Investment Institute *Asset Class Views*

Monthly Investment Viewpoint

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KEY INVESTMENT THEMES

Bond income returns potentially higher in 2025

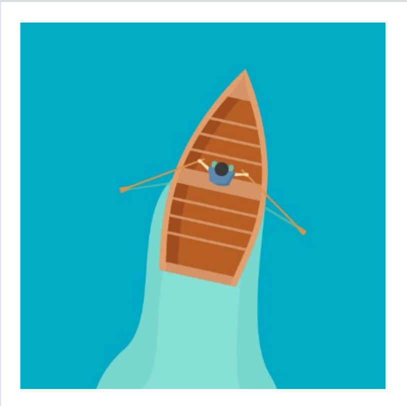
Confidence in US growth should sustain performance

Asia's economy has become increasingly challenging

Steady income should not be overlooked

Many bond investors have been enjoying higher income returns as the average rates (coupons) being paid on bond indices has been rising since 2021 and are likely to continue to do so as lower coupon bonds issued before 2021 mature. Over the past decade, the compound income return from a typical US dollar investment-grade index has been around 4%; in Europe, it has been just over 2%. For US dollar high yield, it has been close to 6.5%. Given the rise in average coupons, income returns should potentially be higher going forward. But bond prices can be volatile. To manage this, investors may choose strategies with less price and interest rate risk – like short-duration bonds. But overall, we believe - given the broad increase in yields – that income levels are becoming more attractive. With uncertainty surrounding the economic outlook, steady income returns should not be overlooked.

European government bonds: Liquidity-driven valuations



Investors might have noticed the rather large swing in valuations of German government bonds (Bunds) relative to interest rate swaps – an agreement to exchange one stream of future interest payments for another - in the post-COVID-19 period. Between 2020 and 2022, Bunds became relatively more expensive. Since then, they have cheapened; Bund yields have risen by 100 basis points relative to swaps.

Post-pandemic government bond buying impacted the perceived scarcity of funds, thus raising liquidity concerns for Europe's benchmark bond and pushing relative valuations to extreme levels. Similarly, the European Central Bank's decision to dial back its unconventional monetary policy from July 2022 put a lid on the liquidity spectre. As with some other European government bonds today, the relative cheapness of Bunds may tempt relative value investors, although political and fiscal concerns will remain.

Region in waiting

Asia's economic environment has become increasingly challenging from a growth, monetary policy, and currency perspective. US monetary policy and the greenback strength are among the main challenges, with the US trade policy as the primary threat. While inflation eased in most Asian economies in 2024, the average remains above most central bank targets. The Federal Reserve's (Fed) policy path remains critical as it could intensify capital outflows from countries that ease rates too aggressively. Most Asian currencies have depreciated, particularly in the final three months of 2024, as expectations for fewer Fed rate cuts grew. Currencies will likely be the pressure valve for adjusting to any growth shock from tariffs, with regional correlations likely to move higher initially, before policy choices, and relative budgetary space in various economies, help differentiate the strong from the vulnerable.

AXA Investment Managers

Asset Class Summary Views

Views expressed reflect CIO team expectations on asset class returns and risks. Traffic lights indicate expected return over a three-to-six-month period relative to long-term observed trends.

Positive	Neutral	Negative

CIO team opinions draw on AXA IM Macro Research and AXA IM investment team views and are not intended as asset allocation advice.

Rates		Budgetary concerns and US politics suggest higher volatility even if rates in fair-value range
US Treasuries		10-year yield likely to stay below 5% unless view on direction of Fed policy changes
Euro – Core Govt.		German Bund yields reflect weak growth outlook and lower ECB rates
Euro – Peripherals		Spain continues to be preferred; French government bonds subject to ongoing political risk
UK Gilts		Bank of England expected to cut rates in February; market anticipating fiscal update in March
JGBs		Bank of Japan's January rate hike reflects inflation concerns; negative on JGBs
Inflation		While real yields are attractive, the break-even rate does not fully reflect inflation risks

Credit		With growth resilient, investor confidence in credit remains strong
USD Investment Grade		Credit yields are attractive; elevated valuations create vulnerabilities if rates keep rising
Euro Investment Grade		Modest growth, alongside lower interest rates support credit's income appeal
GBP Investment Grade		Returns supported by cooling inflation and deeper rate cuts than what is priced in
USD High Yield		Stronger growth, resilient fundamentals, and higher quality universe are supportive
Euro High Yield		Resilient fundamentals, technical factors and ECB cuts support total returns
EM Hard Currency		Attractive income from higher quality universe than recent history

Equities		Growth backdrop supportive but risks of tariffs hitting global trade
US		Earnings growth supportive; performance more balanced as AI bubble somewhat deflates
Europe		Valuations are attractive; low return expectations could be exceeded by positive surprises
UK		Markets need to see how government can improve growth prospects; lower rates will help
Japan		Solid combination of valuations and expected earnings growth
China		Signs of improving confidence but foreign investors need to see more policy support
Investment Themes*		Competition in AI to create more opportunities for beneficiaries of technology

*AXA Investment Managers has identified six themes, supported by megatrends, that companies are tapping into which we believe are best placed to navigate the evolving global economy: Technology & Automation, Connected Consumer, Ageing & Lifestyle, Social Prosperity, Energy Transition, Biodiversity.

Data source: Bloomberg