Rothschild & Co
Asset Management

Why will Fixed Income still be essential in 2025?

Emmanuel Petit
General Partner, Head of Fixed Income

Philippe Lomné
Fixed Income Portfolio Manager
Specialisation: IG Credit IG & Crossover

Geopolitical uncertainty has been driving markets since the beginning of the year. While central banks were steadily progressing towards normalization, the unpredictability of the new U.S. president and Europe's sudden shift have reignited interest rate markets.

Since his election, Donald Trump has been sending mixed signals to the markets. Beyond the issue of tariffs, his approach to resolving the Russia-Ukraine conflict has triggered a strong reaction in Europe. On March 4, the EU-27 agreed on an €800 billion plan to strengthen the region's defense[1]. That same evening, Germany lifted its budget cap, announcing €500 billion in investments to upgrade its national infrastructure[2]. The next day, the 10-year Bund yield surged by 30 basis points[3]—its largest increase since 1990—dragging European interest rates upward. These measures are expected to boost economic growth in the region but simultaneously pose an inflationary risk, especially as the ECB continues to struggle to reach its 2% target. Moreover, financing these measures and their impact on national deficits are putting pressure on interest rates.

Even before these announcements, European interest rate volatility was already being fueled by developments in the U.S. Investors remain attentive to the promises and policies of the new U.S. administration, although their long-term implementation and effects on U.S. growth and inflation remain uncertain. Amid these uncertainties, the correlation between U.S. and European interest rates has been volatile. Following a second rate cut in March, the market now expects only two additional ECB cuts in 2025. Meanwhile, in the U.S., the easing cycle is expected to be more gradual, with three rate cuts anticipated this year.

Despite tight risk premiums, the credit market remains attractive in an environment of global uncertainty, as it continues to offer an appealing yield while maintaining solid fundamentals. Companies remain financially healthy and demonstrate solvency levels that enable them to refinance easily. Additionally, given the valuation levels of risk assets, fixed income remains highly sought after by investors. The prospect of steady returns and income generation makes this asset class particularly appealing. However, this environment has created an unusual dynamic where corporate credit is favored over government debt.

Credit spreads continue to tighten. In the U.S., risk premiums are at their narrowest levels in 20 years, and we believe that market conditions warrant greater volatility. Interest rate volatility is likely to spill over into the credit market. In these more turbulent periods, conviction-driven management can fully demonstrate its value. Various strategies and asset classes could stand out in this context.

This situation calls for active and opportunistic management, where flexibility is key. Adjusting duration and sector exposure, combined with careful issuer selection, will be critical after years in which beta[4] exposure was the main driver of performance. Investment-grade credit offers opportunities, but given current valuations, selectivity and agility are essential. Financial subordinated debt remains particularly attractive given the solid fundamentals of sector players. Maturity-based funds also retain their appeal. The current entry point is especially interesting, as yields have risen alongside interest rates. Lastly, the high-yield[5] segment—particularly in shorter maturities—remains worth considering, as its yield levels can help offset market volatility.

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[1] Source: European Union, Declaration by President von der Leyen on the defence package, 4 March 2025.
[2] Source: Friedrich Merz, 4 March 2025.
[3] Source: Bloomberg, 06/03/2025.
[4] Measure of the risk of volatility of a share in relation to the market as a whole. The market beta is 1.00. Any stock with a beta greater than 1 is considered to be more volatile than the market, and therefore more risky.
[5] High-yield bonds are issued by companies or governments with a high credit risk. Their financial rating is below BBB- on the Standard & Poor's scale.

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More information at: www.am.eu.rothschildandco.com

France

29, Avenue de Messine
75008 Paris
+33 1 40 74 40 74

Belgium – Netherlands – Luxembourg

Rue de la Régence 52
1000 Bruxelles
+32 2 627 77 30

Switzerland

Rothschild & Co Bank AG
Rue de la Corraterie 6
1204 Genève
+41 22 818 59 00

Italy

Passaggio Centrale 3
20 123 Milano
+39 02 7244 31

Germany - Austria

Börsenstraße 2 - 4
Frankfurt am Main 60313
+49 69 299 8840

Spain

Paseo de la Castellana 40 bis
28046 Madrid
+39 02 7244 31

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