Rothschild & Co
Asset Management



A new balance in Fixed Income markets



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Following a first half already marked by the return of geopolitical risk, the fixed income environment became even more complex over the summer. The continuation of the conflict in the Middle East and persistent tensions in energy prices led investors to revise upwards their inflation and policy rate expectations. At the same time, the global economy, particularly in Europe, proved more resilient than expected.

This backdrop prompted markets to reassess their monetary policy expectations. Central banks maintained a hawkish stance in response to inflationary risks, leading markets to price in a higher path for policy rates. At the same time, fiscal and political tensions weighed on certain sovereign debt markets, particularly in France.

Nevertheless, credit markets have not shifted into a period of widespread stress. Corporate fundamentals remain broadly solid and current yield levels now offer more attractive carry opportunities. Most importantly, the closing weeks of the quarter saw a clearer differentiation emerge between risk assets and risk-free assets. In this context, the correction in rates has restored value, while the growing dispersion across credit markets reinforces the importance of issuer selection.

Central Banks Face a Delicate Balancing Act

Macroeconomic activity proved more resilient than anticipated during the quarter. In the euro area, the composite PMI rose from 52.0 in August to 53.1 in September, its highest level in nearly three and a half years[1]. Meanwhile, annual inflation increased from 3.2% in August to 3.8% in September, mainly driven by energy prices, while core inflation stood at 2.5%[2].



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Against this backdrop, central banks are engaged in a delicate balancing act: demonstrating sufficient determination to contain inflation expectations without tightening financial conditions excessively and thereby weighing on economic activity. The ECB consequently raised its deposit rate by 25 basis points to 2.50% in September[3]. In the United States, the Federal Reserve also increased policy rates by 25 basis points, bringing the target range to 3.75%–4.00%[4].

The rise in long-term yields is itself contributing to tighter financial conditions and may therefore reduce the need for central banks to increase policy rates further. The change in market dynamics is not the result of a sudden deterioration in economic activity, but rather of a less favourable combination of growth, inflation and monetary policy.

Sovereign Bonds Gradually Regain Their Protective Role

One of the quarter's most notable developments has been the return of a clearer distinction between risk-free and risk assets. For much of the rates repricing cycle, sovereign bonds and credit markets tended to move in the same direction, reducing the diversification benefits of government bonds. However, the final weeks of September revealed a different pattern: during periods of risk aversion, German sovereign debt gradually regained its traditional safe-haven role, while the riskier segments of the credit market came under greater pressure.

This development has renewed the appeal of duration exposure in portfolio construction. Current yield levels now provide both a higher running yield and potential protection in the event of a deterioration in the macroeconomic environment or an easing of monetary policy expectations.

France also illustrates this growing differentiation. Fiscal and political uncertainties led to a significant widening of the spread between French OATs and German Bunds, from around 85 basis points at the end of August to 127 basis points at the end of September[5]. French credit markets nevertheless proved comparatively resilient. Market tensions were concentrated mainly in financials and, more specifically, in subordinated debt. We nonetheless remain relatively confident in the resilience and solvency of French banks and insurance companies.

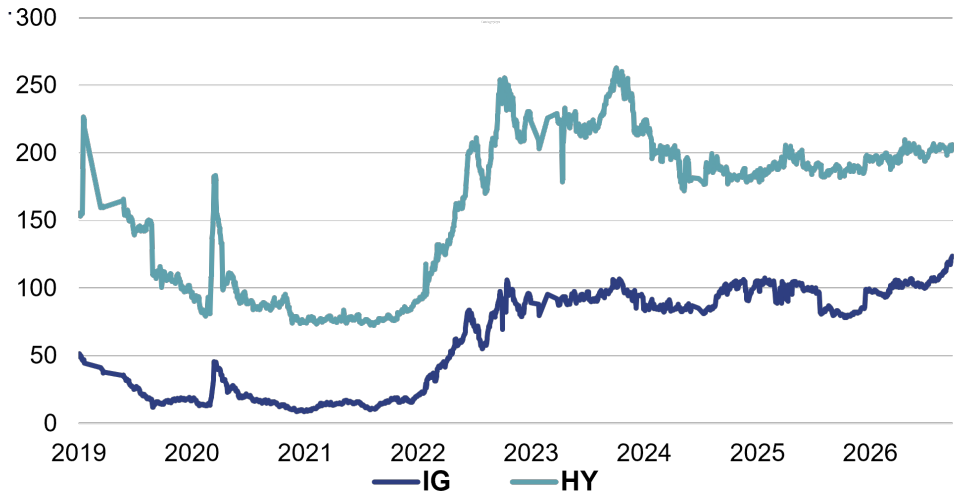
Investment Grade Once Again Offers a Particularly Attractive Profile

Higher yields and wider risk premia in certain segments have gradually improved the income available in credit markets. At the end of September, European Investment Grade bonds offered a yield of approximately 4.3%, compared with around 6.8% for High Yield bonds[6]. In the current environment, Investment Grade appears to offer a particularly attractive balance between yield and credit quality.

Beyond the yield itself, carry now provides a genuine cushion against adverse market

moves. The higher the carry, the greater the market's ability to absorb further increases in yields or wider credit spreads before generating a negative return. For Investment Grade bonds, the break-even level[7] is therefore significantly higher than during the period of ultra-low interest rates. A rise of more than 100 basis points in yield, whether driven by higher government bond yields or wider credit spreads, would now be required to offset the return generated by carry over a one-year horizon.

1-Year Credit Yield Breakeven
in bp



Sources : Bloomberg, Rothschild & Co Asset Management, October 2026.

In this environment, we continue to favour BBB-rated issuers. Current yield levels, in our view, make it possible to seek attractive carry while maintaining a high standard of credit quality.

High Yield Faces the Return of Dispersion

The outlook is more mixed within the High Yield segment. While yields remain attractive, tighter financial conditions are beginning to create greater divergence between issuers.

Companies with the highest levels of leverage are becoming particularly vulnerable. This pressure is no longer confined to issuers facing immediate refinancing needs. In an environment where the cost of capital remains structurally elevated, markets can quickly penalise highly leveraged capital structures when cash generation or operating prospects appear insufficient. Recent developments in the telecommunications sector provide a case in point.

Conversely, issuers that have reduced leverage, operate diversified business models and maintain strong fundamentals continue to prove more resilient. This increasing dispersion further strengthens the importance of fundamental analysis and careful issuer selection.

Our Positioning: Increasing Duration Without Compromising Quality

Our positioning is based on four key convictions.

Firstly, we have gradually increased portfolio duration. The correction in rates has restored value and returned high-quality sovereign debt to its role as a source of protection in the event of an economic slowdown. We remain cautious, however, on the longest maturities, which are more exposed to fiscal uncertainties and rising funding requirements.

Secondly, we maintain our exposure to European credit, favouring Investment Grade and, in particular, carefully selected BBB-rated issuers. Current yields offer attractive carry potential, while issuer fundamentals remain broadly solid.

Thirdly, we are becoming more selective within High Yield. The segment continues to offer attractive carry, but increasing dispersion and mounting pressure on the most indebted companies warrant a cautious approach. We favour issuers with robust business models, recurring cash flows and manageable leverage.

Finally, we are paying particular attention to geographical diversification. We remain cautious regarding additional exposure to France, not because of any specific concerns about company fundamentals, but in order to limit portfolio concentration in an environment where volatility linked to sovereign risk may persist.

In this still uncertain environment, higher yields are once again providing several sources of protection within fixed income markets: greater carry, duration that can once again fulfil its diversification role, and increasing credit dispersion that reinforces the benefits of active and selective management.

Learn more about the fund(s)

R-co Valor Bond Opportunities

R-co Conviction Credit Euro

Check this document on our website

The diversification mechanisms referred to above do not constitute a guarantee of protection against losses. Any investment involves a risk of capital loss.

(1) Source: S&P Global, October 2026.
(2) Source: Eurostat, October 2026.
(3) Source: European Central Bank, September 2026.
(4) Source: Federal Reserve, September 2026.
(5) Source: Bloomberg, 30 September 2026.
(6) Sources: Bloomberg, ICE BofA, Rothschild & Co Asset Management, 30 September 2026.
(7) Break-even refers to the rise in interest rates or widening of credit spreads that a bond's yield can absorb over a given period before its total return becomes negative.

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Dedicated asset management division of the Rothschild & Co Group, we offer personalised management services to a broad client base of institutional investors, financial intermediaries and distributors. We focus our development on a range of open ended funds marketed under four strong brands: Conviction, Valour, Thematic and 4Change, and benefiting from our long term expertise in active and conviction based management as well as delegated management. Based in Paris and based in 9 countries in Europe, we manage more than 31 billion euros and bring together nearly 160 employees. More information at www.am.eu.rothschildandco.com

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

(1) Source: Rothschild & Co Asset Management, 31/07/2026.

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