

AEGON INSIGHTS

2025 Strategic Bonds Outlook

The macroeconomic outlook for the year ahead is expected to see growth moderating from current levels and inflationary pressures broadly under control. The range of outcomes though have broadened following the US election, with the policy agenda from the new administration still to be confirmed. The initial focus on trade tariffs has the potential to nudge US inflation higher initially but in turn act as a modest headwind to US growth. The growth impact on the rest of the world would be more clearly negative, creating a potential divergence in the macro-outlook between the US and Europe, China and beyond.

Rates outlook

The backdrop of low but positive growth and inflation will allow Central Banks to cut interest rates further in 2025 - this backdrop can provide support for Government bonds and rates markets but with a lower level of interest rate risk than was appropriate in 2024.

This environment is especially supportive for short-dated Government bonds given their more attractive relative valuation owing to flatness of the yield curve and the expectation of further Central Bank rate cuts. In addition, increased fiscal spending in the US and beyond could weigh more on longer-dated bonds, causing the curve to steepen.

The ongoing sluggishness of the European economy offers clear fundamental support for German Bunds as the ECB will be required to cut rates further and possibly by more than the market expects. This environment can also offer opportunities in Italian BTPs that benefit from low but positive growth and the lower interest rate backdrop.

The US Treasury market faces the risk of a more robust outlook for growth than other developed market economies and the prospect of trade tariffs adding upward risks to inflation. The back up in yields into the election and the reduced rate cut expectations, though, has already discounted some of these risks. While the range of economic outcomes in the US is increasing, the degree of upside in yields has reduced somewhat.



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Colin Finlayson, investment manager, is a member of the global rates and multi-sector portfolio management teams. He specialises in global government bonds, relative-value analysis, and asset allocation decision-making across the fixed income market. Colin is the co-manager of our absolute return and strategic bond strategies.



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The UK Gilt market benefits from a more attractive yield level than its German equivalent but with an economic outlook that is more mixed. While underlying growth is unexciting and inflation has fallen back to target, the impact of the latest budget on growth and inflation in the period ahead adds some uncertainty to how much the Bank of England will cut rates. Current interest rate levels look too high for the given economic outlook and would support the outlook for Gilts if inflationary pressures can be contained.

Elsewhere, the year ahead is also expected to offer attractive opportunities in Australian and New Zealand rates markets and also selectively in inflation linked bonds within core markets.

Credit outlook

Credit markets are starting the year with attractive all-in yields, tight credit spreads, supportive technical demand, and a decent fundamental backdrop. We anticipate that the demand for credit will continue to be strong in particular during the first half of the year. This is likely to push spreads even tighter in the first half of 2025 and we do not rule out new records. As we progress through the year, we anticipate further easing of global central bank interest rates to coincide with some moderation in growth owing to still restrictive monetary policy. The combination of lower all-in yields and the limited compensation for risk should gradually become more apparent as the year moves on. In our base case, this would lead to a gradual widening of credit spreads across the board, but with an all-in still positive total return environment for corporate bonds during 2025.

In investment grade credit, we see opportunities at the front end of the credit spectrum. Flat/inverted spread curves across dollar and euro, combined with attractive yield roll down makes us positive on this part of the curve. Globally, we favor European Investment Grade over US Investment Grade bonds on valuation grounds, as the risk/reward in particular for the higher quality – long-dated dollar Investment Grade corporate credit seems unattractive. The case for adding much spread duration is weak in High Yield too. Low starting overall spreads in this space may present a challenge to investors at some point in 2025. We think the asset class will be supported by still healthy all-in yields and decent company fundamentals. One major difference versus the past two years, in particular in European High Yield, will be the return of a net positive supply to the market. This, alongside challenging valuations, has the potential to impact the strong technical tailwinds for the sector over the past 24 months.

Sector-wise, the strong economic backdrop should continue to support banking fundamentals. We continue to also be supportive of selected parts of the European real estate market. On the flipside, we see little upside and plenty of risks in telecom/media as well as consumer cyclicals. These sectors are likely to exhibit an uptick in M&A as well as an impact from changes in consumer spendings, at tight valuations. Structurally, junior subordinated risk looks expensive to us here across financials and non-financials and we prefer more senior parts of the capital stack.



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