



FIXED INCOME'S NEXT CHAPTER:

A Q&A on rate cuts, diverging growth and European opportunities

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With solid corporate balance sheets in Europe and room for further rate cuts in the US, conditions appear favourable for fixed income. But with diverging growth stories, and potential shocks such as the ongoing political situation in France, active bond management has never been more important. Salvatore Bruno and Mauro Valle at Generali Asset Management S.p.A. Società di gestione del risparmio ("Generali AM") share their views on the macro environment and how this translates into bond portfolios.

- *Looking at where real yields exceed potential growth, we see greater medium-term opportunities in Europe compared to the US.*
- *However, the various fiscal plans of European governments need to be carefully considered. Active bond picking is key.*
- *The strongest trends in Europe have been the tightening of core-periphery spreads and the steepening of the yield curve.*
- *This environment is favourable for maximizing portfolio yields and the Euro Bonds strategy is exploiting this with a neutral duration stance and a tactical approach.*



Salvatore BRUNO

Deputy Head of Investments & Head
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Generali AM

After all the volatility of 2025, where do fixed income markets currently stand?

Looking at the difference between real interest rates and real potential growth, spreads in the US seem essentially balanced, whereas in Europe – particularly in Germany, the benchmark for European yield curves – real rates appear high relative to potential growth. Over the past 2-3 years, there has been rapid adjustment in rates following more than a decade of “financial repression” by central banks, which kept yields artificially low. That situation now appears normalized, with fundamental macroeconomic variables once again playing a significant role in determining rate trajectories.

So, looking at where real yields exceed potential real growth, we see greater medium-term opportunities in European rates compared to the US. However, the intention of European governments to use fiscal leverage to avoid a slowdown in growth, following the strong post-Covid recovery in recent years, must be considered. Active management will be essential to seize market opportunities.

What do investors need to know about the expected divergence in interest rate paths from the Fed and the ECB?

There has been much discussion about “fiscal dominance” in the US and the risk of the Federal Reserve losing its independence. Essentially, the fiscal expansion promised by the Trump administration needs low

interest rates to limit the cost of interest payments on the debt, which has now exceeded 10% of fiscal revenues. This has led to strong pressure on the Fed from the administration to resume the rate-cutting cycle.

A first cut was indeed made in September, in response to labour market weakening. However, Chair Powell reiterated the need to be highly vigilance on inflation. Resolving the conflict between the White House and the Fed before the expected change of the central bank governor in mid-2026 will not be easy. Nevertheless, there appears to be room for further policy rate cuts, but they may be fewer than the market expects. For the ECB, the situation is different: the market does not anticipate further cuts, as inflation is expected to stabilize and the growth outlook seems improved. Investors will need to assess expected fiscal expansion plans, particularly in Germany, and any spillover effects from French political tensions on local interest rates.

How will Germany's rearmament drive affect wider growth and industry?

Germany's fiscal plan for higher defence and infrastructure spending totals nearly €1 trillion over 10-12 years. While Germany has strong spending capacity, other European countries will need compensatory measures to maintain fiscal balance. Given the positive correlation between German growth and Eurozone countries, the entire region is expected to benefit, though with a smaller multiplier effect. Infrastructure spending will most strongly affect Germany's industrial base, including sectors like construction, capital goods, and finance. Germany also aims to reduce US defence imports, which may further improve the European economy. Regarding rates, debt sustainability is key.

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Yields on German debt rose following the spending announcement, though part of the increase was later absorbed. If spending is spread out over time, concerns may ease. Moreover, Germany's fiscal metrics remain stronger than those of less disciplined countries, so the market may be overestimating the impact of increased spending on Bund yields.



Eurozone sovereign bond spreads are very tight across the region – given the political situation in France, how relevant is the core-periphery divide nowadays?

Two key elements stand out: on one hand, peripheral spreads are resilient, with Italy seemingly on track to reach the 3% deficit target a year ahead of schedule. On the other hand, France's political difficulties have pushed the spread on OATs above that of Italian BTPs. The political instability in France and concerns over uncontrolled spending has led the market to demand higher yields on French debt, surpassing even peripheral countries. The overall spread against Bunds narrowed, meaning the "distance" from the safest assets has decreased, making the distinction between core and periphery bonds less relevant. That said, these dynamics should be continually reassessed.



Mauro VALLES

Head of Active Fixed Income
Generali AM

Let's turn to how these views are translated into portfolios. How are you thinking about duration and the yield curve in the Euro Bonds strategy given the rate environment?

The ECB kept rates steady at 2% in September, projecting stable inflation over the coming years and more balanced growth. Markets are no longer pricing additional cuts. 10-year Bund yields have traded in the 2.4-2.8% range since April, supported by improved economic prospects and fiscal expansion. Bund yields could edge toward 3% if growth exceeds 1% and inflation remains above 2%. Our stance remains neutral for now, awaiting an opportunity to turn short.

The 2-year German rate is hovering near 2.0%, reflecting expectations for no further cuts. The yield curve has seen modest adjustments: the 10-2-year spread narrowed slightly to 70 bps, while the 30-10-year segment steepened to 63 bps¹. We believe the overall steepening trend has limited room to continue, given the ECB's likely pause at 2.0%. However, the 30-10-year spread could keep widening, supported by fiscal expansion across Eurozone countries.

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Within Europe, which opportunities are you most constructive on, and which ones are most vulnerable in the current macro and political environment?

Over the past 18–24 months, the strongest trends in European fixed income have been the tightening of core-periphery spreads and the steepening of the yield curve. While these dynamics may continue, current levels warrant close monitoring. If expectations of an ECB policy rate holding at 2% are confirmed, combined with low rate volatility, the search for yield opportunities through carry trades is likely to persist. European investment-grade corporate bonds also currently offer yields

around 3%, and despite spreads being near historical lows, we think these levels remain attractive for investors.

What are the key risks you are monitoring in the sovereign space – whether monetary, fiscal or geopolitical?

French OAT spreads have widened since mid-August due to the difficult political situation and fiscal concerns, pricing a rating downgrade event. After the resignation of Prime Minister Lecomu in early October, Macron re-appointed him as Prime Minister with his government – while snap elections have been avoided for now, political uncertainty remains high. The fragmented Assembly poses risks for the government, and although there is some willingness to compromise, the broader political climate remains tense. The risk of snap elections remains non-negligible, while fiscal concerns are mounting: the 2026 deficit is now projected to be near 5.5% of GDP, with debt/GDP around 116%, as the promised €40 billion in savings appears unlikely. OAT spreads, given the high level of political uncertainty, are expected to move in the high part of the range seen in the past few months and a spike over 100 bps cannot be ruled out.

The 10-year BTP-Bund spread is stabilizing around 80 bps and should continue to consolidate as Italian growth remains resilient and fiscal discipline improves, with a positive primary surplus expected in the next fiscal law. Germany's fiscal expansion may further support peripheral spreads, as fiscal deficits and debt-to-GDP ratios converge across euro area countries. Our view remains constructive on peripheral bonds, though spread volatility will largely depend on overall market conditions and developments in France.

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How has the Euro Bonds strategy fared over recent months, and how is it positioned for the months ahead?

Recently, rates volatility has been quite low, due to the end of the ECB's cutting cycle and relatively stable economics. German rates have moved in range and are trending neutrally. This is favourable for maximizing portfolio yields and we exploited this with a neutral duration stance in the last two months, after being positive in the first half of the year. We maintained a long positioning in the belly of the curve to exploit steepening opportunities and were short 30-year maturities to be defensive in case of further steepening of the long end. We were also long Italy, Spain and Greece and short French bonds.

Looking ahead, we'll continue to maintain a neutral relative duration with a tactical approach. At a country level we are short Germany and France, long EU bonds, with overweight positions in Greece, Spain, and Italy, while remaining neutral on Portugal. Regarding yield curve strategy, the Euro Bond strategy is slightly short the 2-year segment, long on the 5-10-year bucket, and short the 15-30-year area; we are monitoring the latter exposure as we believe it may become less attractive in a final phase of the curve steepening.

¹Source: Bloomberg. As of 6 October, in euros.



GIS EURO BOND FUNDS RANGE⁴

Generali Investments SICAV (GIS)	GIS Euro Bond [factsheet]	GIS Euro Bond 1-3 Years [factsheet]	GIS Euro Short Term Bond [factsheet]
Fund manager	Mauro Valle	Mauro Valle	Mauro Valle
ISIN (Eur B Acc.)	LU0145476148	LU0396183112	LU0145484910
AUM	€ 2,704.26M as of 29/08/2025	€ 1,508.32M as of 29/08/2025	€ 673.82M as of 29/08/2025
Inception date	2 April 2002	5 November 2008	2 April 2002
Benchmark	JPM EMU GOVERNMENT	JPM EMU GOVERNMENT 1-3Y (TR)	€STR
Funds currency	Euro	Euro	Euro
Domicile	Luxembourg	Luxembourg	Luxembourg
Entry / exit charge	Not Applied	Not Applied	Not Applied
Ongoing charge	0.60%	0.35%	0.27%
Management fees	0.40%	0.15%	0.15%
Performance fees	Not applied	Not applied	Not applied
Management company	Generali Investments Luxembourg S.A.	Generali Investments Luxembourg S.A.	Generali Investments Luxembourg S.A.
Investment manager	Generali Asset Management Società di gestione del risparmio	Generali Asset Management Società di gestione del risparmio	Generali Asset Management Società di gestione del risparmio
Risk level SRI	3/7 [Other significant risks not taken into consideration in this indicator include the following: Credit risk, Liquidity risk.	2/7 [Other significant risks not taken into consideration in this indicator include the following: Credit risk, Liquidity risk.	2/7 [Other significant risks not taken into consideration in this indicator include the following: Credit risk, Liquidity risk.
SFDR⁵	Article 8	Article 8	Article 8

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