

Macro Talking Points

Fixed Income Insights

Week of 6 January 2025

Author



Benoit Anne
Managing Director
Strategy and Insights Group

In brief

- **Reviewing the market risk list for 2025**
- **Carry set to be supportive of fixed income returns**

What can go wrong in 2025. Apparently, quite a lot. I surveyed our MFS® community of fixed income portfolio managers and asked them their thoughts on the top risks for this year. Watch out: The result is a bit scary. Overall, they flagged 25 distinct risk factors, which means that macro risk management and volatility are likely to remain major themes in the period ahead. There was a short list that clearly emerged as the most pressing sources of risk. These, unsurprisingly, included renewed inflation, the impact of a global trade war, geopolitics and a potential eurozone crisis. Besides the consensus list, some portfolio managers also expressed concerns over the downside risk to global growth, the risk of a US recession, the risk that AI may overwhelm and trigger a market correction, potential cyberattacks, the risk of a political crisis in France, the risk of surprising rate hikes in G10, the negative impacts of an immigration rollback, a shortage of funding, a volatility event, a private market crisis, the crypto bubble bursting and, finally, excessive market valuations. In other words, 2025 is lining up to be another busy year in global markets. As I see it, the backdrop remains favorable for active investing given the importance of risk management and the potential dislocations and opportunities that may arise as the result of risk-driven market turbulence.

Keep calm and carry on. Despite the daunting list of market risks discussed above, global fixed income can at least count on the positive contribution from one of the key components of its total return expectations: carry. Carry appears set to remain elevated, compliments of HFLFL, my new favorite acronym for the year ahead: higher for longer, for longer. With US 10-year rates close to 4.6%, the income bit from fixed income should indeed play a big role.¹ But to be clear, the outlook is less constructive for the other components for fixed income total returns. Specifically, falling rates because of aggressive US Federal Reserve easing now looks off the table. Meanwhile, the macro backdrop may well be in great shape, especially in the US, but it looks like a stretch to expect significant spread compression from the current level. Which brings us back to carry as the last bastion of supportive return expectations. Credit spreads may appear compressed, but it's important to remember that the total yield valuation picture looks quite favorable, as illustrated by US IG yields well north of 5%. Another source of comfort on the market insights team's radar is that the Fed's hawkish pivot is now fully priced in. Indeed, Fed rate cut expectations have been crushed. At this juncture, the future market only prices in 36 basis points of cuts — *i.e.*, much less than two full cuts — over the next 12 months.² That seems quite

conservative, which means that it is unlikely that the Fed will under-deliver on the policy front relative to these sober market expectations. Overall, it seems that rate dynamics are likely to continue to drive the show in the period ahead, not only for fixed income but, perhaps, even for riskier asset markets. At what level of rates will the attractive carry of fixed income become a pain point for equities? The rate story also has major asset allocation implications. As the downside momentum in rates is no longer a strong market force, the correlation landscape between bonds and equities will likely be overhauled, with fixed income gradually regaining its attribute as a portfolio diversifier. In other words, the potential drivers of fixed income returns may look quite different from what they were just six months ago, but we believe fixed income is nonetheless well positioned to remain an attractive asset class. ▲

Endnotes

¹ Source: Bloomberg. US 10-year generic treasury yields, data as of 6 January 2025.

² Source: Bloomberg. Based on the forward cash curve, data as of 6 January 2025.

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively “Bloomberg”). Bloomberg or Bloomberg’s licensors own all proprietary rights in the Bloomberg Indices. Bloomberg neither approves or endorses this material or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

The views expressed herein are those of the MFS Strategy and Insights Group within the MFS distribution unit and may differ from those of MFS portfolio managers and research analysts. These views are subject to change at any time and should not be construed as the Advisor’s investment advice, as securities recommendations, or as an indication of trading intent on behalf of MFS. No forecasts can be guaranteed.

Diversification does not guarantee a profit or protect against a loss. Past performance is no guarantee of future results.

GLOBAL DISCLOSURE

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by: **U.S.** – MFS Institutional Advisors, Inc. (“MFSI”), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited. **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited (“MIL UK”), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER. **Note to Europe (ex UK and Switzerland) readers:** Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore** – MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand** - MFS International Australia Pty Ltd (“MFS Australia”) (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong** - MFS International (Hong Kong) Limited (“MIL HK”), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the “SFC”). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to “professional investors” as defined in the Securities and Futures Ordinance (“SFO”).; **For Professional Investors in China** – MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan** - MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments; **Bahrain** - This document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally. The Central Bank of Bahrain assumes no responsibility for the accuracy and completeness of the statements and information contained in this document and expressly disclaims any liability whatsoever for any loss howsoever arising from reliance upon the whole or any part of the contents of this document. The Board of Directors and the management of the issuer accepts responsibility for the information contained in this document. To the best of the knowledge and belief of the board of directors and the management, who have all taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and does not omit anything likely to affect the reliability of such information.; **Kuwait** - This document is not for general circulation to the public in Kuwait. The information has not been licensed for offering in Kuwait by the Kuwait Capital Markets Authority or any other relevant Kuwaiti government agency. No private or public offering of the information is being made in Kuwait, and no agreement relating to the information will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the information in Kuwait.; **Oman** - For Residents of the Sultanate of Oman: The information contained in this document does not constitute a public offer of securities in the Sultanate of Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98). This information is being circulated on a limited basis only to corporate entities that fall within the description of sophisticated investors (Article 139 of the Executive Regulations of the Capital Market Law). The recipient acknowledges that they are a sophisticated investor who has experience in business and financial matters and is capable of evaluating the merits and risks on an investment.; **South Africa** - This document, and the information contained is not intended and does not constitute, a public offer of securities in South Africa and accordingly should not be construed as such. This document is not for general circulation to the public in South Africa. This document has not been approved by the Financial Sector Conduct Authority and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.; **UAE** - This document, and the information contained herein, does not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The information is only being offered to a limited number of exempt investors in the UAE who fall under one of the following categories of non-natural Qualified Investors: (1) an investor which is able to manage its investments on its own, namely: (a) the federal government, local governments, government entities and authorities or companies wholly-owned by any such entities; (b) international entities and organisations; or (c) a person licensed to carry out a commercial activity in the UAE, provided that investment is one of the objects of such person; or (2) an investor who is represented by an investment manager licensed by the SCA, (each a “non-natural Qualified Investor”). The information and data have not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority, the Dubai Financial Services Authority, the Financial Services Regulatory Authority or any other relevant licensing authorities or governmental agencies in the UAE (the “Authorities”). The Authorities assume no liability for any investment that the named addressee makes as a non-natural Qualified Investor diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document you should consult an authorised financial adviser.; **Saudi Arabia** - This document may not be distributed in the Kingdom except to such persons as are permitted under the Investment Funds Regulations issued by the Capital Market Authority. The Capital Market Authority does not make any representation as to the accuracy or completeness of this document, and expressly disclaims any liability whatsoever for any loss arising from, or incurred in reliance upon, any part of this document. Prospective purchasers of the securities offered hereby should conduct their own due diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document, you should consult an authorised financial adviser.; **Qatar** - This material/fund is only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such material/fund. The material does not constitute an offer to the public and is for the use only of the named addressee and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee’s consideration thereof). The fund has not been and will not be registered with the Qatar Central Bank or under any laws of the State of Qatar. No transaction will be concluded in your jurisdiction and any inquiries regarding the material/fund should be made to your contact outside Qatar.