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IN ITALY, FRANCE, AUSTRIA, GERMANY, SPAIN, PORTUGAL AND
LUXEMBOURG.

FIXED INCOME OUTLOOK

Navigating cycles of uncertainty

JUNE 2025

After a turbulent start to the year marked by shifting central bank signals, renewed geopolitical tensions, and disruptive tariff announcements from the Trump administration, fixed income markets are entering the second half of 2025 with cautious resilience.

While inflation is gradually falling in Europe, the US faces a more complex picture of slowing growth and potential policy missteps. From European sovereigns to emerging market debt, fixed income managers from across Generali Investments share where they're finding value in a still-volatile landscape.



Sebastiano Chiodino

Head of Liability-Driven Investments,
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LDI VIEW: A GLOBAL STEEPENING TREND AHEAD

Global fixed income markets are expected to be shaped by trade negotiations, geopolitical risks, sovereign fiscal policies, and central bank action. The yield curve global steepening trend seen across major developed markets is expected to continue, although with bouts of profit-taking, driven by monetary policy shifts, economic growth, and supply-demand dynamics. While markets are pricing in about two rate cuts in both the US and Europe, long-term yields, particularly in the US, may rise further due to concerns over fiscal sustainability and increased bond issuance. The impact of the US tax cut plan, aligned with President Trump's first-term agenda, could in fact add a significant amount to the deficit over the next decade. Japan's long-end yield pressures and Europe's upcoming defence and infrastructure spending, especially in Germany, will also likely contribute to this trend. In addition, in Europe, France's 2026 budget could face challenges amid political fragmentation and tensions between the presidency and government, with the lack of parliamentary majority raising doubts about fiscal policy planning and sustainability.

These factors are likely to drive investor sentiment, impacting fixed income markets going forward. In this context, US and European 10-year rates are expected to remain range-bound in the near-term, hiding upside risks in the longer run.

In credit markets, strong fundamentals and investor appetite for risk and carry should continue to support higher-grade bonds, reflected in robust supply absorption and stable new issue premiums so far. However, volatility could resurface if total returns turn negative, with spread performance crucially dependent on the resiliency of yield buyers' appetite. High yield markets will likely remain technically driven, with recent rallies compressing valuations and limiting further upside potential in our view, so hedging strategies should be considered.



Cindy A. Beaulieu

Managing Director and Portfolio manager,
Conning



COMPLACENCY DESPITE THE CHAOS

President Trump laid out an aggressive plan for his second term in office, one he planned to tackle swiftly with the support of a Republican-controlled Congress. This included immigration reform, trade negotiations, extending and augmenting his tax cuts from 2017, and deregulation. Market participants were optimistic that these policies would spur more consistent and stronger US economic growth, leading to new highs in equity markets, a steepening of the US Treasury curve, and tighter fixed-income spreads.

However, hiding in plain sight was a razor-thin Republican majority that could make it difficult to advance important legislation, as well as economic data signaling a deceleration from the strong second half of 2024. Then came "Liberation Day" on April 2 when President Trump announced sweeping, punitive tariffs designed to bring countries to the negotiating table – resulting in an immediate and violent market downturn. A week later, Trump paused these tariffs for 90 days and it did not take long for markets to fully recover back to levels seen earlier this year.

We look to the second half of 2025 with caution. While the US economy seems to be stabilizing, all be it at lower levels of growth than last year, we believe market valuations are again not accounting for the risks. There is still much uncertainty and unpredictability around Trump administration policy objectives. While labor markets are holding steady there is the potential for weakening, particularly if there is an unfavorable outcome on tariffs. Given the lack of clarity, the Federal Reserve will be forced to stay on the sidelines despite markets pricing in more interest-rate cuts. In the meantime, we see solid fundamentals across many sectors in which we invest and, helped by higher interest rates, the all-in-yield for US fixed-income assets remain attractive.



Mauro Valle
Head of Fixed Income,
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BTP-BUND SPREADS HIT 100BPS: CAN THE RALLY HOLD?

The recent tightening of the BTP-Bund spread to 100 basis points – a level not seen since September 2021 – was driven by a number of positive factors. Italian economic growth in recent years has been solid, outperforming the euro area average, which has helped stabilise the debt-to-GDP ratio. This was supported by a budgetary policy that kept public spending under control. Italy's 2024 deficit was better than expected, at 3.4%, with a slight improvement projected for 2025. These developments have been recognised by rating agencies, as shown by S&P's recent upgrade of Italy's sovereign rating to BBB+.

The 100 bps mark is an important technical threshold, and over the past decade, BTPs have not managed to consolidate below it. Whether spreads can remain at or below this level will depend on two key conditions: continued positive economic momentum and disciplined fiscal policy on one side, and a global backdrop of stable or falling interest rates on the other. Another important element is the shift in fiscal dynamics across the eurozone. Public spending is rising in several countries – not only in France but also in Germany, which has announced investment in defence and infrastructure. This fiscal convergence helps reduce the risk of divergence in sovereign rates, lending support to peripheral bonds.

While current Italian spreads are less attractive from a historical point of view, we believe they are sustainable, and the good performance of BTPs can continue over the medium to long term. A spread below 100 bps is not in itself a reason to reduce exposure. The main risk lies in market volatility, as seen in April, when Trump's announcement of new tariffs pushed the spread to 130 bps. Fundamentally, BTPs remain supported, though volatility may warrant some adjustment to spread positions.

For Bunds, modest growth and inflation near the ECB's 2% target should allow for further rate cuts. Yields above 2.5% offer opportunities for moderate interest rate exposure. In contrast, the Fed remains cautious, with 10-year Treasury yields seen as neutral around 4.5%, unless the labour market weakens.



Stanislas de Baillencourt
Head of Asset Allocation & Fixed Income,
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RESILIENT YIELD OPPORTUNITIES IN RESPONSIBLE EUROPEAN FIXED INCOME

Geopolitical uncertainty, notably from Trump-era politics, continues to weigh on global growth expectations. Despite the 90-day pause on tariffs, the broader effect is still one of heightened unpredictability. So, we expected relatively lower US growth in the second half of the year. In Europe, to contrast, inflation is now under control, and with both lower growth and inflation, the European Central Bank had significant room to cut rates, potentially down to 1.75% in the coming months.

Germany's recently announced €100 billion annual fiscal plan is a substantial stimulus that supports economic activity and credit markets. However, it also creates upward pressure on long-term yields, while the ECB's easing drives short-term rates lower, resulting in a steepening yield curve. This dynamic, combined with the roll-down effect, creates a supportive environment for fixed income investors.

Turning to corporate credit, earnings have shown resilience despite a volatile macro backdrop. As money market halved in 12 months, demand for yielding assets, particularly corporate bonds, is intensifying, as seen in primary markets. Spreads are currently tight, but this reflects strong fundamentals, low default rates, and sustained investor appetite.

Responsible investing is also gaining traction, with investor demand rising as they seek to lock in current yields. At the same time, the supply of ESG-labelled instruments is growing rapidly, with issuers bringing more sustainability-linked bonds (SLBs) and bonds with embedded ESG criterias to market.

Looking at credit sectors, we have reduced exposure to autos and are continuing to focus on crossover names (BBB–BB) for attractive risk-adjusted returns. European high yield continues to show relative resilience versus the US, benefiting from lower exposure to oil, gas, and basic materials – sectors under pressure due to falling commodity prices. Stronger ESG screening in Europe also differentiates the region, offering more structural support and stability in today's environment.

In conclusion, we are optimistic that Europe presents a stronger backdrop for responsible fixed income than the US, given more controlled fiscal dynamics and better sector composition.



Witold Bahrke

Senior Macro & Allocation Strategist,
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EM DEBT: REBALANCING BENEFITS

The consensus at the beginning of the year has proven spectacularly wrong: trade headwinds have not hurt emerging market debt (EMD), outperforming many developed markets. This is not a fluke. Rather, it is testament to EM bonds benefiting from the two key top-down themes that should continue to provide a fertile ground for EMD returns in the second half of 2025.

First, it's about peak US exceptionalism. Growth differentials between the US and the rest of the world are moving in favour of the latter. The fiscal growth impulse is scaled back in the US and ramped up elsewhere. Also, the trade war hits US sentiment hardest. This puts the US dollar under pressure and supports EM currencies. Consequently, monetary conditions ease, supporting EM risk appetite.

Secondly, EM debt returns are buoyed by peak policy uncertainty. It's a rocky road, but US tariffs are set to decline further from their lofty levels in early April as the White House tends to "blink" in the tariff game of chicken. To be clear, geopolitical uncertainty will remain elevated. The good news is that frontier markets and EM local currency bonds in particular do well in an environment of high geopolitical uncertainty.

Lately, US growth expectations bottomed. Tactically, peak policy uncertainty should overtake peak US exceptionalism as the dominant driver of EM risk appetite. Credit risk benefits the most from such a shift. Short-term, EM hard currency bonds therefore stand to outperform. Strategically, we maintain a preference for local currency bonds as growth differentials move back into the spotlight once the initial trade policy uncertainty shock fades.

We prefer segments that are less vulnerable to additional trade restrictions, such as Latin America and the frontier universe. In addition, countries with positive reform momentum such as Argentina or Nigeria or an increased likelihood of an upgrade to investment grade status like Serbia and Oman are among our preferred country picks.



Simon Thorp

CIO of Corporate Credit,
Aperture Investors



SECTOR AND STOCK DISPERSION OPPORTUNITIES ABOUND FOR HEDGED CREDIT INVESTORS

Credit markets have recovered well from the depths of the tariff-driven sell off in April, though US high yield spreads remain 50bps wider than the tightest levels of Q1 2025 (European spreads are 20bps wider). The brief period of outflows has been followed by strong inflows to the asset class. With macro-economic data holding up well (so far), it seems that the volatility witnessed in Q2 might have been misplaced and a thing of the past.

We think that credit markets are well positioned to benefit from a world where growth is expected to moderate and interest rates to fall gradually. Credit spreads are tight from an historic perspective but are justified as the underlying credits are higher quality and shorter duration than in the past, whilst government bond markets are generally much lower quality.

Breaking down the credit market, we see elevated sector and single-name dispersion, indicating that there are attractive opportunities in long, short and relative-value positioning.

Looking ahead, if inflation remains under control, economic growth stays satisfactory, tariffs are set at lower bounds, and rate cuts occur as anticipated in the near-term, we expect to see outperformance particularly from the auto, chemicals, energy and retail sectors.

If, however, a recession becomes a genuine concern and/or we see rising yields in US Treasuries (fiscal largesse/increasing inflation expectations), then credit markets are likely to reverse sharply. This could be driven by outflows and may offer attractive risk-adjusted returns on the short side, as markets begin to price in rising default risk.

In short, whilst the world seems to be a slightly less volatile place than at the start of Q2, we would argue that uncertainty (both economic and geo-political) remains high.

We feel that the credit asset class has the potential to deliver strong risk-adjusted returns in 2025. However, against a backdrop of elevated uncertainty, we believe hedged credit strategies are well positioned to navigate this uncertain environment.



Mauro Ratto

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Plenisfer
INVESTMENTS

CAUTIOUS OPTIMISM WITH A FOCUS ON REAL YIELDS AND UNCONSTRAINED OPPORTUNITIES

The first half of the year has presented a mixed picture for fixed income investors. Credit markets have remained broadly resilient, but volatility re-emerged at the lower end of the ratings spectrum, driven largely by geopolitical risks, tariff-related uncertainties, and spread widening. While much of this has since normalized – with tighter spreads and equity markets nearing their highs – two standout developments are shaping the outlook: a weaker US dollar and growing pressure on the US sovereign curve.

The Federal Reserve's recent shift in tone has been notable. Citing stagflation risks, the Fed has put further rate cuts on hold. Policy rates are now expected to stay around 3.5% for the next two years, halting the bond rally seen earlier in Q1. However, the short-to-medium part of the US yield curve – particularly the five-year maturity – still offers compelling value, with real yields around 1.5% assuming inflation remains stable or declines.

Still, macro forecasting is challenging. Some tech-driven capex, such as US data centre growth, boosted Q1 GDP by about 1%, despite a drag from a widened current account deficit. Employment remains strong, but weak consumer confidence and falling immigration may create labour market distortions. Inflation is stickier due to tariffs being passed onto consumers, adding to the complex picture.

Globally, oil prices remain subdued – largely due to oversupply from OPEC – which supports economic activity and helps curb inflation. But this delicate balance is vulnerable to both geopolitical and demand-side shocks.

In this context, euro curves appear fully priced, while value persists on the short-to-medium part of the US curve. However, this is a risky area if inflation reaccelerates, particularly for the long end.

Spreads remain tight. Our allocation to subordinated debt and AT1s worked well in volatile phases, but there's now limited value there. More promising is local currency emerging market debt, particularly Brazil and Mexico, where independent central banks kept rates high. Brazil's nominal policy rate is around 13.5% versus inflation of 7–8%, implying real rates of around 5–6%. We've initiated small positions in Brazilian local rates and are also looking at interest rate swaps, to capture carry without currency exposure.

Overall, our strategy remains one of cautious optimism, emphasizing selective credit exposure, flexible duration management, and a focus on real yields and inflation trends in a highly uncertain macro environment.

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