

Bond markets steady as Fed stays on hold

Spread assets continued to outperform core rates year-to-date as the US Federal Reserve (Fed) once again held rates steady at 4.25-4.50%. This outcome was in line with market expectations, as was the European Central Bank's decision to stay on hold; however, Europe's central bank was responding to a different economic picture. Euro rates are already in neutral zone, inflation is at target, unemployment is low and economic activity indicators don't look too bad. In contrast, US rates remain far from their neutral range as the Fed assesses the impact of tariffs on inflation and economic activity.

The growth and inflation backdrop supports a patient policy approach. However, dissenting voices in the Federal Open Market Committee (FOMC) seem to be growing in number,

and there is mounting pressure from the Trump administration to cut rates. Going into the next FOMC meeting in mid-September (there is no policy meeting in August), bond markets are narrowly pricing two more rate cuts by year-end. Absent a major upside surprise in inflation, we see September or October in play for a resumption of rate cuts, especially if consumer demand and the job market soften more than expected.

From a strategy perspective, we think the current macro and policy environment continues to favour US yield-curve steepening, with the legislative approval of the "One Big Beautiful Bill" underscoring the longer-term fiscal challenges facing the US economy. We also think it's a good idea to build exposure to US Treasury Inflation-Protected Securities at the five- and 10-year part of the curve – reinflation risks, and attacks on the Fed's independence, should not be discounted. Due to these imbalances, for now we maintain a bearish stance on the US dollar.

In emerging markets, we still see local currency opportunities with attractive carry and credible monetary policy trajectories. We took advantage of

the recent US dollar rebound to rotate from short euro to short US dollar as the funding position for our long Turkish lira position. We also extended the bond maturity of our exposure to Egypt, which is looking to improve its macroeconomic scorecard to regain market interest and unlock funding from the International Monetary Fund. In Asia, we remain overweight in local rates, particularly Indonesia, Malaysia and the Philippines. In Asian credit, we have a slight preference for high yield over investment grade and are looking to add risk on the back of sentiment-driven selloffs.

Among other spread sectors, US and Euro corporate credit spreads look tight, but on average, solid company fundamentals, a benign default outlook and high all-in yields continue to make the asset class an attractive source of income. The primary issue calendar on both sides of the Atlantic has been busy, with deals seeing strong demand. We have participated in several new issues and took the opportunity to rotate out of expensive longer-dated credits. New issuance is also picking up in European commercial mortgage-backed securities, which can offer attractive spreads with investment-grade risk.



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The reporting season began with strong numbers from the US banks, driven primarily by higher trading volumes. US airlines reported a bounce in premium traffic, though this was not reflected in Europe where carriers had weaker numbers and guidance. Airlines are typically good indicators of economic activity, so these trends can be informative about the direction of growth. Another area of US-European divergence was the automotive sector, where US auto suppliers surprised to the upside while

European manufacturers posted weak numbers. We also saw weak guidance from the European chemical sector.

While the next US rate cut looks set to be the most highly anticipated event in the calendar, we think it should not be seen in isolation when thinking about positioning bond portfolios. In many ways, it's the cross-section of monetary, trade and fiscal policy that matters. At this stage, fiscal imbalances seem the most predictable insofar as they

are contributing to higher long-term yields. A more complicated question is how monetary and trade policy are influencing short-term rates. Tariffs risk simultaneously lifting inflation and slowing economic activity – a stagflation scenario. Yet the US trade deals struck with the EU and multiple trading partners in Asia, if they hold up, could help keep stagflation at bay. That could allow the Fed to resume its rate-cutting cycle – which should benefit both rates and credit markets.

Fixed income market performance

Indicative market indices Data as at 24 July 2025	Total return YTD 2025 (%)	Total return June 2025 (%)	Yield-to- worst* (%)	Effective duration (years)
Global convertible bonds	8.81	3.31	-1.8	1.5
Global emerging-market sovereign bonds	6.35	3.56	7.5	6.5
Asian high yield	5.07	2.77	9.4	2.5
US high yield	5.00	3.57	7.0	2.9
Asian investment grade	4.02	1.33	5.1	4.7
US investment grade	3.79	1.86	5.1	6.9
Euro high yield	3.65	1.80	5.2	2.7
US aggregate	3.40	0.81	4.7	6.1
US floating-rate notes	2.85	1.04	4.9	0.0
US Treasury bonds 1-3 years	2.77	0.38	3.9	1.6
Global aggregate	2.40	0.62	3.6	6.5
Euro investment grade	2.25	0.77	3.0	4.5
Euro government bonds 1-3 years	1.60	0.14	2.0	2.0
Global government bonds AAA-AA	1.08	-0.02	3.1	7.4
Euro aggregate	0.69	0.08	2.8	6.4

Source: Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors, data as at 24 July 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

US tariffs

The Trump administration announced a trade deal with the EU setting tariffs at 15% for EU goods including cars – less than the 30% originally planned. (There are some conditions, eg, the EU must spend billions on US fuel.) On 1 August new tariffs are expected to go into effect on other US trading partners that have yet to negotiate deals, such as Canada, Mexico, India and Korea. The Trump administration has warned there will be no more extensions, but that deals could be made even after the August deadline.

Earnings season

The earnings season is only beginning but the US has already seen more beats than misses, compared with analyst expectations. While the outlook may not be as strong as in January, it is better than the post-“Liberation Day” gloom that took hold in April. In Europe it’s a mixed bag so far, with the leisure sector continuing to do well while luxury goods, autos and chemicals feel the strain of uncertain tariffs. The situation could change if the announced US-EU trade deal holds up.

Automotive sector

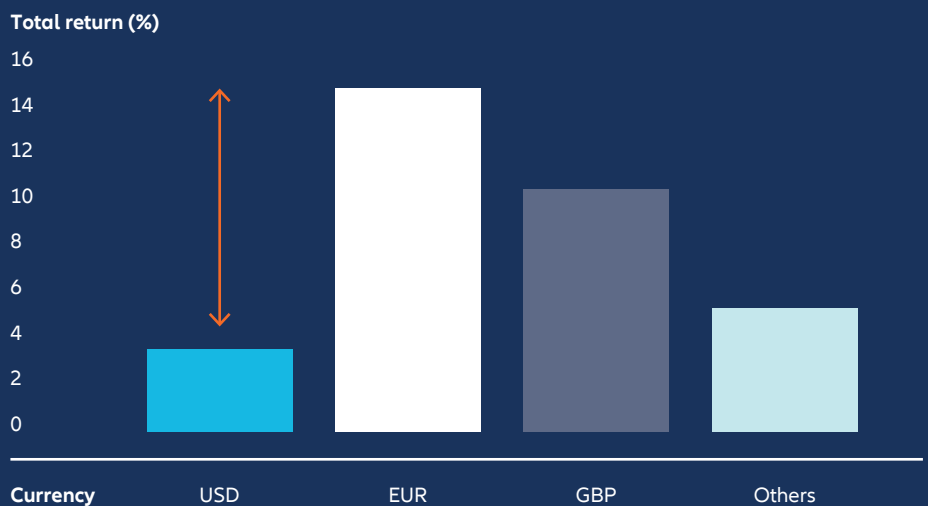
We have been cautious on the sector for several quarters. On top of the secular challenges of e-mobility and autonomous driving, the industry faces significant short-term risks. The most visible relate to tariffs, but even with accommodative trade deals on the horizon, we observe severe price competition in China, persistent supply chain instability (eg, rare earth elements), and regulatory uncertainty. Most carmakers’ credit metrics started to deteriorate in 2024, and we expect fundamentals to weaken further by year-end.



CHART OF THE MONTH

The second quarter of 2025 underscored a growing divergence in global bond market returns. Dollar-based fixed income portfolios, particularly those concentrated in US Treasuries, generated limited or negative returns. The Trump administration’s decision in April to implement a sweeping package of tariffs reignited fears of a global trade deceleration and triggered a repricing of risk in US markets. Foreign central banks and institutional investors reassessed their US allocations. These dynamics are visible in the US Treasury yield curve. The yield spread between seven-year and 30-year Treasury securities, which was 30 basis points at the start of the year, has grown considerably as investors now demand greater compensation for holding longer-dated US debt. In contrast, non-US sovereign debt has outperformed, aided by currency appreciation and accommodative

US debt has underperformed this year



monetary policies. A resumption of Fed rate cuts would benefit the front end of the US curve, whereas our underweight stance on the longer end remains a key conviction. We hold this position both on an outright basis and as a relative trade against other more stable or higher-yielding sovereign curves.

Sources: Bloomberg Global Aggregate Total Return Index Value – Unhedged USD; Allianz Global Investors, data as at 24 July 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.

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