Quarterly Commentary

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"You can give them a date or you can give them a number, but you cannot give them both."
— William White

"Of course we know what to do. What we don't know is how to get reelected after we do it."
— Jean-Claude Juncker

CALM LIKE A BOMB

Barely three months after Trump proclaimed Liberation Day, markets have returned to square one, once again reflecting demanding valuations. In a true round trip, worthy of Mr. Baggins, investors capitulated in the face of uncertainty unleashed by the new trade war, only to skeptically watch markets recover strongly, despite the weaknesses and clumsiness of an administration incapable of articulating a solid and coherent message.

What has become clear is that being the hegemonic power has ended up being very costly, especially in a world where new powers have emerged and resources are increasingly scarce. Over the past decades, the US has plunged into unsustainable deficits and debt, while advancing its deindustrialization and transferring knowledge and technology to its main adversary: China.

In his speech at the Institute of International Finance last April, US Treasury Secretary Scott Bessent acknowledged the need for a **"beautiful rebalancing"**—as proposed by Dalio—as a way to correct the growing dysfunctions of the global economy. To this end, he proposed an ambitious **"factory reset"** of the geopolitical order, international institutions, and the global economic system. Bessent warned that the current international economic framework shows clear signs of imbalance, especially in the trade sphere. In this context, he advocated for a reorientation of institutions born out of Bretton Woods, such as the IMF and World Bank, towards their original missions: ensuring macroeconomic stability and promoting development. He also stressed the need for countries like China to adjust their internal economic policies to help correct global imbalances. In his view, this process opens a window to reach a major agreement that lays the foundations for a more sustainable, balanced, and fair international system.

However, this factory reset has not been without unintended consequences. The rest of the world has begun to perceive the US from a new perspective, recognizing the decline of its hegemony in a new multipolar world and its lack of reliability as an ally. The narrative of the end of American exceptionalism, aggravated by Trump's despotism, has hit the dollar hard, acting as a safety valve and whose position as the world's reserve currency is being questioned. This change in international perception has highlighted the limits of current monetary and fiscal policies in the face of structural challenges faced by many advanced economies, which are increasingly dependent on stimulus to sustain growth.

In this environment, it is more crucial than ever to cling to fundamental principles to avoid being swept away by the aftershocks and volatility resulting from changes in global investor positioning. On one hand, structural forces such as high debt levels, credit contraction, weak economic growth, demographic challenges, and technological advancement continue to push inflation readings down.

On the other hand, public sector inflationary policies aim to revive growth, promoting spending, expanding deficits, and eliminating regulation. This strategy increasingly conditions the actions of central banks, forcing them to keep real interest rates low—a form of financial repression reminiscent of the decades following World War II.

The arrival of summer, accompanied by the usual loss of market liquidity and in a context of demanding valuations, once again leads us to reinforce caution. We are entering months that could confirm the slowdown of the US economy, while an uptick in inflation readings is observed: a potentially explosive combination for debt sustainability. It is worth remembering that, in the current scenario, a rise in long-term interest rates represents the main risk for financial markets. The growing pressure on financing costs, in an environment of high debt and persistent deficits, threatens to break the fragile balance that currently supports investor complacency.

The coming quarters will be decisive. If the growth necessary to stabilize or reduce debt-to-GDP levels is not achieved, the bond vigilantes will reappear and long-term rates will resume their upward path, intensifying the pressure on risk assets. This will again condition the response of central banks in a context of fiscal dominance and of governments, which will likely resort to new stimulus, further fueling underlying tensions around fiat money.

In this environment, the high levels at which risk assets continue to trade are a true reflection of the fear of the impact of policies whose effect leads to constant monetary devaluation. As some of our leaders on both sides of the Atlantic are showing, it is possible to try to control the narrative, but controlling the real consequences of their policies is undoubtedly much more complex.

PERFORMANCE

The fund achieved a return of **+1.52% in Class A** during the second quarter of the year, compared to a Bloomberg Global Aggregate of +4.52% (-3.82% in euros) and a Euro Aggregate of +1.75%. This brings the fund's return at the end of the half-year to +2.48%, compared to +7.27% (-5.37% in euros) for the Bloomberg Global Aggregate and +0.84% for the Euro Aggregate.

The behaviour of global fixed income markets this quarter was mainly marked by two events: **Liberation Day** with the announcement of the new tariff policy and the **Big Beautiful Bill**—the presentation of the US budget. The latter demonstrated the difficulty of undertaking cuts to the swollen US deficit, blowing up the Trump-Musk symbiosis and catapulting the US 30-year above 5% again. Since then, we have witnessed how, despite abandoning spending containment and the deterioration in growth data (making debt sustainability impossible), the administration has managed—through futures and forward guidance—to tame long-term rates and significantly reduce real rates.

During the quarter, we took advantage of the volatility generated by these events to resume some exposure to quality credit, both in Europe and the US, which we had eliminated in the first quarter. In Europe, we prefer maturities between 3 and 5 years, mainly due to the greater ability of economies such as Germany to increase their fiscal programs. In the US, we prefer maturities between 5 and 7 years to better monetize the current administration's pressure on the Federal Reserve in its quest to significantly lower interest rates.

Dollar hedges against the euro have once again been the position that generated the most benefit for the fund. The renewed appetite for risk assets meant that the position in convertibles—especially Galaxy Digital—was the second most profitable position during the period. Then, due to the dollar's devaluation and the good behaviour of rates, the zero-coupon AAA supras, especially in Mexico, once again contributed notably. Also noteworthy during the quarter were positions in European government debt in the belly of the curve.

On the negative side, due to the sharp depreciation of the dollar and the rise in long-term real rates since the beginning of the quarter, positions in US inflation-linked bonds at the long end of the curve were the biggest detractors from the fund's return. Corporate credit positions, and especially Société Générale's subordinated bonds, also detracted from returns.

Positioning and Outlook

We believe long-term rates in the US will continue to trade in the 4-5% range while investors doubt the possible effects of fiscal policies on growth, inflation, and debt sustainability itself. Meanwhile, due to the existing asymmetries in credit markets given the narrow spreads and especially historically low dispersions, we continue to opt for prudence and quality.

It is worth noting that we continue to see a contraction in credit granted to the private sector in the main economies, which, in due course, will translate into higher delinquency rates. In Europe, more specifically, banks' holdings of government debt are at historic highs, reaching the same levels as the previous crises of 2020 and 2015. The lack of lending appetite from banks, which began to close the tap to companies some time ago, has continued to tighten credit standards in the absence of growth and poor prospects for the private sector.

Despite this, deregulatory measures such as the one announced this week—exempting European heavy industry (steel, aluminum, etc.) from applying the Border Adjustment Mechanism to exports—are moving in the direction we predicted at the end of last year: greater regulatory flexibility allowing Europe to regain part of the competitiveness lost in recent decades. It is precisely due to the great transformative potential of a more relaxed regulatory ecosystem, a more "relaxed" fiscal situation, the need to promote self-sufficiency in critical areas, and investor appetite for new horizons beyond the US, that we remain optimistic and see tailwinds for growth and European risk assets.

As we have been warning, whether governments will succeed in their attempt to revitalize growth, combat structural deflationary forces, and thus deflate the huge amount of debt, only time will tell. Meanwhile, what has been proven over the last two decades is that maintaining adequate risk control and an opportunistic spirit is the best way to navigate the environment in which we find ourselves.

At the end of the quarter, the yield to maturity of the Class A portfolio was **3.46%**, with a modified duration of **4.14 years** and a coupon flow of **3.0%**. The average weighted price of the portfolio is **88.22%**. Exposure to the dollar is just **0.50%**.