



Market Commentary

A road to nowhere

There's not much driving price action...but there's a lot of action on the ground

Key points

- Government bond yields remained stable this week, despite the Israel-Iran conflict and elevated geopolitical risk.
- The Fed is keeping rates on hold for the moment, while the White House administration is pushing for cuts in order to ease economic pressures.
- Over the pond, stable yields and growing demand for euro assets supported credit markets and CLO activity.
- In Japan, the Bank of Japan and Ministry of Finance adjusted bond issuance plans, with expectations of spread corrections in super long JGBs.
- Trade uncertainties persist, with market volatility likely on the back of the upcoming tariff deadline.

20 June 2025 (London) - Government bond yields have continued to trade sideways over the past week, notwithstanding a barrage of external events and drivers, which markets have largely shrugged off. The conflict between Israel and Iran is now in its second week. But markets seem content to look beyond this, with oil prices only rising by \$10 since the start of the conflict. This has only returned crude prices to broadly the same level as at the beginning of 2025.

It would appear that investors have concluded that either Iran will surrender in the next few days, or alternatively, the regime will be annihilated and will be forced to capitulate anyway. In this context, it is also possible that regime change could act as a potential catalyst for lower oil prices over the longer term. Conversely, the notion that Iran will successfully blockade the Strait of Hormuz, choking tanker transit, seems unlikely, considering that this would disproportionately impact China, one of Iran's few allies. This said, it is not possible to dismiss Middle East risks completely. It appears likely that the US may participate in a bombing raid on the underground Iranian nuclear facility at Fordow, in a limited capacity. However, were the US to become embroiled in needing to put troops on the ground, in order to defend Israeli incursions, then this could lead to considerably greater investor angst.

Admittedly, there seems limited appetite in the US for such an involvement and we think that Trump will tread carefully, noting how this issue is extremely divisive for his MAGA supporters. Yet armed conflict can be messy and unpredictable, as well as an ugly thing. In that case, geopolitical risk remains elevated. Moreover,

at a time when US attention is directed towards the Middle East, then this could also be a moment when actors in other regions worldwide might adopt an opportunistic stance.

This week's FOMC meeting contained little new information to drive price action. US interest rates remain on hold for the time being, against an uncertain macro backdrop. In line with consensus views, the Fed sees growth somewhat weaker and inflation somewhat firmer, once the full effect of tariffs is passed through the US economy.

That said, the principal takeaway from policymakers at this time is that it has become difficult to provide much forward guidance or to take a pre-emptive stance, with respect to monetary policy. In that context, even less importance should be assigned to forecasts or the dot plot than has been the case in the past. Rather, it remains important to monitor incoming data.

In this respect, we would note some softening of demand over recent weeks, which has seen the Citi Economic Surprise Index drop to -23, the lowest reading since September last year.

In conversation with policymakers, it is clear that the Trump administration is eager to see the Fed cut. There is frustration within the White House that Powell is too preoccupied with inflation. The White House view is that, even if tariffs raise prices, this will only be a temporary one-off shift, akin to a rise in consumption taxes. Moreover, rates need to come down in order to lower the US deficit, given the burgeoning debt service bill. It is also seen as important for the Fed to cut, to enable a steeper curve. This will be important in order to ensure stability of Treasury demand. In this light, the recent SLR changes, which make it more attractive for banks to own Treasuries, are only seen boosting bank demand if banks have a steep enough curve to encourage them to play a carry and rolldown strategy.

A steeper curve is also needed to attract US retail demand, noting the modest premium being paid to own term debt relative to parking cash in money market funds.

The White House also voices concern at elevated mortgage rates, which risk bringing the housing market to a standstill. Mortgage spreads have been impacted by volatility and the administration would like to see Fed cuts, to bring some relief.

However, we sense that the FOMC will remain very wary of political interference in monetary policy decisions. Unless unemployment jumps to 4.5% in the next couple of months, we think policy is likely to remain on hold over the months ahead. There is an argument that if any move up in inflation can be contained, there could be a case for the Fed to cut in September and this seems to be what the White House is hoping for.

Yet much can happen between now and then, and so it pays to keep an open mind. That said, we continue to express confidence that most paths we can construct looking forward from here manifest in a steeper US

yield curve. Consequently, we continue to have much more conviction in curve trades than in calling overall market direction, for the time being.

European yields have remained becalmed over the past several weeks, with bund yields trading in a 2.45-2.55% range for the past month. Sovereign spreads have also been stable, and as temperatures have climbed during June, it feels that summer may have arrived early this year.

That said, we have noted increased client enquiry around euro strategies over recent weeks, on a thematic that investors are looking to diversify away from the dollar and US assets. We think that structural allocation away from the US dollar is a theme that could play out over a number of months and quarters to come. On this basis, we look for opportunities to add to an existing modest short dollar stance, on any short-term, counter-trend rally by the greenback. In this context, we would eye opportunities to buy the euro below \$1.13 or buy the yen, should it weaken back to yen 150 versus the dollar.

Interest in euro assets has been a theme helping to support credit spreads in the Eurozone as well. Investment grade corporate demand has remained robust, with solid demand in evidence for new issues. This has created a strong technical dynamic for the time being, which we have also seen in higher yielding parts of the credit market.

In this light, we were struck to record that there are currently about 150 open warehouses for Euro CLOs. This figure is up materially from the run rate of around 80-90 seen in the past few years. In part, if Japanese investors are happy to own AAA-rated CLO tranches in euro transactions, shifting some of their allocation away from the US market could be a dynamic that supports loan spreads in the region, over the next several months.

In Japan, the focus has been on JGB supply and demand this week. In this respect, the BoJ announced plans to continue to reduce bond purchases into fiscal 2026, albeit slowing the pace of reduction in the rate of purchases in comparison to 2025.

Meanwhile, the Ministry of Finance has communicated plans to reduce long-dated bond issuance by 10%. We had hoped that the MoF would be more decisive in curbing long-dated supply, at a time when super long JGBs have been under considerable pressure. We are confident that 10/30 spreads above 150bps are materially too wide and look for this to correct over the medium term.

However, it may be that we need to stay patient on this trade and there could be a risk in the short term if other investors become frustrated that the MoF is not showing sufficient market understanding and flexibility. Broadly speaking, the levels of active risk we are running across strategies remains relatively subdued for the time being. Generally, we don't think investors are being well compensated for owning too much exposure in risk assets and we would like to use volatility as an opportunity to add on weakness.

Looking ahead

Looking ahead, we are drawing closer to the 9th July deadline on tariff extension. However, no progress has been made in cementing additional trade deals and in speaking with the US administration it seems there is an expectation that the 9th July deadline will be rolled for all countries which have shown a willingness to advance a trade agreement with the US.

That said, we remain wary of the potential for sector-based tariffs on pharma and think that it is unlikely that the July 9th date will pass without some volatility impacting markets. We expect EU tariffs on the US in retaliation and have also been interested to note EU tariffs on Chinese imports, which have been taking effect.

There has been relief that any planned Section 899 tariffs on US investments have been pushed back to 2027. However, in discussions with officials in Washington, it was put to us that it will likely remain politically easier to tax imports and savings in the US going forwards, rather than to add taxes on consumption and income.

This thinking also begs the question that, with debt levels rising globally, whether this will be a conclusion that other governments also come to in the due course of time. In this case, it could be possible that where Trump and the US are leading the way on policies, others may follow. Whether this comes to pass or not is a matter of conjecture.

That said, what we would observe is that there are a number of underlying trends that will be unsustainable over time. In that case, change will need to occur and it is possible that market re-pricing will be the catalyst for such changes coming about.

Yet for the time being, it appears that such conversations are on hold. We are concerned that markets are complacent and that risk premia may be too compressed. But for all the event risk that appears to surround us, we are also aware that risk assets seem content to keep climbing the proverbial wall of worry, for the time being, at least.

Notes to Editors

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