



Rates, risk and reality

From Global Fixed Income

Our core view is that income generation (carry) will replace price appreciation as the primary driver of total returns. With inflation settling at a “sticky” 3%¹ and the term premium rising, we are positioning for a “higher-for-longer” paradigm.

Our approach to portfolio positioning:

1. Duration discipline – play defense, stay neutral

The trade: Neutral duration target with a bias toward the intermediate “belly” (3-7 years).

The rationale: It is our view that interest rate risk remains mispriced. The market is pricing in an aggressive easing cycle (75-100 bps)² that contradicts the reality of resilient growth and structural inflation. We believe the Fed will deliver fewer cuts than anticipated, creating a “policy disappointment” risk that will punish the front end. Simultaneously, the long end is potentially vulnerable to a supply-driven term premium shock.

The risks: A deterioration in the labor market that sees the unemployment rate rising above 5% would force aggressive Fed easing, justifying a duration extension. Alternatively, a growth scare combined with sticky inflation would pressure real yields negative, necessitating a swift move to defensive duration.

2. The quiet winner – Agency MBS

The trade: We hold the view that an overweight Agency MBS as a core carry position and defensive substitute for tight Corporate Credit.

The rationale: We maintain that agency MBS is the most attractive high-quality asset in the market, trading cheap relative to historical fair value. The thesis is dual-pronged; 1) a structural housing undersupply (3-4 million units)³ supports collateral value and 2) we believe demand for mortgages will increase on valuations.

The risks: If the Fed moves to actively sell MBS (quantitative tightening acceleration) rather than letting them roll off, supply will overwhelm demand. Alternatively, a sharp rise in rate volatility would increase prepayment risk and damage the convexity profile of the asset class.

1. <https://www.bea.gov/data/personal-consumption-expenditures-price-index-excluding-food-and-energy>

2. <https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html>

3. <https://www.goldmansachs.com/insights/articles/the-outlook-for-us-housing-supply-and-affordability>

3. Credit strategy – fatten the belly, starve the long end

The trade: It is our view to favor intermediate maturities (3-7 years); avoid long-duration US corporate bonds. Our focus is on defensive sectors (utilities, healthcare) and select European and Emerging Markets for diversification and attractive value.

The rationale: We believe credit valuations are full, and a technical storm is brewing in the US. We are facing a significant supply headwind from AI infrastructure financing and a backlog of M&A deals. This issuance will likely concentrate in the long end, preventing spread tightening.

The risks: If the “AI Arms Race” cools, capex spending—and the associated debt issuance—could plummet, removing the supply overhang. Elevated recession fears would widen spreads materially, creating an attractive entry point for long-duration credit.

4. Securitized markets – idiosyncratic alpha

The trade: We are favorable to being long ABS and AAA CLOs; Selective in CMBS.

The rationale: Recent fraud cases in 2025 look to be idiosyncratic, not systemic.^{4,5} They reinforce the need for active underwriting, not sector abandonment. The US consumer remains a bright spot, with aggregate household balance sheets in their strongest position since the 1980s.⁶

Certain subsectors within the CMBS market have been unfairly punished from model-driven rating agency downgrades.

The risks: If commercial real estate (CRE) refinancing stresses regional bank balance sheets, this could trigger a broader tightening of credit conditions.

5. New frontiers – EM local currency

The trade: We are also long select EM Local Currency Sovereigns (High Real Yields).

The rationale: It is our view that Emerging Markets are the clear beneficiaries of the improving US macro environment. The convergence of falling domestic inflation in EM and a structurally weaker USD (driven by Fed cuts) creates a tailwind. We are targeting countries with fiscal discipline that offer high real yields, using this as a diversifier against US-centric inflation risks.

The risks: A “flight to safety” into the greenback would hurt EM returns, while any new aggressive trade tariffs would hurt EM exports and damage their fiscal balances.

Summary

Our base case is constructive, but risks remain (growth scare, policy mistake, higher inflation). Focus on high quality carry while balancing caution and opportunity, accordingly.

4. <https://www.bloomberg.com/news/articles/2025-09-29/auto-parts-supplier-first-brands-files-for-bankruptcy>

5. <https://www.bloomberg.com/news/features/2025-11-10/tricolor-auto-bankruptcy-kicked-off-by-jpmorgan-phone-call>

6. https://www.federalreserve.gov/releases/z1/20220909/html/recent_developments.htm

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