Fixed Income Quarterly Outlook, January

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Hello and welcome to the first video of the year on fixed income markets. In 2024, we have seen a lot of volatility in the fixed income markets, largely driven by changing expectations around central bank policies. While we have seen surprisingly strong resilience in global growth, inflationary pressures have remained sticky, especially in the first half of the year. We might be at a turning point of significant adjustment in policy rates globally, although there are strong differences between central banks in their approach and their timing.

In this video, I will summarise what happened in global Fixed Income markets over 2024 and I will share with you our perspectives for the coming year.

We have had mixed but overall positive returns in 2024 in the global fixed income markets. The higher-yielding fixed income asset classes performed well, and 10 Year government bond yields have been shifting to the upside while central banks have actually started to cut rates. The improving macro environment has mostly benefited lower credit-quality bonds, and we have, overall, seen a lot of dispersion within credit, both across sectors and across ratings.

Volatility remained high, and European rates outperformed U.S. rates, reflecting differing expectations for the Federal Reserve and ECB (European Central Bank) actions. We are, in the fixed income markets, more and more focusing on this decoupling between those main two areas. In 2024, central banks continued to navigate a delicate balance between controlling inflation and supporting economic growth. The ECB, after aggressive rate hikes over the past two years, began to adjust its policy stance in response to improving inflation dynamics and shifted to a dovish approach. While the U.S. Federal Reserve also stopped its rate hike cycle,

it opted to closely monitor the economic recovery, especially in light of persistent inflation in certain sectors. Overall, 2024 marked a transition year, with central banks pivoting from crisis-mode rate hikes to a data-dependent, flexible approach. 2024 proved to be another strong year for credit assets, delivering a total return of 4.7% for euro investment grade[1],and slightly lower for U.S. credit IG (investment grade). Sector dispersion was a defining theme of the year, with notable underperformance in sectors like Automotive and Retail, contrasted by strength in Financials and Real Estate, where fundamentals remained healthy or even improved. 2024 also marked a record for primary issuance, with €645 billion euros

[1] Source: AXA IM, Bloomberg as of 31st December 2024

issued in investment grade and nearly €100 billion euros in high yield for euro credit assets[2]. At the same time, the credit asset class saw significant inflows, showing investor confidence.

As 2025 begins, the outlook for the Eurozone remains nuanced. We see encouraging signals, such as inflation continuing to moderate and resilience in the labour market. However, recession risks remain, exacerbated by weakening industrial output and lingering geopolitical uncertainties. On the rates side, markets have shifted their focus beyond 2024 and into 2025, pricing in further monetary easing as central banks respond to weaker growth dynamics.

While markets anticipate the ECB to have largely completed its rate-cutting cycle by mid-2025, we expect a more data-dependent approach. In the European government bonds space, we expect the coming months to be loaded with heavy supply, bringing some negative technical factors. Also, the political uncertainty in major economies like France and Germany has narrowed the gap between core and peripheral eurozone countries, and we anticipate this trend to persist in the coming year.

In the credit markets, the picture for corporates in 2025 still appears supportive. Corporate balance sheets, while starting to feel the strain of prolonged tighter monetary conditions, remain generally robust. While we anticipate a modest rise in default rates as companies navigate tighter financial conditions, defaults are likely to remain manageable. Volatility will surely be a key element to watch, driven by higher political risks in Europe and a potential impact from imposed U.S. tariffs on Europe.

Let's look at a few strategies we believe are worth highlighting for investors. First, euro credit investment grade and high yield. For 2025, our scenario of low but still positive growth is supportive for the credit asset class. We expect European companies' credit metrics to stabilise and for technical factors to remain supportive. We know market volatility may persist, driven by fiscal uncertainties, geopolitical risks, and the evolving dynamics between central bank policies and economic stability.

The search for yield is likely to continue, and with lower risk-free rates to follow in 2025; as such, the all-in yields should continue to offer a compelling case for credit investors, with current levels at approximately 3.3% for investment grade and 5.3 % for high yield[2].

In 2025, flat or inverted yield curves across the board make short-duration strategies appealing, with a potential to benefit from central banks' cuts. With ongoing market volatility and strong fiscal concerns, short-duration strategies can provide a defensive positioning while still capturing attractive yields. We believe this approach remains well-adapted to navigate an environment of persistent macroeconomic uncertainty and tight credit spreads. Thank you for watching, see you soon.

Source: AXA IM as of January 2024

[2] Source: AXA IM, Bloomberg as of 31st December 2024