

After Fed cut, attention turns to what comes next

KEY TAKEAWAYS

- Softening growth trajectory should benefit allocations to front-end core rates and high-quality credit assets.
- With divergent interest rate paths, we favour globalising interest rate exposure with relative value trades such as the long-dated sovereign debt of “fiscal saints” (eg, Spain) to that of those more fiscally challenged (eg, US).
- For outright exposure to longer duration assets, consider emerging markets that benefit from a weaker US dollar and favourable debt dynamics.

TOP IDEAS

- Steeper US yield curve
- Weaker US dollar
- High-quality non-cyclical credit
- Asian and emerging markets
- Inflation-protected securities

The US Federal Reserve delivered a much-awaited rate cut of 25 basis points in September. Any concerns about above-target inflation have taken the back seat for now. A key

catalyst seems to have been August’s weak US jobs data combined with a significant downward revision of the figures for June (according to the new data, payrolls fell in June for the first time since December 2020). An additional revision for the 12 months ending March 2025 found that the US had created 911,000 fewer jobs than previously thought, pointing to an extended lacklustre jobs streak. Government jobs are likely to shrink further, while the contraction in manufacturing is confounding hopes for a tariff-driven boost.

For **global bond** markets, this mostly priced-in US rate cut was arguably a non-event by now – much like the European Central Bank’s decision to keep rates on hold in September. The resumption of cuts in a softening growth environment continues to help our base case allocation to core rates and credit assets – mostly at the front end of yield curves. We’re watching for tail risks to this base case, including the chance that policy easing fails to keep pace with a deterioration in economic activity, which could fuel a rally in rates but harm credit. Conversely, faster policy easing coinciding with a bullish pick-up in growth could refuel inflation

and push yields higher. That might hurt both rates and credit.

At this juncture, we think fiscal policy is most informative for taking **rates** risk, as it’s the clearest contributor to (higher long-term) bond yields. As a result, our highest convictions are focused on relative value. They include single-market trades, for instance positions that benefit from a steepening of the US yield curve. They also include cross-market trades favouring longer-dated sovereign bonds backed by fiscal discipline, such as Spain, over those under pressure from fiscal imbalances, like the US and France. For outright directional exposure to rates, we prefer to be long select emerging markets that can benefit from a weaker US dollar and favourable debt dynamics. Examples



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include Peru, South Africa, Romania, Egypt and the Philippines.

In **currencies**, we expect continued pressure on the US dollar due to structural and cyclical headwinds. Another hindrance is the question mark around the Fed's independence. Against the dollar, we prefer to be long the euro (where the bar for more rate cuts is high) and long emerging market currencies that have benefited from strong "carry trade" inflows.

When it comes to **credit**, spreads are tight, but corporate fundamentals have stayed resilient with limited systemic imbalances in key markets. Carry – particularly the 'sweet spot'

of the credit spectrum, ie, BBBs and BBs – remains attractive and may stay more resilient than equities should volatility return, particularly when growth starts to soften. High starting yields also offer competitive long-term return potential, particularly when the default rate is in check.

In today's environment, we believe a global multi-sector approach is the best way to capitalise on opportunities. While there are signs of a late cycle in the US, some European markets show hints of recovery and expansion. We think Asian and emerging markets are well placed to outperform thanks to improving credit fundamentals. On tariffs, we recognise that every

new round imposed, paused or renegotiated alters the landscape and exposures of individual companies. Bottom-up analysis and security selection are critical.

As there are still upside risks to **inflation**, we continue to favour adding some inflation protection to portfolios. One way to express this is through 5-10 year US Treasury Inflation Protected Securities (TIPS). For income-oriented investors, it might make sense to maintain an allocation to floating-rate notes that can deliver a regular payout stream above money-market rates while also controlling for the risk of higher-for-longer inflation and rates.

Fixed income market performance

Indicative market indices Data as at 15 September 2025	Total return YTD 2025 (%)	Total return August 2025 (%)	Yield-to- worst* (%)	Effective duration (years)
Global convertible bonds	16.92	2.56	-2.6	1.5
Global emerging-market sovereign bonds	10.74	1.63	7.0	6.6
Asian high yield	8.53	1.45	8.6	2.5
US investment grade	7.41	1.01	4.7	7.1
US high yield	7.07	1.20	6.6	2.8
US aggregate	6.63	1.20	4.3	6.1
Asian investment grade	6.47	1.18	4.8	4.8
Euro high yield	4.34	0.05	5.1	2.8
Global aggregate	4.23	0.55	3.4	6.5
US Treasury bonds 1-3 years	4.02	0.90	3.6	1.7
US floating-rate notes	3.65	0.44	5.0	0.0
Euro investment grade	2.70	0.01	3.1	4.5
Global government bonds AAA-AA	2.21	0.06	3.1	7.4
Euro government bonds 1-3 years	1.79	0.19	2.1	2.0
Euro aggregate	1.01	-0.20	2.9	6.3

Source: Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors, data as at 15 September 2025. Index returns in USD-hedged except for Euro indices (in EUR). Asian and emerging-market indices represent USD denominated bonds. Yield-to-worst adjusts down the yield-to-maturity for corporate bonds which can be "called away" (redeemed optionally at predetermined times before their maturity date). Effective duration also takes into account the effect of these "call options". The information above is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or as investment advice. Past performance, or any prediction, projection or forecast, is not indicative of future performance.

* Represents the lowest potential yield that an investor could theoretically receive on the bond up to maturity if bought at the current price (excluding the default case of the issuer). The yield to worst is determined by making worst-case scenario assumptions, calculating the returns that would be received if worst-case scenario provisions, including prepayment, call or sinking fund, are used by the issuer (excluding the default case). It is assumed that the bonds are held until maturity and interest income is reinvested on the same conditions. The yield to worst is a portfolio characteristic; in particular, it does not reflect the actual fund income. The expenses charged to the fund are not taken into account. As a result, the yield to worst does not predict future returns of a bond fund.



WHAT TO WATCH

1 Fed independence

The Trump administration has been openly critical of the Fed for not cutting interest rates earlier, and in the meantime has attempted to remove a sitting Fed governor. The latest US jobs data might provoke further attempts at interference. Fed independence is crucial as it has long underscored the safe-haven reserve status of the US dollar and US Treasuries.

2 Tariff enforcement

The US Supreme Court will soon decide whether the Trump administration's tariff regime should be legally upheld. There is a possibility of a "yes, but" decision in which the court allows tariffs under certain conditions. Moving past this final uncertainty around tariff enforcement should support market sentiment.

3 Corporate earnings

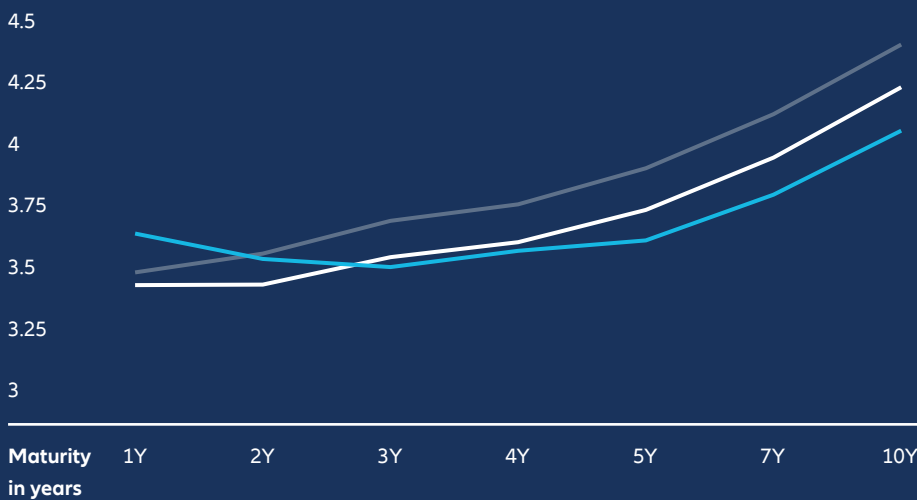
We are wary of some discretionary consumer sectors and heavy industries that struggle to find a floor in demand. We like banks where strong capital and asset quality are supported by normalising yield curves. Defensive non-discretionary consumer sectors like healthcare and telecoms are among our larger allocations. With more certainty on tariffs, some sectors that still trade with wider spreads such as autos and real estate could become more interesting.



CHART OF THE MONTH

US Treasury yield curve – current and 1Y forward

Yield in %



— Current US Treasury yield curve, 15 September 2025
 — 1Y forward US Treasury yield curve, 15 September 2025
 — 1Y forward US Treasury yield curve, 30 June 2025

Source: Bloomberg, Allianz Global Investors, data as at 15 September 2025. The information above is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or as investment advice. Past performance, or any prediction, projection or forecast, is not indicative of future performance.

We expect yield-curve steepening to remain a central theme in fixed income for the rest of the year and most likely into 2026. Market estimates for the slope of the forward US Treasury curve – derived from existing Treasury securities, futures contracts and swap rates – suggest that one year from now short-term rates should fall faster than longer dated yields. Since June, these

market-implied forward curves have maintained the same steepening bias but have shifted the yield curve slightly downwards following the recent weakening in US jobs data. That means that, compared with June, Treasury yields are now expected to be slightly lower in a year's time. With inflation still holding up and fiscal fragilities under the microscope, yields may not have much room

to fall in 2026, particularly those with longer maturities. In our view, that is what makes exposure to yield-curve steepening attractive relative to outright directional bets on duration. Uncertainty around the final destination of rates also supports the case for coupling fixed-rate bonds with floating-rate securities, which can pay regular income above prevailing cash rates.

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