



FIXED INCOME DEEP DIVE • JUNE 2026

Stay short – except in Switzerland

KEY TAKEAWAYS

- Reduced central-bank demand, rising government borrowing and higher Japanese yields are keeping structural upward pressure on long-term bond yields.
- We favour 2–3-year USD and EUR bonds and reserve longer-duration exposure for CHF, supported by limited issuance, low inflation and a resilient investor base.
- Credit spreads near record tight leave little room for error; we prioritise quality and liquidity, with returns more likely to come from income than further spread tightening.
- TIPS offer attractive inflation protection and real income, while selected CLOs and European bank AT1s provide opportunities to enhance portfolio yield.

RATES & STRUCTURAL PRESSURES

Government bonds are under renewed pressure across the developed world. The repricing has been broadly synchronised, with long-end yields climbing to multi-decade highs. The 10-year Bund pushed to its highest since 2011 in May, the 10-year JGB to levels last seen in 1997, and the 30-year Gilt to a high not reached since 1998. On the ICE BofA 10+ Year Government Index, an aggregate of long-dated government bonds, the yield is back to where it last stood in 2007. While rates have retraced from their peaks, the underlying trend toward a widening term premium – the extra yield investors demand to hold a long bond rather than roll short ones – remains intact, as uncertainty around geopolitics, inflation, and fiscal and monetary policy persists. Beyond these fundamental drivers, the following structural shifts should keep pressure on the long end:

- **End of the central-bank backstop:** The majority of developed-market central banks are shrinking their balance sheets (quantitative tightening, QT). Their operational approaches differ: the Bank of Japan (BoJ) is tapering its monthly JGB purchases, the ECB is letting maturing bonds roll off without reinvestment, and the Bank of England (BoE) goes furthest, selling gilts outright. In the US, the new Fed Chair Kevin Warsh – a long-standing critic of the Fed's "bloated" balance sheet – inherits a central bank that ended its Treasury runoff in December 2025 as funding-market stress emerged and has since been adding reserves through T-bill purchases. Restarting balance-sheet reduction would thus mean reversing course. Elevated inflation and his hawkishness on the balance sheet argue for it eventually, though any move would require FOMC consensus. The mechanism of QT is to remove the central-bank backstop for bond markets and to transfer duration risk from the public sector to price-sensitive private investors, who demand compensation to hold an asset class that has become more volatile – lifting the term premium.
- **Supply / fiscal absorption:** Sovereign issuance across advanced economies is set to keep climbing, driven by persistent budget deficits and record refinancing needs. OECD gross borrowing reached a record USD 17 trillion in 2025 and is projected to reach around USD 18 trillion in 2026 – feeding unease about the market's capacity to absorb the supply. With the largest price-insensitive buyer withdrawn, private investors now set the marginal bid, pushing the market clearing yield higher. The pressure is most acute in the US Treasury market, the global benchmark: the federal deficit, 5.8% of GDP in 2026, is projected to widen to 6.7% by 2036, with sustained deficits lifting debt held by the public from roughly 100% of GDP to 120% over the same horizon. Demand at the short end remains robust and relatively price-insensitive, dominated by money market funds; the long end, by contrast, clears only at progressively higher term premia. Because the Treasury market anchors the global rates complex, rising US long-end yields drag other sovereign curves higher.
- **Surge in Japanese yields:** For years the BoJ pinned the 10-year yield near zero under yield-curve control (YCC) – the culmination of a decades-long ultra-low-rate regime – and at its peak absorbed more than half the JGB market. In effect, Japan exported cheap capital and helped suppress yields worldwide. That dynamic is now reversing. Having scrapped YCC, the BoJ is running down its balance sheet and working through a hiking cycle that lifted the policy rate to 1% in June 2026, its highest since 1995, with markets pricing a further hike by year-end. At the same time, fiscal-expansion fears under the Takaichi government are pushing investors to demand a sharply higher term premium on long-dated JGBs. The spillover into the rest of the world runs through capital flows: as domestic yields rise, Japanese investors, who at roughly USD 1.2tn (TIC data) are the largest foreign holders of US Treasuries, have less reason to deploy capital abroad and are beginning to repatriate it, pushing global term premia higher.

DURATION & SWISS FRANC BONDS

In sum, the risk at the long end of the curve is asymmetric and skewed towards higher yields and we believe investors are (still) poorly paid for duration risk. The front end offers more protection as yields would have to climb a long way before the total return turns negative – a buffer long bonds don't have. The Swiss yield curve is the exception. On the supply side, the constitutional debt brake caps issuance and leaves a scarce, AAA-rated market with a firm and steady institutional investor base. Moreover, the SNB holds virtually no domestic bonds to unwind: its balance sheet was built through FX intervention – creating francs to buy foreign assets – rather than domestic QE. While not planned at this point, any potential future reduction of the balance sheet would therefore release duration into foreign markets, not into the Swiss one. Moreover, in stress scenarios, persistent franc strength pulls the SNB toward easing –

potential negative rates included – which anchors the front end and, as investors reach for yield, much of the curve with it. The result is the developed world's lowest yields, underpinned by structurally low and stable inflation. That leaves little room for the kind of term-premium repricing we expect elsewhere, and makes CHF the one market where holding long duration is defensible – consistent with the decline in Swiss long-end yields year-to-date.

CREDIT MARKETS

In corporate credit, spreads widened in the first quarter but have since compressed back toward record tightness. The renewed tightness rests on resilient fundamentals and still-elevated all-in yields that sustain demand, leaving new issues heavily oversubscribed. Yet valuations leave little room for error, with risks skewed toward widening. The technical balance is shifting too: US high-grade issuance, for example, is forecast to rise roughly 35% in 2026 on AI- and data-center-related financing, raising the prospect that supply outpaces demand for the first time since 2022. From here, carry rather than further compression should drive returns. Given the asymmetry, we stay cautious on credit and focus on the highest quality, ready to add risk opportunistically when the compensation improves.

PORTFOLIO IMPLICATIONS

- **Curve Positioning:** Given the persistent pressure on term premia, we expect volatility to increase in the medium- to long-dated segments of the yield curve, and we believe the risk of higher yields outweighs the likelihood of a sustained decline. Against this backdrop, we favour the 2- to 3-year segment in USD and EUR, which in our view offers the most attractive risk-reward profile. We take duration exposure only in CHF.
- **Credit Exposure:** Given still-rich valuations, shifting supply-demand dynamics, and market dislocations in less liquid corners of the credit market, we concentrate exposure at the short end of the curve and prioritise the highest-quality, most liquid segments of the market to reduce drawdown risk in the event of a spread correction.
- **Swiss Franc Bonds:** The Swiss franc is expected to continue its appreciation trend in the long term, supported by a significant inflation differential and its status as a safe-haven currency. If the SNB intervenes on a larger scale, it will, in our opinion, be primarily to slow down the appreciation trend. Overall, CHF bonds should remain relatively insulated from global volatility, as pressures on term premia are expected to remain more contained than in other markets.
- **Inflation-Indexed Government Bonds:** Inflation-indexed government bonds, such as US Treasury Inflation-Protected Securities (TIPS), offer an attractively priced way to hedge against upside inflation surprises and shifts in long-term inflation expectations. The appeal rests on two legs. First, breakevens look cheap at roughly 2.3%, only modestly above the Fed's 2% target, even as the balance of risks skews to the upside. Second, TIPS now lock in a real yield near 2%, close to its highest since before the financial crisis, so investors are paid to hold the hedge rather than sacrificing carry for it. The combination produces a favourable payoff profile: if inflation accelerates, TIPS outperform nominals as breakevens widen and principal accretes with CPI; if it merely holds near target, the real yield would still provide a positive real return.

- **CLOs:** The asset class offers attractive risk-adjusted returns. The edge over private debt lies in liquidity, transparency, and structural seniority. The recent spread widening – driven by private-credit stress and a sharp selloff in software loans early in the year – further strengthens the case for CLOs. We are particularly constructive on CLOs backed by robust underlying loan fundamentals, which offer an attractive illiquidity and complexity premium without adding duration risk, given their floating-rate structure. The downside buffer is thickest in the senior tranches; at the BBB mezzanine level investors are instead compensated with a meaningful yield pickup over comparable corporates – in USD roughly 250 bps – which we view as an attractive yield enhancer within a diversified portfolio.
- **Bank AT1:** European bank AT1s look attractive in our view despite still trading near historic spread tights, as this overlooks the sector's substantial post-GFC balance-sheet strengthening and widespread ratings upgrades. Nearly half of the USD 270bn AT1 market is now investment-grade, yet these bonds still yield approximately 100bp more than similarly rated corporates due to technical factors, notably their exclusion from global bond indices and the absence of forced buyers. Looking ahead, supply dynamics are highly supportive: most upcoming calls are already pre-financed and net new issuance is set to remain scarce in this segment. M&A is a key upside catalyst, as overcapitalised European banks face supervisory caution on large buybacks, enjoy ECB support for consolidation, and increasingly pursue acquisitions as the fastest route to capital optimisation. Finally, should prospective regulatory changes to AT1 structures materialise, existing instruments would likely be grandfathered, creating scarcity value, which could support spreads as these legacy bonds approach their call dates.
- **Emerging Market (EM) Bonds:** EM corporate hard-currency bonds continue to trade at a spread premium to developed market (DM) peers of comparable quality. Focusing on single-A rated issuers offers selective opportunities to enhance yield while diversifying defensive exposure into EM, supported by improving credit metrics and positive rating trends. As most EM hard-currency debt is USD-denominated, a weaker dollar – as we expect – reduces the local-currency cost of issuers' debt service, particularly for those with local-currency revenues, and further strengthens credit profiles. In local currency markets, we maintain a strong preference for the Renminbi, which we view as undervalued by approximately 20–30% on a PPP basis. The IMF now broadly shares this assessment; the main caveat is timing, as Beijing continues to cap the pace of appreciation, so the valuation gap may close only gradually.

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