RBC BlueBay Asset Management

Marketing communication

Fool's gold

All that glitters is not crypto?!

Key points:

- With Trump set to announce Kevin Warsh as the new Fed Chair, the presumption is that he will seek to justify a dovish stance, advancing the notion that AI productivity gains will ensure inflation is held in check.
- Shifts in currency markets were a focus this week, with the dollar trading down. In our view, the current environment is one that appears quite conducive for high yielding emerging market currencies.
- Commodity prices have surged of late, and with precious metals leading the charge from speculative buying, this could increase the vulnerability to a market reversal.
- Japan enjoyed a calmer week as the yen stabilised. There is much focus on the upcoming election, and we think an outright win for Takaichi (our base case) could be viewed as a market positive.
- The backdrop in financial markets has been relatively benign, notwithstanding increasing levels of volatility from the world at large, however possible speculative interest in metals and parts of the equity market leads us to remain cautious.

London, 30 January 2026: Long-dated government bond yields edged a little higher over the past week, against a backdrop of relatively robust US growth. This week's FOMC meeting offered little new information to market participants, with Chair Powell appearing set to maintain rates on hold until the end of his term in May.

Indeed, were there not a change of Fed leadership forthcoming, it is perhaps questionable how much enthusiasm there would be with respect to extrapolating any further monetary easing during the balance of 2026.

However, with Trump set to announce Kevin Warsh as the new Chair of the Federal Reserve, the presumption is that he will seek to justify a dovish stance, advancing the notion that AI productivity gains will ensure inflation is held in check. Consequently, futures markets continue to price two cuts from the Fed this year, as has been the case for a number of months.

Relative to some of the other potential picks, it is possible that Warsh is seen as less dovish than some. In prior meeting with others at the Fed, there is a sense that Warsh is well respected and not a Fed Chair likely to represent a threat to the Fed's independence.

In this sense, some of the fears with respect to the possible undermining of institutional credibility in the US may have been exaggerated in some quarters. There is also an understanding that Warsh will be inclined to shrink the Fed's balance sheet and narrow parts of its mandate.

It may be interesting that if moves on the balance sheet are delivered, then this could also be used as an excuse to ease cash rates. However, it may not do anything to help bring down longer-dated borrowing costs and thus help address the issue of mortgage affordability.

We continue to maintain a neutral stance on US Treasuries and the US yield curve. If 10-year notes head towards 4.5%, we think this could represent buying territory. Conversely a rally below 4% could represent an attractive area to add a short position. However, as we sit in the middle of this range, we are happier to look for opportunities away from US rates at the current point in time.

Elsewhere, a run-up in commodity prices has added to upside price risks in the near term, with the broad GS commodity price index rising by 10% compared to levels seen in the middle of last month. Metals have led the charge, with a notable run-up in gold and silver prices, in the wake of speculative buying.

However, price moves have been broad-based with softs and also energy prices moving higher over the past couple of weeks. At $70, Brent crude prices are now slightly above their 12-month average. Building tensions relating to Iran and the broader Middle East are an aspect of this, and it might seem that hopes from the US administration that oil would head lower towards Trump's $50 target price now seem some way off.

Higher oil prices may help stabilise fiscal finances for a number of oil producers who have more recently been under some pressure. However, in the US, any further run-up in commodity prices won't be welcomed if this starts feeding into consumer prices, given the sensitivity with respect to affordability as we head towards the mid-terms.

Elsewhere, movements in currency markets have been the focus of attention over the past several days. A rate check on dollar-yen coming from the US Treasury at the end of last week saw a dramatic spike lower in the exchange rate, in anticipation of co-ordinated intervention to come.

Although actual intervention itself has not been forthcoming, this move has set the market on edge, and for the time being, seems to have deterred those who may have been looking to speculate on renewed weakness in the Japanese currency.

In part, we see this move linked to growing frustration in the US, that instability in Japanese government bonds was starting to weigh on US Treasuries during the past week, adding to a desire to restore calmer market conditions.

However, these US steps have prompted some to question whether the US administration is tacitly seeking a weaker valuation for the dollar more broadly, acknowledging how it is already a stated desire to eliminate current account imbalances. However, away from the yen and the Korean won, our own sense is that the US would rather see a stable dollar versus other major currencies.

Clearly, the US would like to avoid any scenario in which there is a repeat of the 'sell the US' trade, which emerged at a time of elevated volatility in April last year.

With Europe still smarting over Greenland and increasingly aggrieved at the stance of the US under Trump, there have been a number of high-profile reallocation trades away from US assets over the past few weeks, and policymakers in Washington are eager to ensure any trickle does not turn into a flood.

We tend to see this latter scenario as unlikely. Investors around the globe continue to want to own US stocks, and at a time when strong growth and leadership in AI are driving strong earnings growth, we think it is unlikely that investors will be in a hurry to cut US holdings.

Nevertheless, the dollar has traded down over the week, with the euro briefly breaking above $1.20. We do not hold a strong directional view on the dollar, though would suggest that the current environment is one which appears quite conducive for high yielding emerging market currencies.

In developed markets, we think that economic fundamentals continue to lend support to the greenback, notwithstanding a number of commentators jumping onto a weaker dollar trend. However, given weakness in European economies, we don't view the euro as an attractive long and in the UK, we would still prefer to remain short UK£.

With respect to the yen, a move down to $/Y153 has taken away the pressure that had been building as the cross approached the perceived intervention threshold at Y160. At this point, we doubt there will be follow-through intervention in reality, and it is possible that the rate could drift back above Y155 in the next couple of weeks.

Having missed the opportunity to get long in the yen last week, we may look to utilise any retracement back closer to 160 as an opportunity to add a position.

European yields have remained rangebound over the past week. Although we don't currently project any rate moves from the ECB this year, we do think the risk of a rate cut could be rising, if inflation risks in the region materialise to the downside, as may occur if the euro continues to strengthen in FX markets.

This also inclines us towards a steeper Eurozone curve, though in the short term we are wary that an unwind of existing steepening trades, which were implemented in anticipation ahead of Dutch pension fund changes, could push the curve flatter on position capitulation.

Elsewhere, in the Eurozone, the passage of the French budget has helped OATs to outperform over the past week. Spreads across euro sovereigns are at compressed levels and we think these conditions can persist towards the summer. Eventually, a focus on French elections in 2027 will start to add to political risks, but for the time being, this is too far ahead in the future.

In the UK, somewhat disappointing inflation data saw enthusiasm for Bank of England rate cuts cool somewhat. This weighed on gilts and benefitted the pound, in contradiction to the positioning we have maintained.

An announcement of a 5% hike in water bills in April fed into this sentiment. However, we see the economy remaining weak and evidence indicates that this is leading to a softer labour market, which is weakening wage growth.

Consequently, we remain optimistic that the inflation news should improve as we move through this year. UK house prices are already declining, and underlying sentiment remains downbeat.

Japanese yields enjoyed a much more stable week, after the turbulence in the week before. It may have been hoped that the intervention threat, which moved the yen in FX markets, would also help push yields lower, but this failed to materialise.

With Japan going to the polls next week, there is plenty of focus on the election outcome. Interestingly, it strikes us that whereas the LDP under Takaichi had been regarded as fiscally irresponsible when she first suggested easing the consumption tax rate, it is now the opposition parties who seem to have adopted the most expansionary plans. In this case, we think an outright win for Takaichi (which is our base case) could actually be viewed as a market positive.

An amount has been written with respect to fiscal risks in Japan. However, we do not see the country as vulnerable to a debt sustainability crisis. Gross debt-to-GDP is at a high level, but net debt is below 80% when allowing for abundant domestic savings.

Moreover, Japan runs a strong current account surplus, and the majority of its debt is held domestically by the BoJ who is not a holder that might become a flighty seller. Additionally, Japan's fiscal deficit in 2025 was around 2.4%, a level far below that recorded in many other countries globally.

Even after cutting consumption tax in 2026, we still doubt that the deficit will exceed 4% in the coming year. This being the case, the debt-to-GDP ratio will continue its trend lower in the coming 12 months and should continue to do so, as long as the Japanese economy can remain robust, with healthy levels of expansion in nominal GDP.

We believe that it is currently attractive to be long duration at the long end of the curve in Japan, on an outright basis. Yields above 3.5% on 30-year bonds are close to double the rate required in the context of the Japanese pension fund industry.

We think that there may be a sizeable asset allocation shift towards domestic assets in Japan in the coming fiscal year, and we would note that with the government able to control huge investment funds such as the

GPIF, there is plenty of capital that can be deployed in order to stabilize JGBs, even before needing to ask the BoJ to consider re-implementing its policy of Yield Curve Control.

Reflecting on the past month, it strikes us that the backdrop in financial markets has been relatively benign, notwithstanding increasing levels of volatility from the world at large around us.

Looking ahead

There is a sense that this volatility may permeate moves in asset prices more directly and speculative interest in precious metals and parts of the equity market, and this could increase the vulnerability to a market reversal.

With corporate credit spreads at multi-year tights, we are happy to move in a more defensive direction and look for opportunities to own yield and carry elsewhere in our strategies. We see opportunities in a number of emerging market currencies and rate markets.

Additionally, we would note that on a USD hedged basis, 30-year JGBs yield 6.50%, demonstrating that in very steep rate curves in developed markets, there will also be interesting opportunities to own attractive carry relative to cash rates.

Indeed, when reflecting that this is an identical yield to the US high yield corporate bond index, it does add to the sense that we are in some kind of a “Alice Through The Looking Glass” world, where everything has been turned upside down!

Certainly, there seems no shortage of Mad Hatters racing around the stage. Hopefully they won’t find that they have ended up sitting on a pile of fool’s gold, when all is said and done, as it appears a growing number of crypto investors are already realising.

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