

Fixed Income Weekly

A reassuring Fed Chair for bond investors

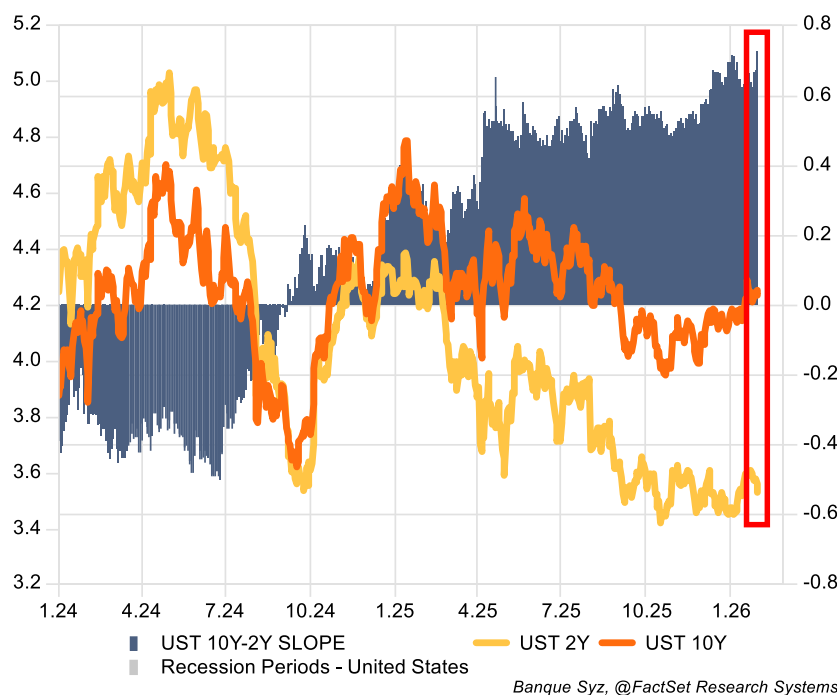


Syz Fixed Income Research – Week from 26 to 30 January 2026

US rate markets took Warsh's nomination with calm, demand for credit and EM debt remains strong

The Chart of the Week

A benign initial reaction from the US Treasury market to Kevin Warsh's nomination



The nomination of Kevin Warsh as Fed Chair has been received as a reassuring signal by US bond markets, reflecting his strong monetary policy credentials and institutional credibility. The initial market reaction has been notably benign, with a modest divergence between the front and long ends of the curve. 2-year Treasury yields have edged lower, consistent with expectations that the next policy move remains a rate cut. By contrast, 10-year yields have moved slightly higher, producing a small but visible additional steepening of the US yield curve.

Importantly, this steepening has not been accompanied by any meaningful rise in inflation expectations. Market-based measures remain broadly stable, even marginally lower post-announcement, suggesting no concern about a de-anchoring of long-term inflation expectations. Instead, the curve dynamics point to reduced tail risks of policy-induced inflation re-acceleration, as investors take comfort in Warsh's perceived commitment to price stability.

What happened last week?

Central banks

The Fed held its key rate unchanged last week as expected but the key news arrived at the end of the week. Kevin Warsh's nomination as Fed Chair is being interpreted as a reassuring signal for bond investors, reflecting his deep experience in monetary policy and strong institutional credibility. The initial market reaction has been benign. Inflation expectations remain broadly unchanged, with a marginal post-announcement dip and no signs of long-term inflation concerns embedded in market pricing. Overall, Warsh's credentials appear to reduce the perceived risk of policy-induced inflation re-acceleration or a de-anchoring of expectations.

Looking ahead, attention will focus on Warsh's confirmation hearings, his public remarks, and potential changes to the composition of the Fed Board. Based on his past views, Warsh could emerge as "the Chair who cuts," with scope to lower policy rates if inflation remains contained or falls alongside productivity gains. He may also resume balance sheet reduction, following the Powell Fed's decision to halt quantitative tightening last year. Following the announcement of Kevin Warsh's nomination, market-based Fed rate cut expectations initially edged up but remain close to two 25bp cuts by the end of the year.

In Europe, the euro slipped modestly after comments from Austrian central bank governor Martin Kocher, who noted the ECB may need to act if euro strength materially dampens inflation. However, he characterized recent gains as modest and emphasized full policy optionality ahead of next week's ECB meeting. The broader backdrop remains one of persistent US dollar weakness. Future markets continue to expect the ECB to remain on hold this week and for the remaining of the year.

In the UK, the Bank of England continued balance sheet normalization, reducing its asset purchase facility by 0.9% to £553.2bn over the past week. Future markets expect no change in BoE rates this week, one 25bp rate cut before summer and a 50% probability of a second rate cut during the second half of 2026.

Rates

Sovereign bond markets absorbed the nomination of Kevin Warsh as Fed Chair relatively smoothly amid a broader risk-off tone late in the week. US front-end yields rallied, with the 2-year Treasury down 7bps on the week to 3.52%, reflecting both safe-haven demand and expectations that the Fed's next move remains a cut. This was reinforced by Wednesday's FOMC decision to hold rates steady at 3.50–3.75%, with Chair Powell offering little near-term guidance but signalling no change in the easing bias.

By contrast, longer maturities cheapened modestly. The 10-year Treasury rose 1bp to 4.24%, while the 30-year increased nearly 5bps to 4.87%, extending the mild curve steepening triggered by Warsh's nomination. Inflation expectations edged slightly higher, with the 10-year breakeven up 3bps, while real yields declined marginally.

In Europe, sovereign yields fell broadly amid ongoing disinflation dynamics and cautious ECB communication. German 10-year Bund yields declined 6bps to 2.84%, with similar moves across France and the periphery. UK gilt yields were broadly stable, while Swiss yields fell sharply across the curve. Japanese yields were little changed.

Bond ETF performance reflected these moves. US short-duration Treasury ETFs posted modest gains, while long-duration funds underperformed amid rising long-end yields. In contrast, euro government bond ETFs delivered solid positive returns, particularly in longer maturities and inflation-linked exposures.

Credit

EUR credit markets remained broadly range-bound last week, despite sharp whipsaw moves in commodities and foreign exchange and a heavy new bond issuance including the Reverse Yankee bonds issued by US-based IBM in euro market.

The sell-off at the long end of Japanese rates did not spill over into EUR or USD investment-grade credit. Japan-domiciled issuers account for only 2–3% of the EUR and USD IG indexes, and we observed no meaningful spread widening among these Japanese companies.

EUR investment-grade credit recorded another week of inflows and delivered a +0.5% total return, while money-market funds posted a second consecutive weekly outflow. Investor positioning suggested skepticism that recent headlines would translate into material risks to credit markets. Within EUR investment grade, autos, construction, metals & mining outperformed.

S&P lifted Italy's BBB+ rating outlook from Stable to Positive. Italy's diversified private sector should support current account surpluses, putting government debt on a slow declining trend through 2028.

European banks kicked off the full year 2025 earnings season with solid results, broadly meeting or exceeding financial targets. Lloyds Banking Group revised its 2025 profitability guidance upward, while CaixaBank maintains an optimistic outlook for 2026–2027.

U.S. credit markets softened amid modest risk-off sentiment following the appointment of Kevin Warsh as Fed Chair. This drove some spread widening across U.S. investment grade and high yield. Nevertheless, total returns proved resilient, with U.S. IG up +0.1% and high yield flat, supported by high coupon carry, which continues to do the heavy lifting in driving the total return performance.

U.S. primary markets closed January on a strong note. Robust investor demand persisted through market volatility, with average oversubscription of 4.2x, above the 2025 average of 3.9x.

Credit spread curves are now so steep, making 5–7-year maturities particularly attractive to own from a risk-adjusted perspective. We continue to advocate avoiding long-duration risk.

Emerging market

Emerging market (EM) credit markets remained stable last week, supported by the Fed's decision to leave policy rates unchanged. Argentina and Romania were among the outperformers.

Trade developments continued to attract attention. The EU–India trade agreement, long under negotiation, has moved back to the top of the agenda as the U.S. has sharply increased trade barriers. In parallel, the EU–Mercosur agreement—covering Argentina, Brazil, Paraguay, and Uruguay—would, if ratified by EU member states, remove tariffs on around 91% of goods traded with the EU. For Latin American exporters, this would materially improve access to European consumer markets, particularly for agricultural, dairy, and food products.

In fact, across Latin America and the Caribbean sovereign, the average S&P's rating has greatly improved in recent years, reaching 50% share of investment grade. This marks a break from the past decade.

EM debt primary market activity was exceptionally strong in January. EM sovereign issuance reached \$73 billion debt, far exceeding the previous monthly record of \$54 billion in April 2020.

EM debt funds recorded a weekly inflow following three consecutive weeks of outflows. To put this in perspective, EM debt funds experienced steady inflows throughout the second half of 2025, following three years of sustained outflows. It is widely expected to see scope for inflows to extend into 2026.

EM sovereign USD bonds were down marginally by -0.1% total return last week despite record new bond issuance (iShares EM Sovereign USD Bond ETF). EM local-currency sovereign bonds were broadly flat after the strong gains in the previous week (The J.P. Morgan EM Local Currency Bond ETF).

The projected positive GDP growth in emerging markets, conservative EM corporate leverage and a weaker U.S. dollar create a supportive backdrop for EM debt to deliver resilient carry.

Our view on fixed income

Rates

NEGATIVE in current environment

We maintain a Negative stance on government bonds. Positive global growth dynamics, price pressures in the US and profligate fiscal policies reduce the attractiveness of long-term government bonds as a potential hedge for economic downturn and increase the risk of higher long-term yields. Limited prospects of further central banks' rate cuts and unattractive yield curve slopes at the front-end also reduce the attractiveness of government bonds on short-to-medium term maturities.

High Yield

NEUTRAL, favor short maturities

We like High Yield bonds with short maturity for their attractive combination of yield and low sensitivity to interest rate movements. HY spreads have tightened, signaling economic stability and contained default risk in the short run. However, those tight spreads are not attractive for medium-to-long term maturities as they do not compensate adequately for a potential deterioration in the economic environment. As such, we hold a Neutral view for High Yield in an allocation, with a clear preference for short-duration investments. We continue to find value in subordinated debt.

Investment Grade

NEUTRAL, harvest the carry

We find Investment Grade corporate bonds attractive in the current environment, given their yield level and our constructive economic scenario. However, tight credit spreads reduced the margin for safety in credit and make the asset class expensive from a valuation standpoint. As a result, we keep a Neutral stance on Investment Grade credit from an asset allocation perspective. The credit market's overall health is supported by robust demand and strategic maturity management.

EM

NEUTRAL, with opportunities

We advocate for a careful selection of issuers to benefit from attractive absolute yields. Global growth dynamic, a weaker US dollar, contained public debt & corporate leverage along with strong flows are supportive for EM debt. However, risks persist, with rich valuations and unpredictable Trump's trade policies. Idiosyncratic risks also remain, notably in Brazil and India. Given this backdrop, we stay selective, favoring short and medium-duration opportunities while remaining Neutral on the broad EM debt asset class in a multi-asset portfolio context.

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