

Macro Talking Points

Fixed Income Insights

Week of 3 February 2025

Author



Benoit Anne
Managing Director
Strategy and Insights Group

In brief

- **The tariff announcement and its impact on fixed income**
- **Fixed income as a compelling de-risking asset class**
- **The maturity wall is not a major risk for HY**

Trumpilocks' left tail risks. There's a new macro regime that has replaced Goldilocks, one Market Insights has dubbed Trumpilocks. Trumpilocks remains a broadly positive regime for risky assets, but it's also characterized by significant macro volatility and a wider range of risks, including the risk of a trade war and greater policy uncertainty. It's the latter that's currently catching investor attention, following the announcement from the White House that 25% tariffs would be imposed this week on Canada and Mexico as well as 10% tariffs on China. As it turns out, both Canada and Mexico subsequently managed to negotiate an implementation delay with the White House, but the tariffs on China have come into force. Regarding the latter, the new tariffs are casting a much broader net that includes small retail activities — which means that the US consumer is no longer shielded from the tariff action — and, in practice, leads to a doubling of existing tariff rates. To be clear, even with the implementation delay, the Trump 2.0 tariff action is a lot punchier than under Trump 1.0 given the larger scale, scope and speed of implementation, with the President using emergency powers. China in turn has announced a number of retaliation measures, which means that the risk of escalation is material. Looking ahead, there is a possibility that the tariff order may be challenged in the US courts due to the President's use of emergency powers under the International Economic Emergency Powers Act (IEEPA). In terms of market impact, it's clear that the risk of a trade war had not been fully priced in. One of the more pronounced market transmission channels has been the currency markets, which have experienced significant volatility over the past few days. After initially suffering severe losses, the Canadian dollar and the Mexican peso have since recovered, a result of the negotiated implementation delay. More generally, the tariff announcement initially caused a risk aversion shock that hurt risky assets. In terms of the implications for fixed income, starting with the United States, the potential implementation of tariffs is likely to further reduce the US Federal Reserve's room to ease policy going forward, given the potential one-off adjustment of US domestic price levels. As a result, it is likely that front-end rates will move higher, thereby triggering some curve flattening. In addition, the cost of energy in the US is likely to go up, which tends to be reflected in higher break-even inflation, as a market signal that investors are ready to price in a rise in inflation risk. Moving on to Canada, if the tariff risk becomes reality, it should ultimately lead the Bank of Canada to consider further easing. Our Canada fixed income portfolio manager Soami Kohly holds a high-conviction view that the local curve will continue to steepen in the period ahead. On the EM front, the strong dollar will likely continue to act as a headwind even though tariffs are unlikely to have a significant adverse impact on EM sovereign creditworthiness. Overall, we anticipate that the tariff risk will reinforce the market theme of the great bifurcation, with the US looking very different from the rest of the world. It also looks like macro volatility is bound to remain elevated, which ultimately strengthens the case for an active management approach. For now, investors are back in headline-watching mode in the face of elevated policy uncertainty.

A compelling de-risking asset class. In the face of elevated macro volatility, there is probably a need to de-risk multi-asset portfolios, especially given the challenging valuation landscape in many pockets of global equity markets. Market developments over the past couple of weeks — DeepSeek and tariffs — are a case in point. While it is true that equity markets have performed quite well, a basic risk management approach would suggest that now may be a time to reassess portfolio risk exposure. That is where fixed income comes in as an attractive strategic asset class. Fixed income risk-adjusted returns are competitive given the historical levels of total yields, while the asset class also displays interesting defensive attributes. From a long-term perspective, duration, even in the US, looks attractive, even though the tactical case for being long US duration has become more challenging. The case for fixed income is even stronger outside of the US. In Europe for instance, there are strong arguments in favor of both a tactical and strategic exposure to European fixed income. One interesting market theme has been the significant monetary policy divergence, not more obvious than last week when the Fed hit the pause button, while other central banks — the ECB included — went ahead with rate cuts. Our head of developed market sovereign research Peter Goves continues to hold a high-conviction call to be long duration in Europe. Levels need monitoring given the scale of recent moves, but the potential threat of tariffs being extended to the region makes that call even more relevant.

Where is the wall? A number of clients in Continental Europe inquired about the topic of the HY maturity wall last week. After all, higher for longer, which has made a big comeback as a market theme, could be a source of potential refinancing headaches for the non-investment grade universe. However, the numbers are rather reassuring. In the US, it's not until 2028 and 2029 that the volume of maturities falling due peaks, which leaves us with a couple of years of cushion. In addition, when comparing the current yield on the high-yield index with the weighted average fixed coupon at which these debt obligations were issued, the gap is not that big. In other words, if US HY issuers had to fully roll over their existing debt, the refinancing cost does not look insurmountable. Given the strength of the macro backdrop and asset class fundamentals, it is possible that the financing needs of the HY sector may have declined compared with a few years ago. Meanwhile in Europe, refinancing risk seems to be a bit more front-loaded, with 2026 and 2027 showing sizeable maturities falling due. However, the ECB easing in the pipeline is likely to help alleviate some of the potential refinancing pain. Overall, it appears that HY refinancing risks, excluding some idiosyncratic stories, do not constitute a major challenge for the asset class at present. ▲

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.