

Bond markets go from strength to strength

Bond markets have gone from strength to strength following the August speech at Jackson Hole by US Federal Reserve Chair Jerome Powell. Largely received as a clear policy easing signal, Powell's speech seemed to suggest that the balance of risk had now shifted from inflation to employment and growth. We think the door is now open for more than one 25-basis-point cut in the near term from the current 4.25–4.5% range. However, there is still a chance tariffs and economic activity may lift inflation in the coming quarters. We believe those factors could set an "interim floor" for the Federal Funds rate around 3.75–4.0%.

Even though long-term rates fell after Mr Powell's speech, the US still faces the risk of persistently large



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fiscal deficits and higher term premia. That is likely to stop long-dated US Treasury bonds from outperforming shorter-dated maturities. We remain positioned to profit from sustained steepening of the US curve with a seven-year versus 30-year steepening position. Moreover, given the risk of supply constraints in US goods (via tariffs) and labour (via immigration), we also maintain an overweight stance on US Treasury Inflation Protected Securities (TIPS) at the five- and 10-year parts of the curve.

The recent resumption of US dollar weakness lends support to our bearish view on the greenback, taking into account potential currency realignment in markets with large trade and current account surpluses versus the US, as well as the risk that the independence of the US Federal Reserve (Fed) will come under further attack. The currencies likely to benefit most are from nations with large positive net international investment positions and sufficient fiscal space to adopt more expansive policies. We favour a short US dollar position funded with long positions in the euro, Korean won and Indonesian rupiah.

We expect greater fiscal orthodoxy in Europe compared with the US, hence we hold relative-value positions that anticipate the potential for very long-dated UK and Spanish government bonds to outperform their US Treasury equivalents. The picture at the front-end of yield curves is more complicated. A US-EU trade deal has put in question another imminent rate cut by the European Central Bank; President Christine Lagarde, who also spoke at Jackson Hole, gave away no clues. In August, the Bank of England narrowly voted to cut its key rate by 25 basis points to 4%, but stubborn inflation remains a challenge and may keep further rate cuts at bay.¹

Emerging markets may offer better risk-reward dynamics for outright duration exposure, as higher real interest rates (after inflation) give central banks in emerging economies more leeway to cut. We favour select local currency bond markets that also benefit from currency appreciation – in particular Brazil, South Africa and Romania. Emerging market hard currency bonds have also outperformed other major fixed-income asset classes so far this year. While spreads have narrowed, yields

¹ Bank Rate reduced to 4% - August 2025 (Bank of England website, 7 August 2025).

remain high compared with historical averages and other high-yielding spread assets.

In high yield corporate credit, Asia is ahead of the US and Euro markets year-to-date. As global investors reassess the concentration of risk in US assets, we believe Asia stands out as a compelling destination for diversification. We remain constructive on Asian US dollar credit and maintain overweight positions in India and Macau. The gaming sector in Macau is a highlight – July recorded the strongest gross monthly gaming

revenue since the Covid-19 pandemic. Through August, both the US and Euro high yield markets added to their July gains, but the US gained more after comparatively stronger second quarter earnings.

In investment grade credit, valuations appear historically rich. In August, US credit spreads tightened to their narrowest levels in 25 years (see Chart of the Month); however, they appear to be well supported by strong demand for still-elevated carry ahead of policy easing. We maintain a moderately overweight

credit allocation, leaning toward higher-quality tiers with a preference for senior financials and utilities over cyclical industrials.

Looking ahead, a low growth environment could spell trouble for very levered and cyclical businesses but should not be a showstopper for quality issuers that benefit from limited refinancing walls and robust fundamental metrics. The main risk to watch for, in our view, is stronger-than-expected growth coinciding with policy easing, which could push yields higher and refuel inflation.

Fixed income market performance

Indicative market indices Data as at 22 August 2025	Total return YTD 2025 (%)	Total return July 2025 (%)	Yield-to- worst* (%)	Effective duration (years)
Global convertible bonds	12.69	1.85	-2.1	1.5
Global emerging-market sovereign bonds	8.59	4.87	7.3	6.5
Asian high yield	6.52	4.23	9.2	2.5
US high yield	5.78	3.98	6.8	2.9
US investment grade	5.39	1.92	4.9	6.9
Asian investment grade	5.08	1.84	5.0	4.7
US aggregate	4.82	0.54	4.5	6.1
Euro high yield	4.07	3.00	5.0	2.8
US treasury bonds 1-3 years	3.53	0.31	3.7	1.6
US floating-rate notes	3.32	1.57	4.9	0.0
Global aggregate	3.17	0.54	3.5	6.5
Euro investment grade	2.40	1.28	3.1	4.5
Euro government bonds 1-3 years	1.74	0.15	2.0	2.0
Global government bonds AAA-AA	1.46	-0.18	3.1	7.4
Euro aggregate	0.77	0.09	2.8	6.3

Source: Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors, data as at 22 August 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 US inflation

The US personal consumption expenditures (PCE) price index for July showed a 2.6% increase in annual headline inflation, holding steady compared to June. However, the index rose by 2.9% (vs. 2.8% in June) when excluding food and energy. That still easily exceeds the Fed's 2% target and brings the US jobs report for August (due on 5 September) into even greater focus – as the Fed is likely to need another weak US payrolls reading to comfortably justify a rate cut.

2 Ukraine conflict

While the US-Russia summit in Alaska has yet to mark a turning point in the Ukraine conflict, the impact of a breakthrough could yet be significant. On the eve of the summit, Ukrainian hryvnia rallied strongly. If a durable ceasefire does materialise, and depending on the terms and conditions, there could be a positive spillover to other emerging markets. This could particularly benefit central and eastern Europe as well as industries linked to reconstruction.

3 Tariff deals

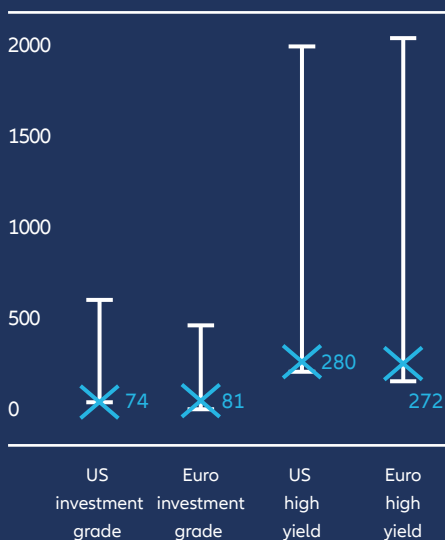
US tariffs on imports from India doubled at the end of August as there was no indication of an impending trade deal. The Trump administration continues to criticise the country for its purchase of Russian oil. Meanwhile, US and Canadian trade representatives are set to meet just days after Canada announced it would pull back some of its counter-tariffs on US goods. Another holdout is Brazil, which announced on 25 August it will buy several domestically produced food products hit by the 50% US tariff.



CHART OF THE MONTH

The march to tighter credit spreads continues

Option-adjusted spreads (basis points), 17 Sep 2002–22 Aug 2025. Chart shows current spreads (blue cross) against highest and lowest values for the period.



Credit spreads are historically tight, particularly for US credit, but demand for both investment grade and high yield bonds remains strong due to high all-in yields and the possibility of forthcoming rate cuts. US investment grade hit its tightest spread since 2002 this August (74 basis points) and remains in that vicinity. Euro spreads too are at the low end of their historical range. Across investment grade and high yield, spreads widened the most during the 2008 financial crisis, with high yield spreads reaching their tightest

on the eve of that crisis; however, this time round we don't see a credit crunch in the offing. Second-quarter earnings were generally solid, as are credit fundamentals overall. Demand continues to outstrip new bond supply. Nonetheless, the economic backdrop has weakened due to uncertainty around monetary, fiscal and trade policies. At this juncture, and with these compressed spread levels, we favour highly diversified credit strategies that focus on issuers with resilient balance sheets and business models.

Source: Bloomberg, ICE BofA indices; Allianz Global Investors, data as at 22 August 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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