MFS®

Macro Talking Points

Fixed Income Insights

Week of 14 April 2025

Author

Benoit Anne
Senior Managing Director
Strategy and Insights Group

In brief

- **Signs of a confidence shock**
- **Rate volatility is back**
- **Where are the safe havens?**

Symptoms of a confidence shock. It is rather uncommon to see a triangular market correction where the treasury bond market, the equity market and the currency market of a given country all sell off at the same time. But it happens on occasion. Historically, this unusual phenomenon has mainly been observed in emerging markets such as when financial crises in Brazil and Turkey broke out back in the 1990s and 2000s. This is not purely an EM phenomenon, however. We all probably remember the UK mini financial crisis episode of October 2022. At the time, investors lost confidence in the ability of the government to run the country's financial affairs in a credible way, which led to the swift resignation of the prime minister. Fast forward a couple of years, and we see signs that global investor confidence towards USD-denominated assets has been meaningfully dented. The US dollar is down, Treasury prices are down and the US equity market is down. What do all these market events, in EM or in DM, have in common? To put it bluntly, a policy credibility shock. Policy credibility matters and no country is above this basic market law, not even the United States, it seems. In our view, the most concerning signal is coming from the UST market. While the deteriorating macro fundamentals should in principle have pushed bond yields lower, the opposite is happening. Why? Perhaps because the UST market may have lost — at least temporarily — some of its legendary defensive characteristics. In the face of higher risk aversion, UST do not currently seem to offer the protection that they used to, hence leading to upward pressure on yields. To be clear, it is still too early to tell if this confidence shock is going to persist for a long time. Given the extreme level of policy uncertainty, the market backdrop can radically change in relatively short order. But for now, this unusual market regime entails some major implications. For a start, the correlation between bonds and equity seems to be rising again, which, if sustained, is going to undermine the role of fixed income as a portfolio diversifier. Meanwhile, US market rates are rising, but for the wrong reasons: It has nothing to do with an improved macro environment and everything to do with the repricing of sovereign risk. On the currency front, something unusual is also going on. The interest rate differential between the US and Europe has gone up substantially, a development that traditionally would trigger a strongly bullish signal for the USD, but currency markets no longer care about interest rate dynamics. The euro is up, the dollar is down. Finally, there seem to be global asset allocation shifts, with investors looking at diversifying away from the US and looking at Europe and the rest of the world as more attractive places to invest. Overall, the market backdrop is quite challenging these days, which reinforces the case for active management. Caution towards risky assets is warranted in the near term, given this US triangular correction risk and what it means.

FOR INSTITUTIONAL AND INVESTMENT PROFESSIONAL USE ONLY

MOVING the wrong way. Market volatility has made a big comeback. This is particularly true for the equity market, but rate volatility has not been spared either. The MOVE index is back to around 138, its highest level since October 2023, an important development for fixed income.[1] Indeed, the higher the rate volatility, the lower the conviction on duration. In other words, duration is unlikely to be a major driver of total return if elevated rate volatility persists in the period ahead. Prudence is warranted when it comes to the rate view given the significant uncertainty. There are many opposing forces. In the category of market pressures that should push rates down, we find the downside risks to growth in the face of the potential tariff shock as well as higher expectations for future US Federal Reserve rate cuts. Meanwhile, the resurfacing of inflation risks, an upward shift in inflation expectations and poor UST market technicals are all pushing in the opposite direction. Overall, we believe that fixed income managers that heavily rely on duration in order to generate excess returns are likely to face significant challenges in the period ahead. Given the rate volatility landscape, alpha arising from security selection is likely to be less unpredictable.

Safe Havens Can't Wait. It is fair to say that global markets have been quite turbulent since the so-called "Liberation Day." The risk appetite picture changes quickly in the face of elevated volatility. So which global assets played the role of safe haven during the recent market turbulence? As underscored above, definitely not the US Treasury market, whose index lost 1.52% since April 1.[2] The bund index, in comparison, did much better, with a EUR-denominated gain of 1.34% during the same period — and considerably more in USD terms.[3] Given current market dynamics, the outperformers in global fixed income are likely going to be found in the asset classes that display low duration and low credit risks, together with low correlation with the US, such as the Global Agg index, with a positive return of 0.83%.[4] EUR investment grade also displayed strong resilience, with just marginally negative return (-0.20%).[5] Meanwhile, it is also worth pointing that EM local debt performed strongly during that period, helped by the weaker dollar. The EM local debt index produced a return of 0.72%.[6] Away from fixed income, some currencies strongly benefited from the broad dollar weakness. The Swiss franc has risen almost 8% since April 1, reaffirming its status as a defensive asset. Gold gained about 3.5% during this time. Looking ahead, we need to see strong signals that tariff relief will be put in place or evidence that the US government is shifting its policy focus to growth-supporting measures before the risk backdrop will recover in a sustainable way. ◢

Endnotes

[1] Source: Bloomberg. Bloomberg UST index. Returns are gross and in USD. Data as of 11 April 2025.

[2] Source: Bloomberg. Bloomberg Bund index. Returns are gross and in EUR. Data as of 11 April 2025.

[3] Source: Bloomberg. Bloomberg Global Agg index. Returns are gross and in USD. Data as of 11 April 2025.

[4] Source: Bloomberg. Bloomberg pan-European IG credit index. Returns are gross and in EUR. Data as of 11 April 2025.

[5] Source: Bloomberg, JP Morgan. JP Morgan GBI-EM Diversified index. Returns are gross and in USD. Data as of 11 April 2025.

[6] Source: Bloomberg, JP Morgan. JP Morgan GBI-EM Diversified index. Returns are gross and in USD. Data as of 11 April 2025.

FOR INSTITUTIONAL AND INVESTMENT PROFESSIONAL USE ONLY

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg neither approves or endorses this material or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

The views expressed herein are those of the MFS Strategy and Insights Group within the MFS distribution unit and may differ from those of MFS portfolio managers and research analysts. These views are subject to change at any time and should not be construed as the Advisor's investment advice, as securities recommendations, or as an indication of trading intent on behalf of MFS. No forecasts can be guaranteed.

Diversification does not guarantee a profit or protect against a loss. Past performance is no guarantee of future results.

GLOBAL DISCLOSURE

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by:

U.S. – MFS Institutional Advisors, Inc. ("MFSI"), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited.; **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited ("MIL UK"), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER.; **Note to Europe (ex UK and Switzerland) readers**: Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore –** MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand –** MFS International Australia Pty Ltd ("MFS Australia") (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong –** MFS International (Hong Kong) Limited ("MIL HK"), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the "SFC"). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to "professional investors" as defined in the Securities and Futures Ordinance ("SFO").; **For Professional Investors in China –** MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan –** MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments. **For readers in Saudi Arabia, Kuwait, Oman, and UAE (excluding the DIFC and ADGM). In Qatar strictly for sophisticated investors and high net worth individuals only. In Bahrain, for sophisticated institutions only:** The information contained in this document is intended strictly for professional investors. The information contained in this document, does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Whilst great care has been taken to ensure that the information contained in this document is accurate, no responsibility can be accepted for any errors, mistakes or omissions or for any action taken in reliance thereon. You may only reproduce, circulate and use this document (or any part of it) with the consent of MFS international U.K. Ltd ("MIL UK"). The information contained in this document is for information purposes only. It is not intended for and should not be distributed to, or relied upon by, members of the public. The information contained in this document, may contain statements that are not purely historical in nature but are "forward-looking statements". These include, amongst other things, projections, forecasts or estimates of income. These forward-looking statements are based upon certain assumptions, some of which are described in other relevant documents or materials. If you do not understand the contents of this document, you should consult an authorised financial adviser. Please note that any materials sent by the issuer (MIL UK) have been sent electronically from offshore. **South Africa –** This document, and the information contained is not intended and does not constitute, a public offer of securities in South Africa and accordingly should not be construed as such. This document is not for general circulation to the public in South Africa. This document has not been approved by the Financial Sector Conduct Authority and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.