



Bubblicious!

And the week when the Louvre lost its sparkle

Key points:

- Long-dated yields edged lower against a calm backdrop this week in the US, with the September CPI report expected to show higher headline inflation but stable core inflation.
- Eurozone growth remains sluggish, with fiscal measures and defence spending yet to boost activity. Challenges persist in the auto sector, while relative energy costs, green taxes, and regulatory red tape continue to hinder economic activity.
- UK inflation remains elevated at 3.8% but a better-than-expected CPI print this week has eased pressure on policymakers.
- Japan's new prime minister, Sanae Takaichi, has started work on fiscal easing plans, while her desire to push for a more dovish stance on monetary policy weighed on the valuation of the yen.
- Price action in precious metals prompted talk of a debasement trade, however we observe that there has been an ongoing asset allocation shift into precious metals since a perceived weaponisation of FX reserves after Russian currency assets were sanctioned in 2022.

London, 24 Oct 2025: Long-dated yields continued to edge lower during the past week, albeit in relatively quiet markets that continue to function in the absence of regular US economic data, due to the ongoing government shutdown.

In this respect, today marks a change, with the BLS set to release the September CPI report. Inflation data have been prioritised and workers recalled, as these figures are needed in order to index pension and benefit payments. A move up in headline inflation is expected, albeit with the core rate projected to remain stable at 3.1% year-on-year.

As tariff costs are passed on to consumers, we think that this is likely to add to goods inflation over the next few months, with analysis on tariff inflationary pass-throughs suggesting that this effect peaks in the 3rd and 4th quarters following the imposition of a tariff.

More recently, lower oil prices have been helping to mitigate against a pickup in inflation. However, an intensification of US sanctions on Russian oil in the past week has pushed crude back towards its levels at the start of September. Meanwhile, it has also been interesting to note how AI data centre demand is also pushing electricity prices higher.

From this standpoint, we think that the breakeven inflation rate on US TIPs is starting to look attractive, at around 2.3% in 5-year maturities. However, breakevens tend to correlate with movements in nominal yields.

In that sense, moving long in inflation-linked bonds on a breakeven basis can be viewed as structurally analogous to moving to an outright short duration position, and we think that it may be premature to adopt this stance just yet.

As we have previously noted, we expect to see data with respect to US payrolls show further signs of softness, once it is released when the government shutdown is resolved. This could see yields continue to move lower in the short term, with the Fed also set to lower rates at next week's FOMC meeting.

Yet we maintain the view that soft payroll prints will be more of a function of a reversal in immigration flows, which boosted labour supply in past years, more than a sign of any impending weakening in the economy.

Therefore, we think that the unemployment rate is likely to remain relatively stable and that a further dip in Treasury yields may present an opportunity to sell and move to a short duration stance at a more attractive entry point.

Newsflow in the Eurozone also remains relatively muted. Broadly speaking, since the upswell of enthusiasm related to German fiscal easing and plans for increased EU defence spending, which were announced earlier in 2025, there has been a sense of some disappointment that this has done little to lift activity up to this point.

That said, with budgets needing to be allocated and orders being placed, it should not come as a big surprise that this planned spending is not showing up in growth just yet, and this may become a more discernible factor later in 2026. That said, the underlying backdrop in the Eurozone economy remains pretty muted. The auto sector is in a state of disarray as China dominates the global EV market.

Meanwhile, relative energy costs, green taxes, bureaucracy, and red tape all continue to stymie economic activity. Consequently, we continue to think that the ECB may deliver one more rate cut to 1.75% in Q1 2026. Notwithstanding this, we don't see much value in 10-year bunds if they trade below 2.5%, given the prospects for increased supply in the quarters ahead.

In the UK, a better-than-expected CPI print delivered some welcome relief to embattled policymakers. Although CPI is still running at 3.8%, with the RPI measure of inflation at 4.5%, interest rate futures discount that the Bank of England will lower rates by 50bps by the middle of next summer.

On the back of this rally in shorter-dated yields, we have closed a long position on short-dated UK rates, having reached our target on the trade, and have returned to a neutral position. At 4.4% we think that 10-year gilt yields are looking too low, so we may be inclined to move short duration as a next step.

However, gilts have lagged behind bunds and Treasuries, and if overseas yields continue to move lower, then this could also help the UK market to catch up in a rally. Lower yields will also be welcome to Rachel Reeves as she prepares for the November budget. Ultimately, the lower yields are trading at, the less action to raise taxes or lower spending is needed, in order to address any black hole in government finances.

Nevertheless, the tendency to focus on taxes rather than spending remains a policy flaw, in our opinion. Political troubles for Starmer continue to brew and we continue to think that the gilt market could easily come back under pressure in the months ahead.

In Japan, Sanae Takaichi has been confirmed as Prime Minister and has started work on plans to deliver some fiscal easing, with a gasoline tax reduction imminent and further measures planned to follow.

However, the need to ensure support within the Diet may limit the extent of policy easing that can be delivered, unless new elections take place, which seems relatively unlikely in the near term. This has helped to keep JGB yields relatively stable over the past week, with the long end of the curve recouping losses posted in the wake of Takaichi's win in the LDP Leadership election at the start of the month.

Meanwhile, her desire to push for a more dovish stance on monetary policy has been weighing on the valuation of the Japanese yen. Although it remains some way from its lows versus the US dollar, which it posted in the middle of last year, the valuation of the Japanese currency has moved to a new record low valuation, at 177 versus the euro during the past week. Indeed, with the yen also at a 17-year low versus sterling, there seems little doubt that Tokyo is the place to be to get your Christmas shopping bargains this year!

In credit markets, it seems that bargains are few and far between. Yet although it remains true that corporate spreads are historically tight relative to government bonds, any bubble talk seems misplaced.

Part of the valuation of spreads reflects the cheapening of government collateral at a time of overabundant supply of government bonds. This is seen with Treasuries continuing to trade at a material premium above swaps, as the true reference for the risk-free rate. From that perspective, IG corporate spreads remain around 15bps wide to swaps relative to valuations seen as recently as 2021.

Meanwhile, with Jamie Dimon speaking about cockroaches and the metaphor that where one or two credit blow-ups occur, then others will be lurking just below the surface, we would note that issues, such as were seen in an ABS issuer like Tricolor, represent corporate fraud rather than an underlying symptom of credit market conditions.

Bull markets will breed complacency and a loss of scrutiny, but we don't think fraud is widespread or endemic. Moreover, away from private markets, we don't see many signs of stress in credit markets when looking at leverage ratios and the upcoming economic outlook.

In this sense, credit tends to continue to perform ok, as long as recession fears are low, or falling. When recession risks are high, or rising, it is typically the time when we should get more concerned on credit, but this is not currently the case.

Looking ahead

We think that pressure to resolve the US government shutdown should start to build into the end of the month, if there is no breakthrough prior to this. It is blindingly obvious that the government won't stay shut down indefinitely, so the question remains when, not if, a compromise can be found.

Meanwhile, with the Fed set to lower interest rates by 25bps next week, any comments citing downside risks to jobs, relating to the shutdown, can help cement prospects for a further easing at the December FOMC. Two cuts prior to the end of 2025 would bring cash rates to levels not far above where a number of Fed participants would see the neutral long-term level of interest rates.

From this point of view, we think that this will mean that further monetary easing in 2026 becomes less likely. This seems especially true if economic activity accelerates to a 3% growth rate in 2026 on the back of lower rates, lower taxes, and deregulation. Meanwhile with CPI inflation set to hit 3.5% or more in the months ahead, this creates a bigger hurdle for those seeking a more aggressive policy trajectory.

Elsewhere, price action in precious metals has continued to attract plenty of attention over the past week. The recent speculative run-up in gold and silver prices has prompted chatter of a debasement trade, at a time when some have been airing concerns with respect to Fed independence, under a Trump administration.

However, we think this characterisation is mis-placed. Instead, we would observe that there has been an ongoing asset allocation shift into precious metals since a perceived weaponisation of FX reserves after Russian currency assets were sanctioned in 2022.

In this light, it is not surprising that reserve managers, along with entities in jurisdictions who may have future reason to fear something similar to what happened to Russia could happen to themselves, would want to seek safety in a commodity such as gold.

More recently, this move has been given added impetus, with retail investors jumping on momentum trades, and it has also been interesting to see some rotation out of crypto and other forms of 'digital gold' into the real thing itself. From this perspective, we don't think too much should be read into price action, including the record drops in gold and silver prices seen in the past week, as a building speculative bubble was, at least temporarily, burst.

Talk of bubbles has been prominent in recent months, largely as a result of the ongoing inflation in US tech and AI valuations. In this respect, aggregate valuations appear to have become badly stretched, in that these need to be supported by earnings growth that exceeds, or at least matches, what has been recorded in the past five years, in the next five years.

Yet this seems wholly unrealistic, now that earnings are at a much higher base. Therefore, it would seem inevitable that the second derivative of earnings growth is soon set to slow quite rapidly and is then likely to reverse. But valuation analysis is not driving stock prices and retail investors remain in the driving seat.

This explains the struggle that many active professional equity managers have been experiencing, in order to keep pace with their benchmarks in recent times. This has led to comparisons of what happened to the Nasdaq in 1999.

However, we would also observe that the end of any bubble occurs when the bears end up forced to capitulate. This is yet to occur, it seems. Moreover, there may be room for leverage to accumulate and for greed to continue to build, before this moment occurs.

In this way, the reminder stands that the Nasdaq posted gains of 129% between January 1999 and March 2000, before crashing more than 70% in the 18 months which followed. Making the error to be early in opposing a bubble as one inflates can be a costly mistake. Perhaps even more costly than the mistake made by the individual responsible for pointing the CCTV cameras in the wrong direction at the Louvre last weekend!

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