GSFM FUNDS MANAGEMENT

Media Release

18 March 2025

Absolute return focus needed in 2025 to deliver reliable income on bonds in the midst of global uncertainty

The challenges fixed-income markets face are rising, with inflationary pressures potentially denting bond prices as US President Donald Trump proceeds with tariffs which could also depress global economic activity. These factors will play an important role in shaping the trajectory of bonds markets in 2025, according to Eric Souders, director and portfolio manager with Payden & Rygel.

In a landscape of shifting economic forces and greater bond market volatility, 'Bond Wars' could unfold this year, and with that, a flexible and adaptable investment approach, or absolute return strategy, is required to deliver reliable income for investors and avoid capital losses on bonds, according to Mr Souders.

"As we move through 2025, the interplay of economic, fiscal, and political factors has created a landscape filled with both opportunity and risk for bond investors. We are likely entering a new regime characterised by higher volatility in interest rates, inflation, and credit spreads. The ability for portfolio managers to adapt, without being constrained by a bond benchmark, will become increasingly important this year in the face of greater uncertainty.

"Inflation dynamics remain in flux as a new US Treasury Department strategises the balance between fiscal and monetary conditions, and Trump's second administration introduces important dimensions to policy and growth such as tariffs and US-focused policies," he said.

Mr Souders favours the flexibility to invest in certain fixed income asset classes while avoiding others, which will be key for investors retaining their capital.

"Market forces across the bond market can shift in both cyclical and structural ways. Cyclical shifts can occur rapidly, rendering forecasts outdated, increasing uncertainty, and driving price volatility across financial assets. Structural shifts typically take longer to unfold and require time to unveil unexpected plot twists," he said.

Already this year, US government bond yields initially jumped, but have since fallen back to multi-month lows after results from a US manufacturing survey in March suggested slowing growth in the world's biggest economy.

"An absolute return fixed income strategy is important in the current uncertain environment, with greater volatility in bond prices," Mr Souders said.

"The bond market is at an inflection point. Forces of light have been strong in the last two years, with solid growth, stable employment, and record-high asset prices. However, the dark side lingers as inflation remains elevated and bond market volatility is too high. Order must be restored as the key players in this saga aim to complete their various objectives."

According to Mr Souders, growth in the US has been above 5 per cent in nominal terms for seven out of eight quarters and above 2.5 per cent in real terms for seven out of eight quarters. Asset prices, including US equities and housing prices, are at or near all-time highs, while credit spreads are near 20-year lows, which all put downward pressure on bond prices heading into 2025.

"The US economy is doing well and does not need more growth, with some arguing it could even benefit from less growth. Donald Trump's victory in the 2024 elections was largely driven by voters prioritising the economy, particularly inflation, over asset appreciation or economic growth. Tariffs have only added to inflationary pressures.

"The Payden Unconstrained Bond team envisions a potential plot twist in the Bond Wars, where bond yields must rise before they can fall. A rise in yields, particularly in longer-term maturities, would tighten financial conditions and temper growth expectations. As a result, the Unconstrained Bond team prefers less exposure to the long end of the yield curve.

"Conversely, the team finds the front end of the bond yield curve attractive, with two-year interest rates just above the Fed Funds Rate and aligned with the US Federal Reserve's reaction function to any deterioration in the labour market or growth," he said.

Unlike core bond strategies, which are driven by market benchmarks, an absolute return strategy does not rely on a benchmark and typically starts with cash. This provides fund managers with greater flexibility to adapt to changing market conditions, focusing on reasonable returns relative to cash while prioritising capital preservation, according to Mr Souders.

"The question remains whether the new coalition within the red wave, helmed by US Federal Reserve Chair Jerome Powell, US Treasury Secretary Scott Bessent, and President Donald Trump, can vanquish inflation, or if the scales will tip, reigniting the eternal battle between the forces of order and chaos lurking in the bond market," he said.

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About GSFM

GSFM was established in 2007 as a subsidiary of the Grant Samuel Group. In 2016 Canadian wealth manager CI Financial Corp, which oversees more than C$529.4 bn in funds under management (at 31 December 2024), acquired a majority stake in the business, previously held by Grant Samuel.

GSFM delivers comprehensive responsible entity services, operational support, commercialisation assistance, and expert distribution and marketing for funds managed by leading local and international investment managers, serving both Australian and New Zealand institutional investors as well as Australian retail investors. It has partnered with nine specialist investment managers, who collectively manage more than A$1.078 trillion.

- Epoch Investment Partners: Based in the financial heart of New York, Epoch Investment Partners specializes in global equity investing focused on free cash flow as the primary driver of returns.
- Payden & Rygel: This independent investment management firm, headquartered in Los Angeles, is renowned for its fixed-income expertise and a commitment to delivering client-focused investment strategies for over three decades.
- Munro Partners: An independent global equity manager from Melbourne, Munro Partners is recognised for its forward-thinking approach, actively investing in innovative and growth-oriented businesses worldwide.
- Man Group: A London-based leader in alternative investments, Man Group brings together cutting-edge technology and deep market insights to deliver diverse strategies across global markets.
- Tanarra Credit Partners: Specialising in private credit instruments, Australian-based Tanarra Credit Partners is dedicated to creating tailored credit solutions, offering unique investment opportunities in niche credit markets.
- Access Capital Partners: This European independent private asset manager is focused on private equity, private debt, and infrastructure, providing investors with access to diversified private markets.
- Eastspring Investments: As a global asset manager based in Singapore, Eastspring brings deep insights and a disciplined approach to investments across Asia, catering to a wide array of asset classes.
- Alantra: With a strong presence in Europe, Alantra specializes in small and mid-cap investments, leveraging local knowledge to drive growth in niche markets.
- Australian Entertainment Partners (AEP): Creators of the AEP Screen Fund, this investment vehicle is dedicated to supporting Australian film and television projects, backing local talent and boosting the creative industry.

GSFM currently manages approx. $10.61 billion funds under management (at 28 February 2025).
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