

Fixed Income Weekly

Hawkish repricing sends sovereign yields higher and bonds lower

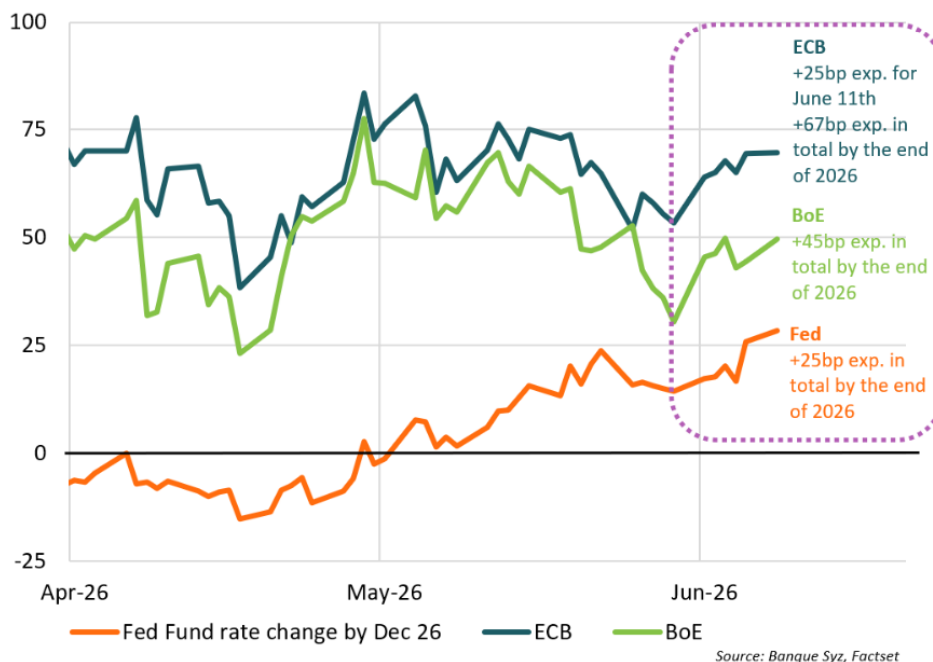


Syz Fixed Income Research – Week from 1 to 5 June 2026

Rising rates weight again on bonds' performance while Corporate and EM spreads remain tight

The Chart of the Week

Expectations for central banks' rate hikes rise again



Rate markets have turned more hawkish again after a brief pullback in late May, with investors increasing expectations for additional policy tightening across the Fed, ECB and BoE.

In the US, stronger-than-expected May payrolls and hawkish comments from Fed officials reinforced concerns that the US economic situation might require a Fed reaction later in the year. Cleveland Fed President Beth Hammack emphasized that inflation remains a greater risk than the still-resilient labor market, while New York Fed President John Williams left the door open to further action. Markets now fully price a 25bp Fed hike by the end of 2026.

The most significant repricing has occurred in the euro area ahead of the ECB meeting on June 11th. A 25bp hike is widely expected following the rise in inflation to 3.2% in May. Beyond June, markets fully price another hike by September and now assign a 67% probability to a third 25bp increase by end-2026.

In the UK, the BoE is expected to remain on hold this month, but markets continue to price a 25bp hike later this year, reflecting lingering concerns over energy-driven inflation risks. Overall, markets increasingly expect rates to remain higher for longer.

What happened in the last ten days?

Central banks

The release of the US Employment report for May has only reinforced concerns around inflation risks repeated earlier in the week by several Fed members. Cleveland Fed President Beth Hammack argued that while keeping rates unchanged is appropriate for now given economic uncertainty, policymakers may soon need to respond if inflation remains persistently elevated. She stressed that inflation remains a greater concern than the still-resilient labor market and suggested policy may not currently be restrictive. New York Fed President John Williams similarly described policy as appropriately positioned, while noting no clear direction for future rates. Stronger-than-expected payroll growth reinforced this hawkish tone, prompting markets to fully price a 25bp rate hike by year-end and fueling expectations that the June FOMC meeting could signal a greater willingness to tighten if inflation pressures persist.

Attention is firmly on Thursday's ECB meeting, where a 25bp rate increase is widely expected, especially in the context of the acceleration in euro-area inflation to 3.2% in May. Policymakers remain concerned that higher energy prices linked to the Middle East conflict could generate broader second-round effects through wages and corporate pricing. While the June move appears largely settled, officials continue to signal caution regarding the policy path beyond next week amid a weakening growth backdrop. Beyond the June 11th decisions, future rate markets continue to fully price another 25bp rate hike at the September meeting, and the probability of a third rate hike by the end of 2026 bounced up to 67% last week after having declined in the 2nd half of May.

BoE: Bank of England officials continued to express a cautious stance last week, that is expected to lead to a status quo on rates at the June 18th meeting. MPC members Swati Dhingra and Alan Taylor both indicated rates are sufficiently restrictive for now, though neither ruled out further tightening should energy-driven inflation risks intensify. Future markets continue to price a 25bp rate hike later in the year, and the probability of another one rose back last week to 85%.

Rates

Global sovereign bond markets endured a broad sell-off last week as renewed inflation concerns and rising expectations of tighter monetary policy pushed yields higher across major markets. The key catalyst came on Friday, when a stronger-than-expected US employment report reinforced the resilience of the labor market and fueled speculation that the Federal Reserve may need to raise rates. Markets now fully price a 25bp Fed hike by December, prompting a sharp repricing across the Treasury curve. The 2-year Treasury yield rose 14bps on the week, including more than 10bp on Friday alone, to a one-year high of 4.15%, while the 10-year yield climbed 9bps to 4.53%. The move was concentrated at the front end, leading to a modest flattening of the curve.

European government bonds broadly tracked the Treasury sell-off as investors positioned for an expected 25bp ECB rate hike next week. German 2-year yields rose 16bp and 10-year Bund yields increased 10bps, while French and Italian 10-year yields up 14bp and 15bp respectively.

The weakness was reflected in ETF performance, with losses increasing with duration. US Treasury ETFs declined between -0.5% and -1.1%, led by intermediate and long-maturity segments, while euro government bond ETFs fell between -0.6% and -1.2%, with 10-15 year maturities posting the weakest returns. UK gilt yields rose 9bps, while Japanese government bond yields were broadly unchanged.

Credit

Credit spreads were generally resilient despite global rate selloffs, with spreads tightening across Euro Investment Grade (IG) and High Yield (HY). However, total returns were negative across most credit segments, driven by higher U.S. Treasury and German Bund yields. The only segment to generate positive returns was Banks AT1, supported by historically strong European bank fundamentals. Although US banks saw capital ratios decline modestly in 1Q due to shareholder distributions, capital levels remain comfortably above regulatory requirements.

Fund technicals continued to provide strong support. EUR IG funds attracted another week of sizeable inflows, with the asset class now offering a yield of 3.6% in a higher-rate environment. Pension funds and insurers increasingly find public credit attractive relative to private credit. EUR HY funds recorded their eighth consecutive weekly inflow.

Fundamentals remain constructive. US corporate profit margin expectations continue to rise, reflecting productivity gains from AI adoption. US hyperscalers remain structurally less leveraged than the broader IG universe, with average gross leverage of 1.8 times versus 3.3 times for the rest of the market.

Looking ahead, markets are fully pricing a 25-basis point ECB rate hike this Thursday, that would be the first in almost three years. Historically, initial hiking cycles have rarely disrupted corporate credit performance. With the ECB real policy rate after the pending rate hike at around negative 1%, financing conditions remain favourable: companies can invest and refinance debt.

Meanwhile, primary issuance has exceeded last year's pace, but supply should begin to slow as the summer lull approaches. Together with strong fund inflows and the prospect of negative net supply, technicals should remain favourable, potentially keeping credit spreads rangebound.

Emerging market

Emerging market (EM) debt delivered negative total returns last week as higher U.S. Treasury yields weighed on performance. EM local currency sovereign bonds were the weakest segment, hurt by a stronger U.S. dollar. EM corporate bonds fared better in a weak market.

Beneath the rate impact, market technicals remained supportive, with global EM debt funds attracting inflows for an eighth consecutive week. In fact, EM High Yield (HY) has outperformed US HY, generating year-to-date returns more than double those of U.S. High Yield.

Performance dispersion across regions remains striking. Africa has emerged as the standout performer, returning approximately 3.5% year-to-date, well ahead of Latin America at 1.1%, even Latin America is relatively insulated from the Strait of Hormuz disruption.

A notable trend this year has been the growing use of the euro funding market by EM sovereigns. EUR-denominated issuance now represents roughly one-quarter of the total outstanding hard-currency EM sovereign debt universe. Lower funding costs, more contained inflation in Europe relative to the U.S., and a decline in EUR/USD hedging costs have encouraged issuers to diversify funding sources beyond the dollar market. In several cases, including Romania, Brazil, Indonesia and Côte d'Ivoire, parts of the EUR curve trade wider than comparable USD bonds, creating relative value opportunities.

Investor attention remains focused on Colombia's presidential election on 21 June, with markets broadly expecting a business-friendly outcome. Meanwhile, stronger oil prices are supporting

Colombia's fiscal and external balances, while a recent court ruling reinforced the operational independence of the central bank.

The wide dispersion in performance across countries, sectors and issuers, alongside with the high volatility in oil prices reinforces the importance of careful credit selection, a primary source of alpha in EM debt portfolios.

Our view on fixed income

Rates

NEGATIVE in current environment

We maintain a Negative stance on government bonds. Upward price pressures from the shock in energy prices and prospects of continuously profligate fiscal policies reduce the attractiveness of long-term government bonds as a potential hedge for economic downturn. Prospects of potential central banks' rate hikes (+ no more rate cuts ahead) and unattractive yield curve slopes also lower the attractiveness of government bonds on 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 remain tight, and 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 continue to find Investment Grade corporate bonds attractive, given their yield level and our still constructive economic scenario over the medium term. However, still tight credit spreads reduce the margin for safety, especially in a more uncertain macro-economic environment. As a result, we keep a Neutral stance on Investment Grade credit from an asset allocation perspective.

EM

NEUTRAL, with opportunities

EM debt remains our favored segment of the Fixed Income market. Global growth dynamics, contained public debt & corporate leverage in many EM economies are supportive for EM debt. However, risks persist, with rich valuations, a more uncertain economic outlook and unpredictable US policies. 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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