money aggregates in the U.S. and Europe are back to growth, sustaining loose financial conditions that encourage investment in risk assets.

Forward-looking rates and forecasts



Consensus Forecast-based USD interest curves, Bloomberg

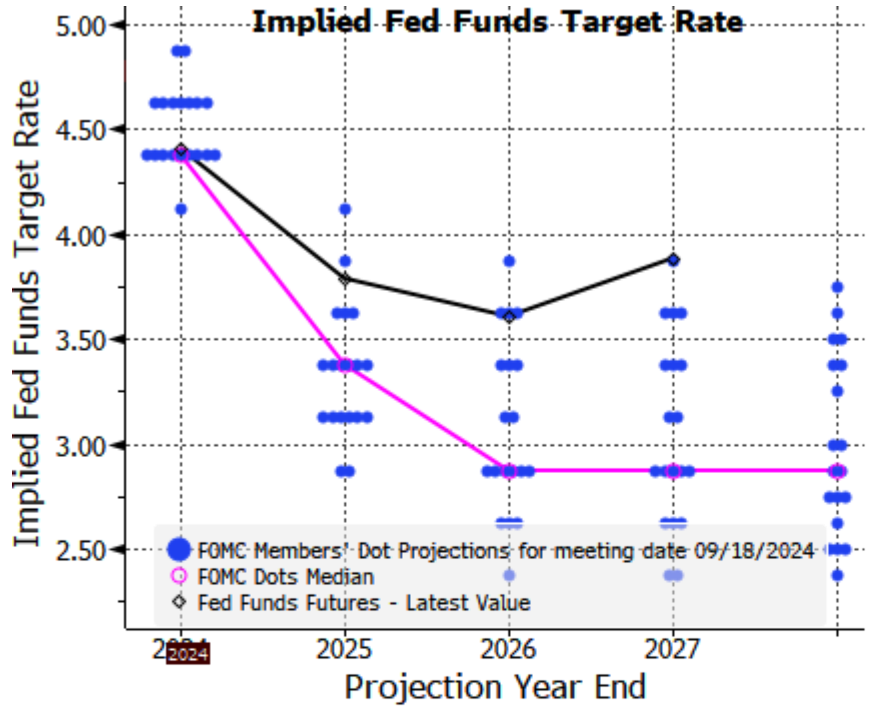


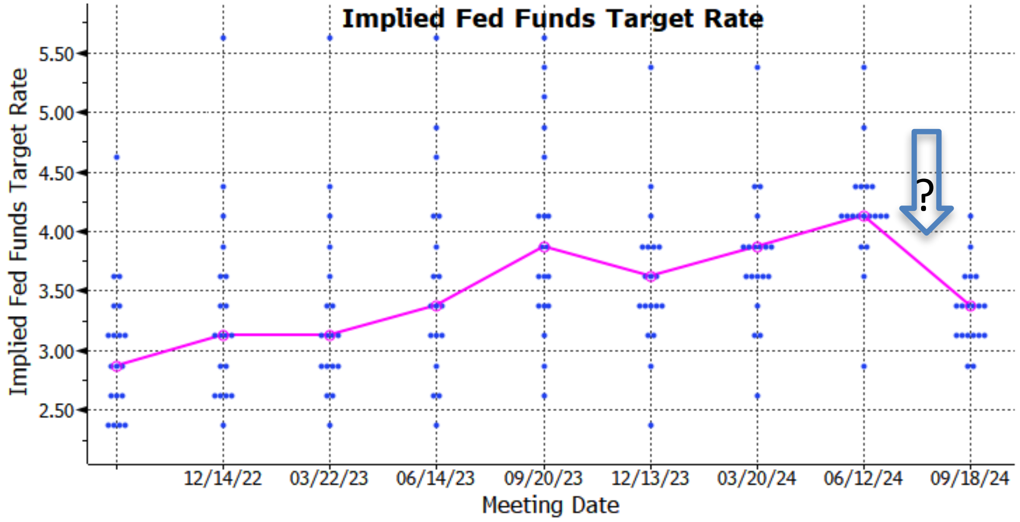
Consensus Forecast-based EUR interest curves, Bloomberg

- **USD Yield Curve:** Consensus forecasts suggest a strong case for bull steepening in the USD yield curve over the next several years, driven by expected rate cuts at the short end while longer-term yields remain more stable.

- **EUR Yield Curve:** In contrast, forecasts for the EUR yield curve indicate marginal tightening, with noticeable changes primarily in money market rates, reflecting expectations of dovish ECB policies that are already largely priced in.

FED Dots and Forecasts



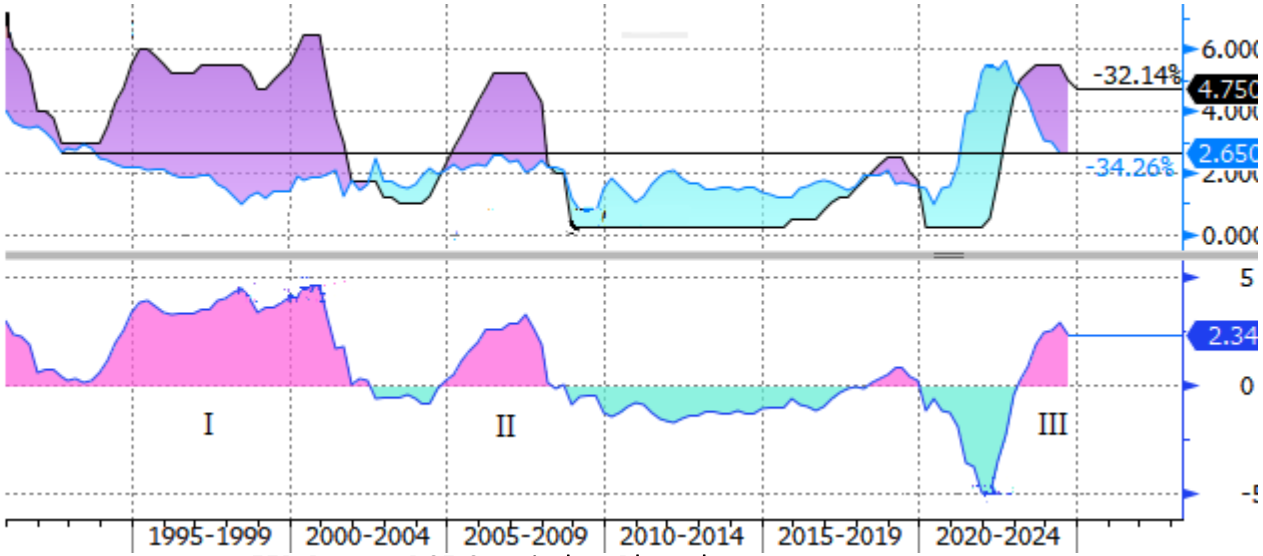


Historical projections for end 2025 FED rate, Bloomberg

- FED's Changing Projections: Since June, the Fed has lowered its end-2025 rate projection from 4% to 3.4%, even though economic indicators have remained stable. This may reflect the Fed's data-driven approach or a shift in their economic outlook.

- Market Skepticism: The Treasury yield curve and futures market remain skeptical, pricing in higher rates—3.75% by the end of 2025 and 3.6% by the end of 2026.

Historical Inflation and Rates



FED Rate vs PCE Core index, Bloomberg

Median spread FED Rate vs PCE Core index, Bloomberg

FED's Dual Mandate: The Federal Reserve operates under a dual mandate of Price Stability and Labor Market Support.

- Historical Trends: When focused on Growth Support, the median spread between the FED rate and the PCE index averaged around -100 bps. In periods aimed at Inflation Control and Economic Stabilization, the spread was approximately +250 bps. The current spread of 230 bps aligns well with historical data.

- Current Outlook: With the U.S. economy showing strength and unemployment around 4%, it may be reasonable to expect the FED rate to sit about 2% above the PCE index in the near term. This suggests that current FED forecasts could be overly optimistic about the rate cut cycle if inflation remains at current levels.

Sector positioning: Developed Market Bonds

- In the current environment of low spreads, fixed-income markets are highly sensitive to any risk-off shifts or volatility in base rates. Under a stable economic scenario, interest carry may become a key driver of returns in the fixed-income space.

- **Money Market Exposure:** We like exposure to the money market and short duration in general as it offers safety, a higher interest carry and provides flexibility to capitalize on tactical opportunities.

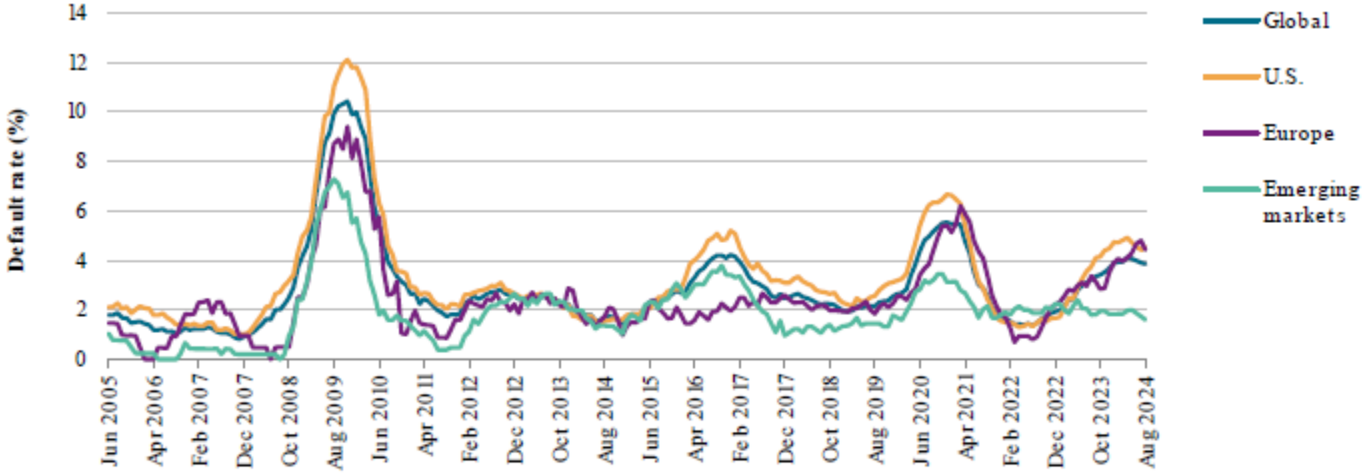
- **Duration Positioning:** We begin to favour extending duration by increasing exposure to 3-6 duration year bonds. This allows to lock in current high yields and positions us well for a potential “bull steepening” scenario.

- **High-Yield Bonds:** Developed market high-yield (HY) bonds provide attractive carry and historically high yields for dedicated fixed-income investors. However, as equity risk drives HY returns, we prefer U.S. equities over U.S. HY bonds for multi-asset portfolios due to greater upside potential. In Europe, we favour EUR HY bonds over EU equities, given the stagnating EU economy and the dampening effects of Trump’s protectionist policies.

- **EUR Market Focus:** Within the EUR space, we see value in South European exposure, where economic growth is stronger than in Germany and France.

Sector positioning: Making the case for EM markets

Why We like EM bonds?



Trailing 12-month speculative-grade default rates, S&P Global ratings

- Outperformance in Key Scenarios: EM bonds have historically outperformed DM bonds during rate-cutting cycles and in "Goldilocks" scenarios.

- Higher Yield and Carry: EM bonds offer more attractive yield and carry than DM bonds, appealing to income-focused investors.

- Stronger Fundamentals: EM issuers generally have stronger fundamentals than DM high-yield issuers with similar ratings, reflected in lower default rates.

- Diverse Alpha Opportunities: EM markets provide a range of alpha-generating opportunities for fixed-income investors, supported by current liquid environments.

CONTACTS:
Alexander Viner
Head of Portfolio Management
Wise Wolves Group

m: +357 97 837 153
alexander.viner@wise-wolves.com

BROKERAGE I FIDUCIARY I PAYMENTS I CRYPTO

Spyrou Kyprianou 61, Mesa Geitonia, 4003, Limassol, Cyprus
t: +357 25 259 377
office@wise-wolves.com
www.wise-wolves.com