MFS®

Macro Talking Points

Fixed Income Insights

Week of 10 March 2025

Author

Benoit Anne
Managing Director
Strategy and Insights Group

In brief

- **A game changer for Germany and the eurozone**
- **The case for long duration in Europe is now more complicated**
- **Euro credit valuation looks attractive through a long-term lens**
- **Volatility episodes feel painful but tend to be brief and not too numerous**

Exactly what the Doktor ordered. Germany produced a major surprise last week with what our DM sovereign research team described as a "fiscal bazooka," an ambitious plan to boost government spending and lift deficit limits. This was a welcome development not only for Germany but also for Europe. It aims to address two fundamental problems: first, the need for Europe, in the context of a more complicated geopolitical landscape, to catch up with its defense spending and second, boosting Germany's public investment following years of fiscal austerity. A strong fiscal program appears to be the right policy response, so this can be viewed as a risk-on signal for risky assets in Europe. Don't underestimate this development: It may be a game changer for global markets. It is certainly a game changer for global rates, global currencies and global asset allocation, with the latter benefiting Europe. At this juncture, it is possible that the strong dollar environment that had prevailed for a while may face a serious challenge. Suddenly, European assets, including European fixed income, look a lot more attractive, helped by a rejuvenated euro, which had looked like the sick currency of Europe for some time but is responding to the fiscal steroid injection. Meanwhile, euro credit spreads are showing downside momentum, driven by the positive repricing of European growth and a strong technical backdrop. My colleague Mike Dembro from Client Strategy couldn't have said it better: Global investors are having major Europe FOMO.

Goldilocks has left the chat. Until recently, Market Insights believed that while the US had already moved away from a Goldilocks macro regime, at least the eurozone was enjoying a Goldilocks fixed income backdrop, with rates set to move lower. That's no longer the case. Following the big fiscal signal coming from Germany, our investment team has had to revisit its core view on European duration. Indeed, the sharp repricing of long-end European rates has warranted turning more cautious on duration in Europe. To be clear, the upward move in bund yields has been nothing short of spectacular: The 40-basis-point rise in 10-year bund yields over the past week was the largest move since February 1990, and for the statisticians among us, it has been a 3.9-sigma event,[1] which supposed to happen only once every 125 years. In addition, the ECB changed its tone, which caused the market to price out some future rate cuts. Keeping that in mind, while the market environment has turned more supportive of risky assets in the eurozone, investors will likely be less able to count on a significant drop in market rates to help drive European fixed income total returns. The good news is that euro credit remains well positioned, supported by strong fundamentals and solid technicals. If anything, the yield valuation for euro credit has improved dramatically, with yields now standing at 3.4%.[2] More on that below.

The strategic power of entry points for Euro credit. Entry points matter for long-term fixed income expected returns. Given the current attractive level of European investment-grade yields, the outlook for expected returns has improved considerably. This is because there has historically been a strong relationship between starting yields like today's and robust future returns. For instance, at a starting yield of 3.4% for European IG, the median annualized return for the subsequent five years — using a 30-basis-point range around the starting yield — stands at 4.40%, an attractive hypothetical return with a return range of 3.09% to 5.88%.[3] By comparison, the 20-year annualized return for European IG stands at 2.72%, suggesting that at current yields, the asset class is well positioned to potentially deliver higher-than-average returns over the next few years.[4]

Market volatility watch. There's some good news and some bad news here. Starting with the bad news: Equity volatility has been on the rise since mid-February, with the VIX now standing at 26.33.[5] Technically, it probably doesn't meet the definition of elevated just yet — using the criterion of a 1-sigma move from the long-term average — but we may get there soon. If the VIX crosses 28.8, that will meet our technical definition. Now the good news: Previous episodes of elevated volatility have historically been brief and not too numerous. Since January 2000, there have been 742 days of elevated volatility, or only 11% of the total number of trading days. In addition, since 2000, episodes of elevated volatility have lasted 6.8 days on average, and that includes during the global financial crisis, which alone produced a 171-day stint. Excluding the GFC, the average episode lasted 5.3 days. Granted, five days can feel like a long time when markets are experiencing severe turbulence, but it's fair to say we're not talking about a prolonged shock, outside of recessions. Away from equities, the moves in fixed income have been subdued, even when considering high yield. US HY spreads have widened by 35 bps over the past month, which doesn't represent a big slide by historical standards. Overall, fixed income remains well positioned as an attractive defensive asset class in the face of ongoing volatility and market uncertainty.

Endnotes

[1] Source: Bloomberg. Bund = Bloomberg 10yr Bund generic yields. Data as of 7 March 2025. One sigma = one unit of standard deviation.

[2] Source: Bloomberg. Euro credit = Bloomberg pan-European corporate credit index. Data as of 7 March 2025.

[3] Source: Bloomberg. Euro credit = Bloomberg pan-European corporate credit index. Data as of 7 March 2025.

[4] Source: Bloomberg. Euro credit = Bloomberg pan-European corporate credit index. Total return in gross in EUR. 20-year return calculated between March 2005/ March 2025 (as of 7 March).

[5] Source: Bloomberg Chicago Board Options Exchange. VIX = The VIX Index is a financial benchmark designed to be an up-to-the-minute market estimate of the expected volatility of the S&P 500® Index, and is calculated by using the midpoint of real-time S&P 500 Index (SPX) option bid/ask quotes. Data as of 7 March 2025.

FOR INSTITUTIONAL AND INVESTMENT PROFESSIONAL USE ONLY

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg neither approves or endorses this material or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

The views expressed herein are those of the MFS Strategy and Insights Group within the MFS distribution unit and may differ from those of MFS portfolio managers and research analysts. These views are subject to change at any time and should not be construed as the Advisor's investment advice, as securities recommendations, or as an indication of trading intent on behalf of MFS. No forecasts can be guaranteed.

Diversification does not guarantee a profit or protect against a loss. Past performance is no guarantee of future results.

GLOBAL DISCLOSURE

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by:

U.S. – MFS Institutional Advisors, Inc. ("MFSI"), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited.; **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited ("MIL UK"), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER.; **Note to Europe (ex UK and Switzerland) readers**: Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore –** MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand –** MFS International Australia Pty Ltd ("MFS Australia") (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong –** MFS International (Hong Kong) Limited ("MIL HK"), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the "SFC"). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to "professional investors" as defined in the Securities and Futures Ordinance ("SFO").; **For Professional Investors in China –** MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan –** MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments. **For readers in Saudi Arabia, Kuwait, Oman, and UAE (excluding the DIFC and ADGM). In Qatar strictly for sophisticated investors and high net worth individuals only. In Bahrain, for sophisticated institutions only:** The information contained in this document is intended strictly for professional investors. The information contained in this document, does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Whilst great care has been taken to ensure that the information contained in this document is accurate, no responsibility can be accepted for any errors, mistakes or omissions or for any action taken in reliance thereon. You may only reproduce, circulate and use this document (or any part of it) with the consent of MFS international U.K. Ltd ("MIL UK"). The information contained in this document is for information purposes only. It is not intended for and should not be distributed to, or relied upon by, members of the public. The information contained in this document, may contain statements that are not purely historical in nature but are "forward-looking statements". These include, amongst other things, projections, forecasts or estimates of income. These forward-looking statements are based upon certain assumptions, some of which are described in other relevant documents or materials. If you do not understand the contents of this document, you should consult an authorised financial adviser. Please note that any materials sent by the issuer (MIL UK) have been sent electronically from offshore. **South Africa –** This document, and the information contained is not intended and does not constitute, a public offer of securities in South Africa and accordingly should not be construed as such. This document is not for general circulation to the public in South Africa. This document has not been approved by the Financial Sector Conduct Authority and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.