In Credit

29 September 2025

Wind of change

As Germany passes its budget, the country is spearheading a new – possibly permanent – era of defence spending by NATO countries. Elsewhere, US and UK government bond yields crept higher. Read on for a breakdown of fixed income news across sectors and regions.

Chart of the Week

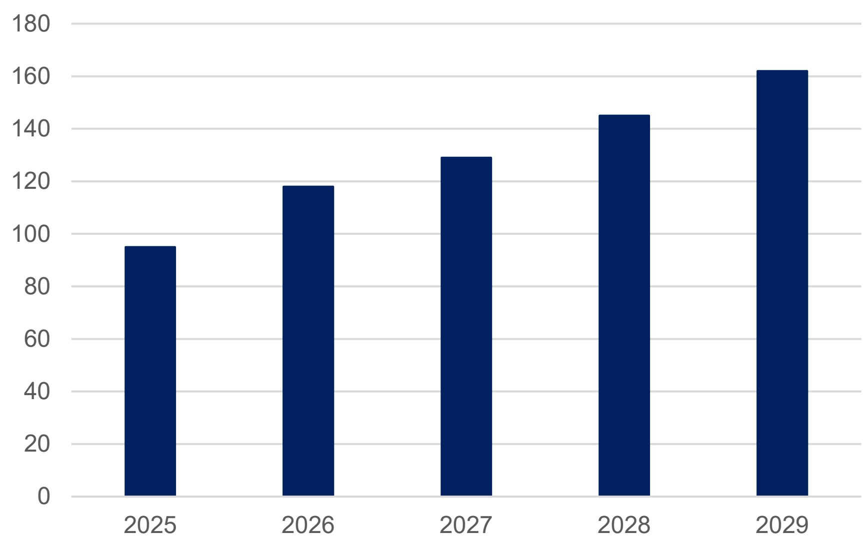
Gary Smith,
Head of Client Portfolio Management team, Fixed Income, EMEA

The German rock band Scorpions recorded their iconic track Wind of Change in 1990. It was inspired by optimism that enmity between communist and capitalist blocs was over and will always be associated with the collapse of the Berlin Wall.

Earlier this year, the German 'debt brake', in place since 2009, was amended to exclude defence spending (as well as a new special fund for infrastructure and climate projects), and last week the German parliament passed a budget that foresees defence-related spending rising to 2.8% of GDP this year, before reaching 5% of GDP in 2029.

The need for catch-up spending by NATO countries reflects the reality of a new wind of change, which signals a (probable) permanent shift higher in such spending. The outlook for long-term investors has become more complex and volatile and will be an era that, we believe, argues for an active approach to investment management.

German government forecasted defence spending (€ billion)



Source: German Government, September 2025

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.14%	1 bps	1.3%	5.2%
German Bund 10 year	2.72%	-3 bps	-0.6%	-1.2%
UK Gilt 10 year	4.71%	-1 bps	-1.1%	1.3%
Japan 10 year	1.64%	0 bps	-1.5%	-4.1%
Global Investment Grade	76 bps	1 bps	1.8%	5.3%
Euro Investment Grade	77 bps	1 bps	0.8%	2.6%
US Investment Grade	75 bps	1 bps	2.4%	6.7%
UK Investment Grade	66 bps	-3 bps	0.5%	3.9%
Asia Investment Grade	122 bps	-2 bps	2.4%	6.3%
Euro High Yield	291 bps	5 bps	1.9%	4.8%
US High Yield	275 bps	3 bps	2.3%	6.9%
Asia High Yield	460 bps	5 bps	4.3%	7.9%
EM Sovereign	256 bps	-10 bps	4.4%	10.1%
EM Local	5.9%	5 bps	2.5%	15.0%
EM Corporate	233 bps	-5 bps	3.2%	7.3%
Bloomberg Barclays US Munis	3.7%	11 bps	2.9%	2.5%
Taxable Munis	4.9%	5 bps	2.4%	6.1%
Bloomberg Barclays US MBS	29 bps	0 bps	2.3%	6.6%
Bloomberg Commodity Index	262.28	2.1%	4.1%	9.8%
EUR	1.1718	-0.4%	-0.7%	13.0%
JPY	148.64	-1.0%	-3.7%	5.2%
GBP	1.3431	-0.5%	-2.4%	7.1%

Source: Bloomberg, ICE Indices, as of 26 September 2025. *QTD denotes returns from 30 June 2025.

Macro/government bonds

Simon Roberts
Product Specialist, Global Rates

Last week saw a further small rise in yields in the US and the UK. The US 10-year rose 5bps to 4.18%, while the UK 10-year moved 3bps higher to 4.75%. The main trigger was stronger than expected Q2 US GDP, which grew at an annualised rate of 3.8%, exceeding market expectations of 3.3%. The GDP report overshadowed PMI survey data, which pointed to slowing growth momentum and softening demand in the current quarter. Core PCE data came in at 0.2% for August. The relatively restrained inflation report tempered the upwards shift in yields.

The messaging from US policy makers was mixed, ranging from concerns over inflation to the state of the weakening labour market. The lack of coherence around messaging highlighted the current tension between the dual goals of the Federal Reserve's mandate: full employment and 2% inflation.

Although global factors shaped the upward path for rates in the UK, domestic factors were also at play: Keir Starmer's position as prime minister came under pressure from the mayor of Manchester, Andy Burnham, who has called for more expansionary fiscal policies. The prospect of a leadership change at a time when UK finances are already challenged exerted upward pressure on gilt yields.

In the eurozone, limited yield movement in the bond market reflected continuing efforts by European Central Bank policymakers to drive home the message that interest rates are close to the bottom of the cutting cycle. The market sees little likelihood of a further cut to eurozone rates over the next 12 months.

Positioning We remain constructive on duration and yield curve steepening strategies in the eurozone and the US, although we have reduced the scale of these positions in recent weeks. We also established a yield curve flattening position in Japan to reflect the recent cheapening in valuations at the long end, alongside the prospect of reduced long-end issuance.

Investment grade credit

Charlotte Finch,
Client Portfolio Manager, Investment Grade Credit

Investment grade credit spreads were mixed last week, albeit by small amounts. UK IG outperformed, tightening 3bps over the week to 66bps, a level not seen for more than a decade. Meanwhile, US, European and global spreads widened by 1bps.

In corporate news, Banca Monte dei Paschi di Siena SpA now has a majority share (86.3%) in fellow Italian bank Mediobanca SpA, following a €17+ million deal. The combined entity will become the third largest Italian lender by assets. The acquisition saw the resignations of CEO Alberto Nagel, who served 17 years, as well as all but one members of the board. A new board will be put in place by the end of October by Monte dei Paschi.

Elsewhere, London's Gatwick airport was given the go-ahead for a second runway costing £2.2 billion. Transport secretary, Heidi Alexander, announced the approval, with Gatwick estimating that an extra 80 million passengers will pass through the airport annually due to the additional 100,000 flights.

US high yield credit and leveraged loans

Chris Jorel,
Client Portfolio Manager, US High Yield

US high yield bond valuations remained stable over the week as the market absorbed significant new issuance activity, modest fund outflows and supportive economic data. The US high yield new issue market priced more than $18 billion of new bonds over the week, leaving September on track to be the busiest month of capital market activity since May 2021. The ICE BofA US HY CP Constrained Index returned -0.25% and spreads widened 4bps. The index yield-to-worst increased 10bps to 6.67%. According to Lipper, US high yield bond retail funds saw a $365 million outflow for the week, which follows consecutive weekly inflows.

US leveraged loan prices were stable, with modest fund inflows and resilient macro data. The S&P UBS Leveraged Loan index average price declined slightly to $96.5. Floating rate funds saw a $162 million inflow over the week.

European high yield credit

Angelina Chueh,
Client Portfolio Manager, European High Yield

European high yield had a flat week following an especially heavy primary market. This was also true within the credit rating buckets, as the market and the individual ratings all returned from -0.01% to -0.04%. CCCs remain the biggest underperformer. Spreads rose +5 bps to 291bps, while yields rose +4 bps to 5.76%. The EHY primary market saw 11 deals launched, all coming 50bps-60 bps inside initial price talk, with some deals upsizing. The total market size was around €7 billion. Stable flows into EHY continued, with €154 million last week, but once again it was strictly via managed accounts with ETFs remaining sidelined. This takes the year-to-date net inflows to €7.8 billion.

In auto news, Jaguar Land Rover (JLR) announced that production restart has been postponed to 1 November and the company had not signed its cyberattack insurance so is not covered for the hacking. The delayed reopening does not bode well for the manufacturer and is also damaging to suppliers, especially the smaller ones. A news article claimed the UK government could buy the auto suppliers parts usually bought by JLR, before selling them on to JLR when the business is back up and running. By the end of the week the government announced a £1.5 billion loan that would be repaid in five years to help payments to suppliers. Separately, Tata Motors, the parent company, is raising £2 billion of support from global banks to help ease the financial strain.

In sector news, Donald Trump's tariff on pharmaceutical firms (+100% except for those who are building US-based facilities) is expected to have a greater impact on companies in Asia given the focus on generic drug production in that part of the world.

Asian credit

Justin Ong,
Research Analyst, Asian Fixed Income

The JACI index delivered a small 9bps loss over the past week, evenly split between wider spreads and higher rates. Emerging market (EM) bond flows experienced another strong week, with retail inflows rising to US$1.3 billion from $870 million the previous week. Approximately 53% of EM bond flows last week were denominated in local currencies.

China has confirmed the dates for its Fourth Plenum this month (20-23 October). The meeting is expected to outline China's next Five-Year Plan (2026-2030). Key areas will include technology and self-sufficiency initiatives, measures to support domestic consumption, and strategies to increase household contribution as a share of GDP. On the social development front, emphasis will likely focus on improving social safety nets and healthcare coverage. The plenum will be held a week before the Asia-Pacific Economic Cooperation (APEC) meeting in South Korea, where US president Donald Trump and China president Xi are also scheduled to meet.

Following preliminary trade deals agreed between the US and South Korea and Japan several months ago, South Korea has clarified that its $350 billion investment pledge is not in cash, in response to comments from Trump about the upfront nature of such investments. South Korea views the investment as comprising loans, guarantees or equity. Several issues remain unresolved, including project selection, fund control, profit distribution and safeguards.

New World Development, a Hong Kong property developer currently facing financial distress, has strengthened its short-term liquidity position. The company agreed a HKD3.95 billion facility with Deutsche Bank secured against Victoria Dockside in Kowloon. The company's cash coverage over short-term debt improved to approximately 3.9x as of June 2025, up from around 0.7x in December 2024. This followed a HKD88 billion refinancing in June. However, underlying operating results remain weak due to its exposure to property projects in mainland China. The company said it has no plans for rights issues or equity placements, and additional capital injection by the family shareholder is not imminent.

Issuance The primary market will be active this week. Among sovereigns, both Egypt and Kuwait are conducting investor calls, and in the corporate sector mining company Vedanta is looking to issue a seven-year bond to refinance private debt.

Emerging markets

Priyanka Prasher,
Product Specialist, Emerging Market Debt

Emerging market (EM) sovereigns returned +0.31% last week, with spreads tightening almost -9bps. High yield credits substantially outperformed investment grade (+0.70% versus -0.07%) as high-beta credits rallied, particularly in Latin America. Local currency assets underperformed on the week (-0.67% in US dollar terms) as a result of dollar strengthening.

Argentina was last week's biggest outperformer, returning +17.27% after US Treasury Secretary, Scott Bessent, unexpectedly pledged a financial lifeline for the government. The US announced plans to extend a $20 billion swap line to Argentina and buy the nation's dollar bonds. Markets perceived this as a show of support to Argentine president, Javier Milei, ahead of October's crucial midterm elections. Following the announcement, Argentina's central bank slashed its one-day peso repo rate, prompting the Argentine peso to rally before reaching previous levels. The bond market echoed this move.

US verbal intervention in the Russia-Ukraine conflict continued last week. President Donald Trump urged Turkey's president, Recep Tayyip Erdoğan, to curb energy imports from Russia, which is currently Turkey's largest energy provider. Spreads on Ukraine's 10-year bonds compressed by -59bps over the week (-5.44%) as momentum continued to build behind Europe's plan to channel financing to Ukraine using frozen Russian assets.

Coming up China's 'Golden Week' will commence and the nation's new Five-Year Plan will be revealed. Elections will be held in Moldova and the Czech Republic. Central bank policy decisions will be made in Colombia and India.

Responsible investment

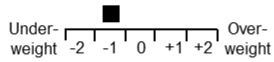
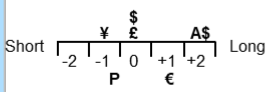
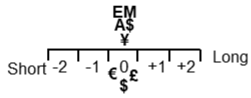
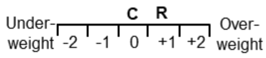
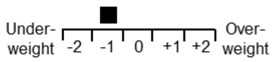
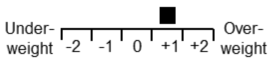
Charlotte Finch,
Client Portfolio Manager, Investment Grade Credit

Danish energy company Orsted was given the go ahead from US courts to continue work on its offshore wind farm near Rhode Island. The project, which is 80% complete, has been subject to stop-work order since 22 August. It will still face the White House in a lawsuit aimed at permanently halting construction. Orsted claims it is in the public's best interest to complete the wind farm, as the longer it is left unfinished the more damage could occur. President Trump is very much in favour of not having offshore wind farms, claiming the turbines 'kill birds, cause cancer and drive the whales crazy'.

Last week, China announced underwhelming plans to cut greenhouse gas emissions by 7%-10% by 2035. Some environmental groups estimate the reality of the decarbonisation will be higher than this (ie better), especially with an additional pledge to increase renewable energy capacity. Oddly, a baseline year to compare against has not been specified, and emissions will instead be linked to when they peaked, which looks to be 2024.

Fixed Income Asset Allocation Views

29th September 2025

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk		▪ Spreads are historically tight across nearly all sectors. Investor demand post-tariff volatility has been robust as balance sheets of borrowers remain strong. However, current valuations leave limited upside to returns in most credit sectors. ▪ The group discussed relative value across sectors that should fare better if the labor market in the US continues to deteriorate, while acknowledging that the creditworthiness of many issuers has become less influence by economic growth. ▪ **The group maintained a moderately underweight view on credit risk, with no changes in views since last month.**	▪ Upside risks: the Fed achieves a soft landing with no labour softening; lower quality credit outlook improves as refinancing concerns ease; consumer retains strength; end to Global wars ▪ Downside risks: Fed is not done hiking and unemployment rises, or the Fed pivots too early and inflation spikes. Restrictive policy leads to European recession. China property meltdown leads to financial crisis. 2024 elections create significant market volatility.
Duration (10-year) ('P' = Periphery)		▪ Longer yields to be captured by long-run structural downtrends in real yields ▪ Inflation likely to normalize over medium term, although some areas will see persistent pricing pressures ▪ As markets have reduced the amount of cuts expected by the FED in 2025, we have used the back- up in yields to go long US duration	▪ Inflationary dynamics become structurally persistent ▪ Labour supply shortage persists; wage pressure becomes broad and sustained ▪ Fiscal expansion requires wider term premium ▪ Long run trend in safe asset demand reverses
Currency ('E' = European Economic Area)		▪ Dollar has been supported by US growth exceptionalism and depricing of the Fed while the ECB looks set to embark on a cutting cycle. ▪ Dollar likely to continue to be supported into year end, where a Trump presidency looks most likely, and with it a return to tariffs and America First policy.	▪ Central banks need to keep rates at terminal for much longer than market prices, to the detriment of risk and growth and to the benefit of the Dollar
Emerging Markets Local (rates (R) and currency (C))		▪ US weakness can enable EM currency performance. ▪ Inflation normalisation and currency strength allows EM central banks to stimulate domestic demand. ▪ Risk premium to leak out of local bond curves.	▪ Global risk aversion restores bid for US dollar. ▪ Weaker oil environment requires fiscal premium among exporters ▪ Higher global term premium.
Emerging Markets Sovereign Credit (USD denominated)		▪ Even after good performance, Emerging Markets offer a somewhat unique set of risks relative to other sectors. In addition, spreads are not as historically tight despite stellar performance. ▪ EM High Yield and local currency bonds provide more value than EM Investment Grade, though this varies on an issuer-by-issuer basis. ▪ The expected headwinds from tariffs have been more issuer specific, especially because broad weakening of the US dollar has eased EM financial conditions.	▪ US trade policy aggression strengthens USD against EM currencies. ▪ EM policy makers constrained by currency pressure; rates remain tight. ▪ Fiscal concerns leak into local risk premia.
Investment Grade Credit		▪ Spreads are as tight as they have been since before the 1998 Asian Financial Crisis. ▪ Demand has remained strong despite spread, as a function of the high all-in yield. ▪ This is especially true for long maturity Investment Grade. ▪ The group discussed that the AI infrastructure build out will increasingly be funded via debt instead of equity, as many of the large tech issuers will no longer be able to use retained earnings to do so.	▪ Tighter financial conditions lead to European slowdown, corporate impact. ▪ Lending standards continue tightening, even after Fed pauses hiking cycle. ▪ Rate environment remains volatile. ▪ Consumer profile deteriorates. ▪ Geopolitical conflicts worsen operating environment globally.
High Yield Bonds and Bank Loans		▪ The group has reduced some of the risk that they added during April's dramatic spread widening. The group remains cautious on the sector because current rich valuations are hard to square with weaker fundamental outlook. ▪ Most companies continue to report solid earnings and financials. However, companies that report weak earnings are being increasingly punished in financial markets. ▪ Despite the negative outlook on the sector, the group still sees pockets of good opportunity, especially in higher quality issuers.	▪ Lending standards continue tightening, increasing the cost of funding. ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rally in distressed credits, leads to relative underperformance ▪ Volatility in the short end of the curve, eroding potential upside where we are positioned for carry.
Agency MBS		▪ Spreads remain wide relative to other high-quality sectors ▪ The group remains positive on Agency MBS because the carry and convexity are still attractive, and pre-payment risk is low because of the elevated mortgage rates. ▪ As the group reduces credit risk, they are reinvesting that allocation in Agency MBS. ▪ Prefer call-protected inverse IO and Agency Floaters, a large beneficiary of aggressive cutting cycle.	▪ Lending standards continue tightening even after Fed pauses hiking cycle. ▪ Fed fully liquidates position. ▪ Market volatility erodes value from carrying. ▪ More regional bank turmoil leads to lower coupons to underperform.
Structured Credit Non-Agency MBS & CMBS		▪ The group maintains a large allocation of high-quality carry positions. ▪ RMBS: Spreads have tightened but are still wide of longer-term medians. Delinquencies remain low. ▪ CMBS: Stress continues with the highest delinquencies in office, but multi-family is increasing. New issue is plentiful, but valuations are unattractive & underwriting is weak. ▪ CLOs: AAAs are attractive for a defensive high-quality credit option but are nonetheless fairly tight. Extra spread compensation for taking on more credit risk is low. ▪ ABS: The group prefers higher quality, liquid securities. Fundamentals have deteriorated (60+ delinquencies are elevated, debt service ratios worsening) but not to a degree to affect bond performance, especially higher-quality tranches.	▪ Weakness in labour market ▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening. Consumer (retail/travel) behaviour fails to return to pre-covid levels ▪ Student loan repayments weaken consumer profile more than anticipated, affecting spreads on a secular level. ▪ High interest rates turn home prices negative, punishing housing market ▪ Cross sector contagion from CRE weakness.

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