Global Rates Strategy

Marketing material for professional / institutional investors only

Market backdrop

Overall, 2024 saw generally higher-than-expected growth and slow progress on bringing inflation back to target. However, we did see rate cuts and against this backdrop risk assets generally performed strongly. US equities did particularly well and responded very positively to the election of Donald Trump and the Republican party. The appointment of Scott Bessent to the post of Treasury Secretary appeared to allay some of the fears that the worst excesses of Mr Trump might be contained. With inflation proving stubborn and no clear signs that governments in many countries are committed / able to control their deficits, inflation hedges such as Bitcoin and gold also performed strongly.

In bond markets, the major developed markets saw returns in a -4% to +5.2% range. The UK was the worst performer, and Italian bonds the best. Italy was helped by the generally more positive risk environment while the UK suffered on the back of growing signs that inflation is proving stickier than elsewhere. In the US, overall bond returns were +0.5% though there was a clear dispersion across the curve. Two-year treasury yields ended the year largely unchanged. However, inflation concerns resulted in a weakening in longer-dated bonds, with 10-year yields ending 2024 around 70 basis points (bps) higher.

Returns from emerging market bonds were worse than their developed market peers. The emerging market bond index was down 1.6% on the year, while bonds from the Latin American region were hit particularly hard, falling 14.2%.

With US growth stronger, risk assets performing well and Mr Trump winning a clear mandate with his promises of tax cuts and tariffs, the US dollar performed strongly, with the dollar index up over 7% on the year. Within the more mature markets the Japanese yen and the Australian dollar were the worst performers, falling respectively 10.3% and 9.8%. Outside of the US dollar, sterling held up relatively well on the back of expectations that the Bank of England would have less room to cut rates than previously expected. The real action in currency markets was in emerging markets where the strong US dollar added to some country-specific concerns to make life difficult. Brazil, Russia, Argentina and Mexico all saw their currencies fall close to 20% versus the USD. Turkey and Hungary also saw double-digit losses over the course of the year.

December

Both developed and emerging bond markets suffered losses in December. One market that came under particular pressure was Brazil where we had a meaningful position.

At the start of December, and throughout much of 2024, we were of the view that Brazilian interest rates were too high. We spent much of the second half of 2024 building a meaningful long position in front-end rates. However, both the global backdrop and domestic factors proved unsupportive. On the global front, the strong US economy and resulting strength in the USD resulted in downward pressure on the currency which was not helped with the election of Mr Trump. The Brazilian real fell over 21% during 2024 (making the job on bringing inflation down that much harder), but the Mexican peso was also down 18.5%, the Argentine peso down 21.6% and the Turkish lira 16.5% lower. Domestic factors were also unhelpful. The Brazilian economy performed much better than expected at the start of the year, thereby reducing the case for near-term interest rate cuts. The government also failed to reassure investors over the fiscal outlook which ultimately became the primary concern for investors. These factors were then exacerbated by position unwinds. As a result, Brazilian rates came under significant pressure during the later part of the year. Over the course of 2024 the January 2026 DI futures sold off by around 570 bps, with over a quarter of this move coming in December.

In light of the selloff in Brazilian rates we fully stopped out of our long positions in the Jan 2026 futures. We recognise that it is going to take longer than expected for the tighter monetary policy to slow the economy and for the authorities to convince investors that they are on track to meet their fiscal goals. We do however believe that with an implied policy rate above 16% (rates are currently 12¼%) and investors largely out of any Brazilian risk that completely exiting the position at this point would be a mistake. We have therefore re-entered some risk further along the curve, but with a current interest rate exposure of around 40% below our peak levels at the start of Q4.

Performance

The USD (Institutional) share class was down 400 bps in December, leaving the strategy down 520 bps for the year.

Adrian Owens
Manager of the Global Rates Strategy

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GAM Investments

December performance contributors

- Long euro area rates versus Sweden +140 bps
- Long US breakeven inflation +15 bps
- Long Australian rates versus UK +40 bps
- Long USD versus euro and GBP +30 bps

December performance detractors

- Long Brazilian rates -495 bps
- Long UK rates versus Europe -85 bps
- Long NOK versus SEK -35 bps
- Long BRL versus GBP -10 bps

Positioning

We established a long UK interest rates position versus the euro area. This is expressed at both the front and long end of the market. We took profit on our long Australian rates position versus the UK by converting it to a long Australia versus short Canada rates position. Long dollar positions were established versus both the euro and sterling. Our positions in Brazilian interest rates were restructured and reduced by around 30% as stops were hit. We fully stopped out of a tactical long Brazilian real position versus sterling.

Outlook

So much of the focus for 2025 centres around the US and the likely policies of Mr Trump. For now, we are keeping our focus a little more short-term given some of the uncertainties. That said, the outlook for inflation does appear to us to be a little more certain. An apparent rejection of sound fiscal policies from many of the major countries, tight labour markets, the green transition and central banks keen to cut rates suggest to us that most of the inflation risks continue to be on the upside. And this is without potentially harmful tariffs that are threatened by the incoming US administration. We therefore continue to favour long inflation breakeven trades, particularly in the US.

In terms of individual markets, for much of last year we favoured short interest rate positions in the UK given our concerns over the relative stickiness of UK inflation. For much of 2024 we held short UK rates positions versus Europe and Australia. We feel a lot of this is now in the price. With a number of leading indicators suggesting that the outlook for UK growth is deteriorating and with many UK yields close to highs versus markets such as the euro area we are becoming more constructive on the relative near-term outlook for UK rates.

A couple of other countries that are on our radar are Australia and Canada. The two countries have been at different stages in their interest rate cycle. In Canada the central bank spent the second half of 2024 taking rates from 5% down to 3¼%. Meanwhile the Australian central bank left interest rates unchanged at 4.35%. Looking ahead, we feel the scope for rate cuts from Australia exceeds that from Canada. The market currently sees both central banks cutting to the same degree over the coming year. We will elaborate further in subsequent monthly letters.

Brazil remains a meaningful position for the strategy. The fiscal situation in Brazil is not ideal but measures are being taken to address it. The spending reduction bill has been approved by Congress. In the end the bill was only watered down from BRL 72 bn to BRL 69 bn, a better outcome than expected. President Lula has also acknowledged in a statement alongside Finance Minister Haddad and the central bank governor Galipolo that they acknowledge market concerns. This has been clear from the estimated USD 21 billion of spot currency intervention and over USD 11 billion of currency repos undertaken last month. We estimate that under current plans the government should not be too far off a primary balance or modest primary deficit this year. The seriousness of Brazil's situation is now being acknowledged by key policy makers. Measures are being taken on both the fiscal and monetary front. However, this is yet to be acknowledged by investors, with the market pricing in rate hikes in excess of a further 400 bps.

In terms of currency, for now we favour long positions in the US dollar given the expected relative interest rate path of the US versus other major markets as well as our forecast for continued economic outperformance of the US over the coming months. Elsewhere, we continue to favour the Norwegian krone on grounds of value, positioning and technicals.

The bulk of our risk (70%) remains in interest rates, around 10% is in currency and 20% in inflation trades.

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