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NEW

Compass

Welcome to the first edition of Fixed Income Compass, a new forward-looking series designed to provide a structured and strategic view across the full spectrum of fixed income asset classes.

Compass draws on the insights of our “Matrix Pods”. These are cross-functional forums that bring together portfolio managers, strategists, economists, and traders to generate forward-looking, consensus-based views on key fixed income asset classes. Each quarter, Compass distils top-down macro perspectives and bottom-up market intelligence into a cohesive outlook. This provides investors with a clear directional view on key risk drivers, helping guide portfolio positioning and enhance decision making across the key fixed income asset classes.



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Steepening ahead

Fraser Lundie
Global Head of
Fixed Income



This quarter’s Compass reflects a cautiously optimistic stance as we navigate an evolving macroeconomic landscape. While uncertainty remains, particularly around inflation, central bank policy, and global growth, we continue to see selective opportunities. Especially in UK rates, money markets, and emerging market local debt.

In rates and government bonds, we hold a modestly positive view on UK short-term rates and gilts, while turning more neutral on the US as risks appear more balanced. We expect yield curves to steepen in most major markets, driven

by potential policy easing and a return to more “normal” market conditions. Flexibility and selectivity remain key as we manage duration and curve positioning across regions.

Credit markets are showing signs of stress, particularly in high yield (HY) segments, where recent defaults have highlighted vulnerabilities. Investment-grade (IG) credit remains more resilient, though we are cautious overall and focused on quality and shorter maturities. Private credit is also under scrutiny, with isolated stress events reminding us of the need for vigilance.

Emerging markets (EM) continue to stand out. We favour EM local currency debt over hard currency, reflecting a more attractive risk-reward profile, supportive fundamentals, and a constructive outlook for local markets. In our view, select EM currencies offer attractive opportunities, particularly those with high yields and supportive domestic stories.

Overall, our positioning reflects a disciplined approach; balancing income opportunities with careful risk management as monetary policy continues to shift and market dynamics evolve (see the Matrix Pod summary table in [Figure 1](#)).

“Credit markets are showing signs of stress, particularly in high yield segments, where recent defaults have highlighted vulnerabilities.”

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Figure 1. Matrix Pod summary – fixed income allocation overview

Key: 1-point up No change 1-point down

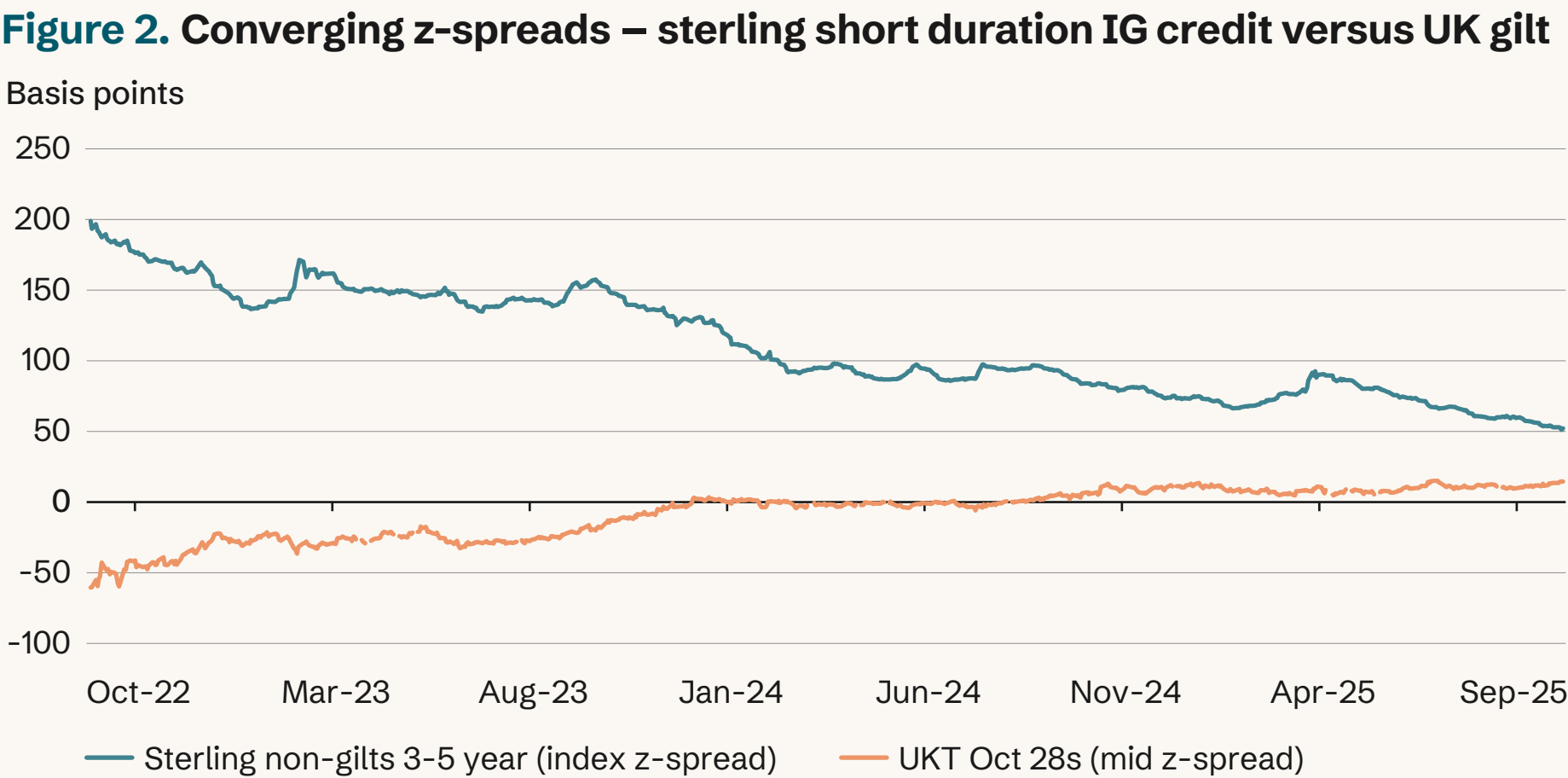
| | Parameter | Latest pod score | | | | | | | | | | | Change versus previous score | 3 month average |
|------------------|-----------------|------------------|----|----|----|----|---|---|---|---|---|---|------------------------------|-----------------|
| Liquidity | ABS | 0.0 | | | | | | | | | | | — | 0.0 |
| | Risk-free rates | 0.1 | | | | | | | | | | | | 0.6 |
| | MM spreads | 1.0 | | | | | | | | | | | | 0.0 |
| | Govt spreads | -0.3 | | | | | | | | | | | — | -0.6 |
| Duration | US | 0.0 | | | | | | | | | | | | 0.7 |
| | Europe | 0.0 | | | | | | | | | | | — | -0.3 |
| | UK | 1.0 | | | | | | | | | | | — | 1.0 |
| | Japan | -1.0 | | | | | | | | | | | — | -1.0 |
| | Canada | 0.0 | | | | | | | | | | | | 0.3 |
| Curve | US | 1.0 | | | | | | | | | | | — | 1.0 |
| | Europe | 1.0 | | | | | | | | | | | | 0.7 |
| | UK | 1.0 | | | | | | | | | | | — | 1.0 |
| | Japan | -1.0 | | | | | | | | | | | | -0.3 |
| | Canada | 1.0 | | | | | | | | | | | — | 1.0 |
| Credit (OAS) | Global IG | -1.0 | | | | | | | | | | | | -0.7 |
| | Global HY | -0.6 | | | | | | | | | | | | -0.9 |
| | EM IG | -1.0 | | | | | | | | | | | | -0.9 |
| | EM HY | -1.0 | | | | | | | | | | | | -0.8 |
| Emerging markets | EM sovereign | -1.0 | | | | | | | | | | | | -1.3 |
| | EM LC rates | 2.0 | | | | | | | | | | | | 1.7 |
| | EMFX | 1.0 | | | | | | | | | | | | 1.3 |
| | | -5 | -4 | -3 | -2 | -1 | 0 | 1 | 2 | 3 | 4 | 5 | | |

Note: Duration; a positive score indicates bond yields expected to fall, negative to rise. Curve; a positive score indicates a steeper yield curve expected, negative a flatter. Source: Aviva Investors. Data as of October 2025.

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Liquidity Pod: Cautiously constructive

The pod is modestly bullish on UK front-end rates and neutral on the US as risks look balanced. We maintain a bullish stance on money markets, modestly bullish stance on gilts, neutral on covered bonds and asset-backed securities (ABS), and negative on corporates.



Past performance is not a reliable indicator of future returns.
Note: Z-spread (zero-volatility spread) is a measure used to understand the extra yield a bond offers compared to a risk-free Treasury bond. Source: Aviva Investors, Bloomberg. Data as of October 10, 2025.

Macro and rates

The team continues to favour a modestly bullish stance on UK front-end rates, while shifting to a neutral view on the US, from previously having a bullish bias. In Europe, we still expect no adjustment to the European Central Bank (ECB) deposit rate over the next six months.

Money markets

Spreads remain attractively priced across GBP, EUR and USD markets and retain a bullish bias.

Government bonds

We have upgraded UK gilt spreads from neutral to modestly bullish, reflecting the recent widening of short-end gilt yields relative to swap rates. The upcoming budget introduces uncertainty but our base case assumes a package will be delivered that will sufficiently reassure markets. We remain bearish on German bund spreads versus swaps.

Figure 2 reflects our bullish view on gilt spreads and our negative bias on credit spreads.

Credit and ABS

We retain a negative bias on credit, with historically tight spreads that look like staying that way until the end of the year and limit upside potential. Opportunities are primarily in the lower rated segments of the credit spectrum. The neutral stance on ABS remains, though some opportunities remain in sub-sectors such as Auto ABS and CLOs, where investors may benefit from a complexity premium.

What this means for positioning and implementation

Overall, the pod continues to favour flexibility and selectivity, balancing carry opportunities with a disciplined approach to risk as monetary policy pivots evolve.

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Duration and Curve Pod: Long UK and US, short Japan and Canada

The pod maintains a steepening bias across all markets apart from Japan. We maintain a bullish duration bias in the UK, a bearish bias in Japan and have switched back to neutral in the US given the recent rally.



Regional views

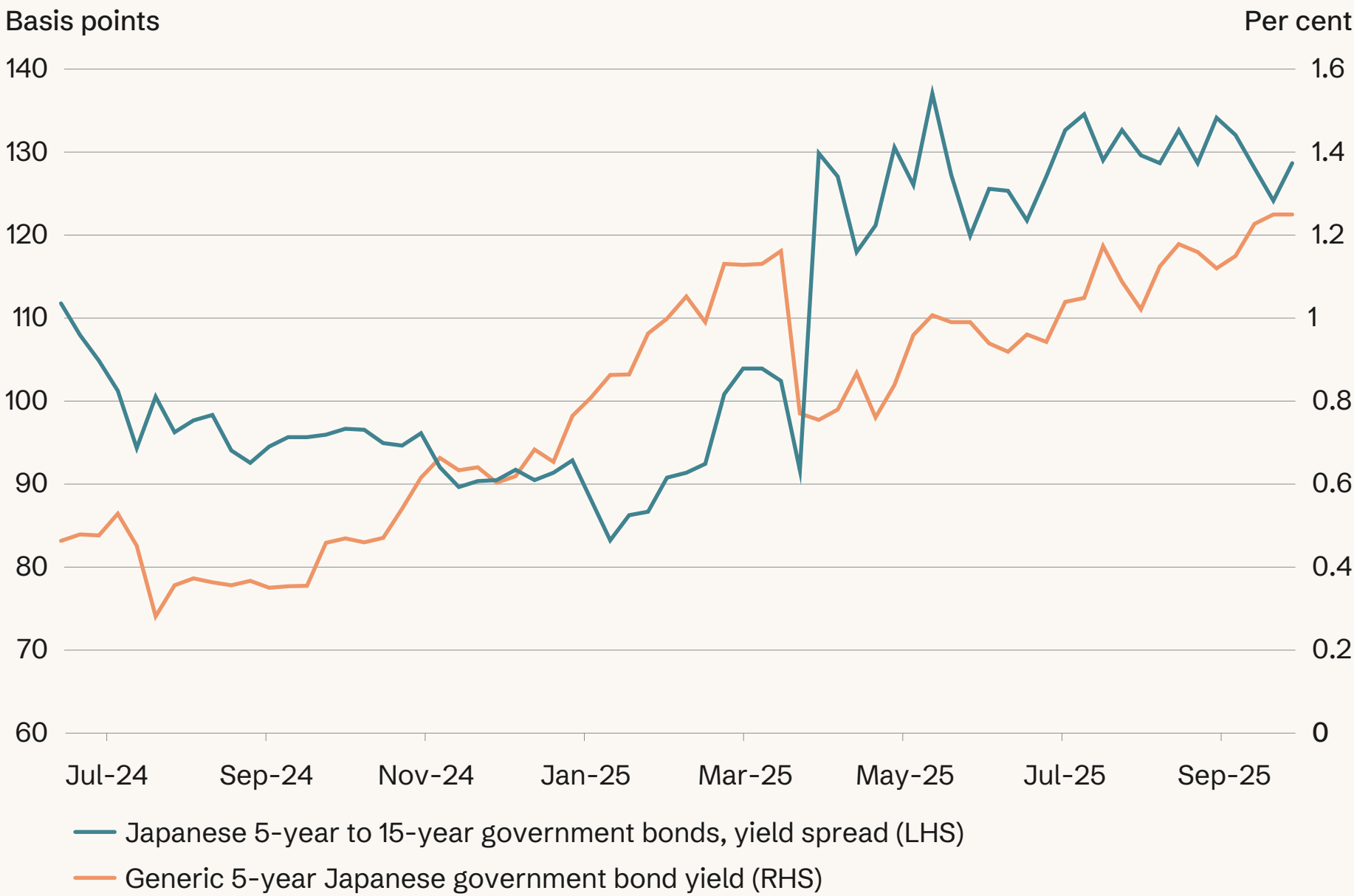
US
We have switched to neutral duration at the short end of the curve given pricing now looks fair after labour market concerns led to a repricing of policy expectations. We expect the front end to remain anchored by further Federal Reserve cuts, while, looking further out, growth and inflation uncertainty should also continue to support a steeper yield curve.

UK
We remain bullish duration, favouring a long bias, and believe risks are still skewed to more cuts being delivered in 2026 as inflation falls and labour market weakness remains. The focus for Q4 will be the shape of the yield curve and level of 10+ year yields before and after the budget and whether the chancellor can provide comfort to the gilt market.

Europe
We retain a short duration and steepening bias, expecting higher medium and long-dated yields. Our economic view remains positive and our inflation view has improved. We expect German yields to continue to cheapen gradually as the market adjusts to higher issuance.

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Figure 3. The Japanese curve has steepened excessively on fiscal concerns



Past performance is not a reliable indicator of future returns.
Note: Five-year Japanese government bond (JGB) yields shown versus the spread between the five- and 15-year JGB yields. Source: Aviva Investors, Bloomberg. Data as of October 3, 2025.

Regional views

Japan
We maintain a short duration view, albeit reduced, heading into Q4 given there remains upside risks to our yield targets. Despite recent steepening in the Japanese curve (see [Figure 3](#)), driven by fiscal concerns, we have kept a flattening bias on the expectation that the Bank of Japan (BoJ) is on course to deliver its next hike over the coming months.

Canada
We think the front end is now fairly priced following September’s rate cut and so have moved back to neutral duration. However, we continue to assess the risks of a further downside case for the Canadian economy. We continue to prefer steepeners and the budget in Q4 will be important to gauge the impact on yields.

What this means for positioning and implementation
We maintain a steepening position in the US, with a neutral to long bias in the front end and a neutral to short duration bias in 10+ year maturities. In Europe, we retain a short duration and steepening position going into Q4, but are more cautious. Japan retains a flattening bias as the BoJ’s policy adjustments are expected to remain gradual.

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Credit Pod: High yield stress and decompression

Credit markets remain at the tighter end of recent ranges, though recent credit events for First Brands and Tricolor have awoken the market to risks in high yield and loans. The pod remains constructive on credit fundamentals but cautious on valuations, favouring selective risk-taking in higher-quality names while maintaining a defensive stance in sectors vulnerable to refinancing pressures.

Figure 4 shows how the price of First Brands’ 2027 loan has been impacted in recent weeks.

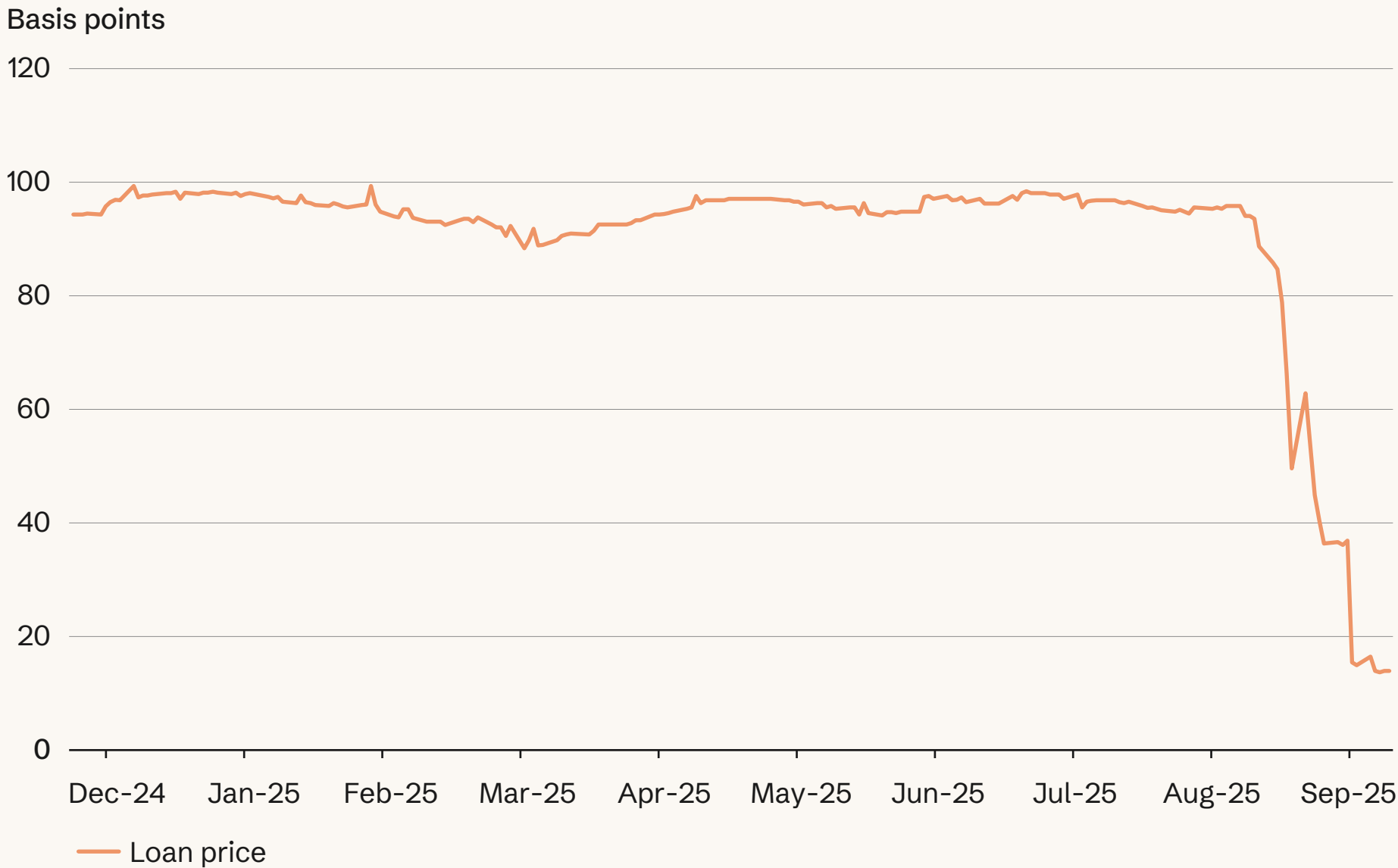
Macro and fundamentals

The growth trajectory globally remains on a downward trend with a US shutdown providing another headwind. Equity markets though remain buoyant. Fundamentals in CCCs have been weak with leverage and interest coverage deterioration. We expect IG fundamentals to broadly remain more resilient in this environment barring certain sectors with structural issues such as autos and chemicals.

Valuation and technicals

Spreads remain tight overall, though some softness has crept into the market with French political risk rearing its head again. Technicals have remained resilient, though we are seeing a slowing in flows into the credit markets, especially in high yield. A switch to meaningful and persistent outflows in high yield would see recent weakness deepen.

Figure 4. First Brands’ 2027 loan price



Past performance is not a reliable indicator of future returns.
Source: Aviva Investors, Bloomberg. Data as of October 10, 2025.

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Private debt: relative value persists but selectivity is key

Private debt remains attractive, particularly in the context of higher base rates and achievable illiquidity premia, which has moved above long-term averages. However, with increased competition, selectivity is increasingly critical.

Recent stresses in private credit can be deemed idiosyncratic, but it is important to remain mindful of further such episodes which could appear. Ultimately, the linkages of credit lines are opaque by the very nature of private credit and we remain vigilant to signs of excess in the space.



Asset class views

Global IG

We see the IG market as still showing exceptional technicals despite record issuance in recent months. Some sectors do display negative structural trends but we believe the IG market should overall remain well supported in coming months.

Global HY

This has been a bifurcated market with index level spreads being dominated by very weak CCCs while higher rated segments have remained supported. In the slowing growth environment, we expect lower rated HY to underperform.



What this means for positioning and implementation

The Credit Pod recommends a cautious stance, favouring carry over directional risk. Positioning reflects a preference for liquidity and resilience, with modest duration exposure and a focus on relative value opportunities rather than broad beta risk. Tactical opportunities may arise from volatility, particularly in EM and shorter-dated IG.

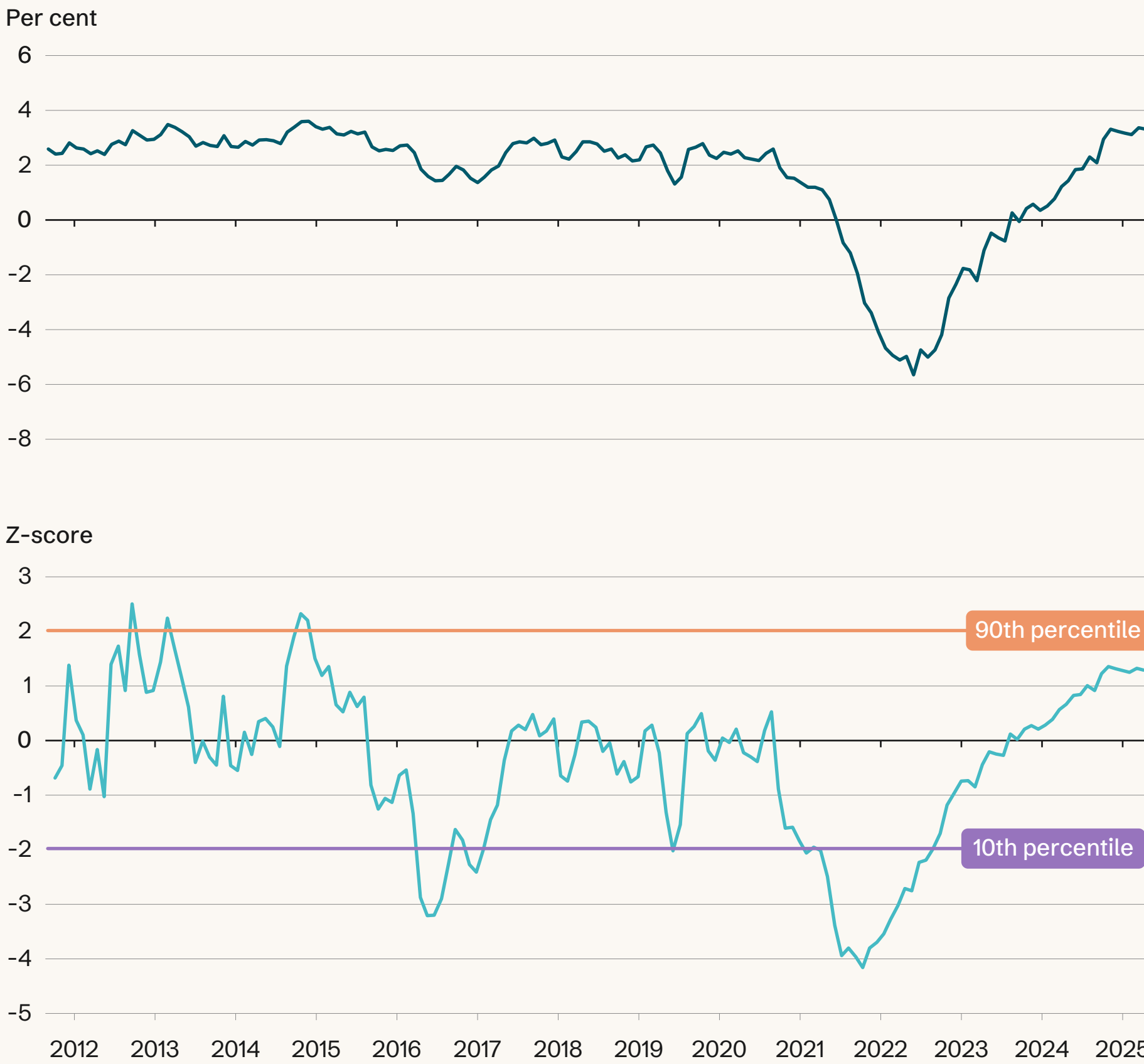
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Emerging Markets Pod: Overweight local currency and cautious on credit

The EM Matrix Pod retains a clear preference for EM local currency debt over hard currency, reflecting a more attractive risk-reward profile, supportive fundamentals, and a constructive outlook for local markets.

The top chart in [Figure 5](#) shows ten-year real yields in EM local bond markets sitting near the upper end of their historical range, while the bottom chart presents its z-score, illustrating how current yields compare to long-term norms.

Figure 5. Emerging market real yields - elevated and historically strong



Past performance is not a reliable indicator of future returns.
Note: The z-score shows how far a value is from its historic average, helping identify if it's unusually high or low. Source: Aviva Investors, Macrobond. Data as of August 31, 2025.

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Macro and fundamentals
EMD shows resilience with fiscal surpluses, falling debt and IMF engagement. Weaker USD and stable oil support easing cycles, currency stability and reserve rebuilding amid benign conditions.

Valuation and technicals
EM spreads are fairly priced; HY offers selective value and IG spreads remain historically tight but well supported. Technicals remain supportive, with limited issuance and a broader investor base underpinning market stability and demand.




Asset class views

EM local currency debt
We believe this asset class stands out in terms of attractiveness, with sound fundamentals, strengthened balance sheets and positive effect of weaker USD.

The combination of appealing valuations, high real rates, and favourable external conditions should help EM rates outperform DM.

EMFX
The underlying trends continue to indicate a potential for further dollar weakening over the medium term versus EMFX. We favour the high carry options with good bottom-up stories, namely Turkish lira and Egyptian pound, and the high yielders such as the Brazilian real, South African rand, and Mexican peso.

EM sovereign credit
While EM credit fundamentals remain robust, valuations largely reflect this. We downgraded EM HY from neutral to negative and think any value in the EM HY space is in the idiosyncratic stories in the lower rated universe, namely Ukraine and Argentina.

 **What this means for positioning and implementation**
Despite the positive outlook, actual portfolio allocations to EM local remain modest (~5 per cent), reflecting implementation challenges such as liquidity, volatility, and operational complexity. There is growing interest in developing a more investable list of local markets to better align with core portfolios and improve execution efficiency.

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The main risks to watch and how we're hedging them

The rates market remains in a tight trading range environment as market consensus forms tightly around a three per cent terminal rate in the US. A significant move higher in yields and bear flattening in curves (where short-term rates rise further than long-term rates) remain the key risks to portfolios. We use optionality to hedge for higher rates.

In credit, the pod continues to forecast a widening in spreads, with positive technicals and valuations still very tight. However, recent credit events such as Tricolor and First Brands raise the possibility of spread decompression, with HY spreads widening more than IG. We have been constructing ideas in the event of a broader widening in HY spreads.

In EM, key risks include significant equity weakness, tariffs on EM economies and term premium repricing. We are looking for cheap ways to hedge the main pain trade: dollar strength.





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Key risks



Investment risk and currency risk

The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency and exchange rates. Investors may not get back the original amount invested.



Credit risk

ond values are affected by changes in interest rates and the bond issuer's creditworthiness. Bonds that offer the potential for a higher income typically have a greater risk of default



For further information, visit:
avivainvestors.com/en-gb/capabilities/fixed-income/



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