

Market Commentary / Outlook

Global equity and bond markets have experienced a turbulent start to 2025, primarily on concerns that a potential tariff-driven trade war could heighten inflation and recession risks. Financial markets subsequently staged a rally, with the tariff imposition paused to allow for trade negotiations. There is now greater conviction that tariff levels will settle well below the original headline levels that scared markets.

In mid-June 2025, President Trump followed through on his threats to attack Iran. The airstrikes targeted Iran's nuclear infrastructure after Tehran refused to return to negotiations and continued advancing its uranium enrichment program. In response, Iran vowed retaliation on US bases in Qatar. A temporary closure of the Strait of Hormuz would lead to a material increase in oil prices, and if prolonged, could risk disrupting the global interest rate-cutting cycle as higher oil prices are passed through to inflation.

Global long-term government bond yields have been choppy over 2025 as risk sentiment has oscillated and recently dropped. In the US, the growing deficit and supply concerns are at the forefront, and Moody's joined S&P and Fitch in downgrading the US's AAA rating. Rates were left on hold in the US, with the next rate cut expected in September 2025. In Australia, there is a 94% chance of a 25bps rate cut in July 2025. The Australian bond yield curve remains impacted by global factors despite the RBA tailwind. The RBA already had the green light to move towards a neutral policy rate of around 3%.

AUD corporate and bank credit spreads have broadly tracked USD investment grade (IG), with lower beta. Within the major bank complex, spreads have moved wider across the capital structure, including senior and Tier 2 debt. Hybrid discount margins have moved more, given their higher beta characteristics.

Portfolio Construction

As we enter the second half of 2025, we see the importance of diversification across assets and sectors and remaining alert for opportunities to add to risk assets during volatile periods.

Our preferred portfolio construction is:

- **Duration:** Moderate long position, with 70% in fixed-rate bonds and 30% in floating-rate notes. This mix offers steady income and potential capital appreciation.

MARKET OUTLOOK

2025



- **Yield Curve:** With inflation back in range and the rate cut cycle progressing slowly, longer-dated (10-year plus) fixed-rate bonds offer attractive yields amidst a steepening yield curve and steady income with recent market volatility.
- **Sector/Credit Mix:** A broadly diversified portfolio consisting of 60% investment grade (IG) and 40% high-yield (HY). A barbell strategy is used to capture higher spread securities whilst managing risk between IG and HY. Shorter and mid-curve credit is preferred, given credit spread sensitivity, and a small allocation to semi-govt/govt bonds offers protection.

Matthew Macreadie

Executive Director, Credit Strategy and Portfolio Management

MARKET OUTLOOK

2025



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