Fixed Income Insights

Macro Talking Points

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In brief

- **The tariff announcement and its impact on fixed income**
- **Fixed income as a compelling de-risking asset class**
- **The maturity wall is not a major risk for HY**

Trumpilocks' left tail risks. There's a new macro regime that has replaced Goldilocks, one Market Insights has dubbed Trumpilocks. Trumpilocks remains a broadly positive regime for risky assets, but it's also characterized by significant macro volatility and a wider range of risks, including the risk of a trade war and greater policy uncertainty. It's the latter that's currently catching investor attention, following the announcement from the White House that 25% tariffs would be imposed this week on Canada and Mexico as well as 10% tariffs on China. As it turns out, both Canada and Mexico subsequently managed to negotiate an implementation delay with the White House, but the tariffs on China have come into force. Regarding the latter, the new tariffs are casting a much broader net that includes small retail activities — which means that the US consumer is no longer shielded from the tariff action — and, in practice, leads to a doubling of existing tariff rates. To be clear, even with the implementation delay, the Trump 2.0 tariff action is a lot punchier than under Trump 1.0 given the larger scale, scope and speed of implementation, with the President using emergency powers. China in turn has announced a number of retaliation measures, which means that the risk of escalation is material. Looking ahead, there is a possibility that the tariff order may be challenged in the US courts due to the President's use of emergency powers under the International Economic Emergency Powers Act (IEEPA). In terms of market impact, it's clear that the risk of a trade war had not been fully priced in. One of the more pronounced market transmission channels has been the currency markets, which have experienced significant volatility over the past few days. After initially suffering severe losses, the Canadian dollar and the Mexican peso have since recovered, a result of the negotiated implementation delay. More generally, the tariff announcement initially caused a risk aversion shock that hurt risky assets. In terms of the implications for fixed income, starting with the United States, the potential implementation of tariffs is likely to further reduce the US Federal Reserve's room to ease policy going forward, given the potential one-off adjustment of US domestic price levels. As a result, it is likely that front-end rates will move higher, thereby triggering some curve flattening. In addition, the cost of energy in the US is likely to go up, which tends to be reflected in higher break-even inflation, as a market signal that investors are ready to price in a rise in inflation risk. Moving on to Canada, if the tariff risk becomes reality, it should ultimately lead the Bank of Canada to consider further easing. Our Canada fixed income portfolio manager Soami Kohly holds a high-conviction view that the local curve will continue to steepen in the period ahead. On the EM front, the strong dollar will likely continue to act as a headwind even though tariffs are unlikely to have a significant adverse impact on EM sovereign creditworthiness. Overall, we anticipate that the tariff risk will reinforce the market theme of the great bifurcation, with the US looking very different from the rest of the world. It also looks like macro volatility is bound to remain elevated, which ultimately strengthens the case for an active management approach. For now, investors are back in headline-watching mode in the face of elevated policy uncertainty.

A compelling de-risking asset class. In the face of elevated macro volatility, there is probably a need to de-risk multi-asset portfolios, especially given the challenging valuation landscape in many pockets of global equity markets. Market developments over the past couple of weeks — DeepSeek and tariffs — are a case in point. While it is true that equity markets have performed quite well, a basic risk management approach would suggest that now may be a time to reassess portfolio risk exposure. That is where fixed income comes in as an attractive strategic asset class. Fixed income risk-adjusted returns are competitive given the historical levels of total yields, while the asset class also displays interesting defensive attributes. From a long-term perspective, duration, even in the US, looks attractive, even though the tactical case for being long US duration has become more challenging. The case for fixed income is even stronger outside of the US. In Europe for instance, there are strong arguments in favor of both a tactical and strategic exposure to European fixed income. One interesting market theme has been the significant monetary policy divergence, not more obvious than last week when the Fed hit the pause button, while other central banks — the ECB included — went ahead with rate cuts. Our head of developed market sovereign research Peter Goves continues to hold a high-conviction call to be long duration in Europe. Levels need monitoring given the scale of recent moves, but the potential threat of tariffs being extended to the region makes that call even more relevant.

Where is the wall? A number of clients in Continental Europe inquired about the topic of the HY maturity wall last week. After all, higher for longer, which has made a big comeback as a market theme, could be a source of potential refinancing headaches for the non-investment grade universe. However, the numbers are rather reassuring. In the US, it's not until 2028 and 2029 that the volume of maturities falling due peaks, which leaves us with a couple of years of cushion. In addition, when comparing the current yield on the high-yield index with the weighted average fixed coupon at which these debt obligations were issued, the gap is not that big. In other words, if US HY issuers had to fully roll over their existing debt, the refinancing cost does not look insurmountable. Given the strength of the macro backdrop and asset class fundamentals, it is possible that the financing needs of the HY sector may have declined compared with a few years ago. Meanwhile in Europe, refinancing risk seems to be a bit more front-loaded, with 2026 and 2027 showing sizeable maturities falling due. However, the ECB easing in the pipeline is likely to help alleviate some of the potential refinancing pain. Overall, it appears that HY refinancing risks, excluding some idiosyncratic stories, do not constitute a major challenge for the asset class at present.

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