RBC Global Asset Management

Flexibility amid fluctuations

Navigating fixed income volatility with an unconstrained approach

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Key points:

- Market reactions to new U.S. economic and trade policies have been substantial, invoking wild swings in valuation as investors' outlooks for growth and inflation fluctuate constantly amidst the uncertainty.
- In this environment, it is important for investment managers to be flexible while acting with conviction to exploit opportunities that may arise.
- The unconstrained nature of our strategy combined with a disciplined investment process allows us to capitalize on high conviction ideas to generate diversified and differentiated sources of alpha.

Year to date, investors have faced a persistent backdrop of market turbulence requiring careful navigation and deliberate portfolio management. Such significant dispersion across sectors and securities creates a compelling environment for actively managed, unconstrained strategies to add value. Capturing emerging opportunities in this landscape requires the flexibility to allocate across sectors, subsectors, geographies, credit quality, and even duration bands with precision and speed and without the bounds of traditional benchmark constraints. In this overview, we discuss the implications of heightened volatility within fixed income, detail how we have adapted to shifting market dynamics, and outline our plans for navigating continued turbulence in 2025.

A period of heightened volatility

We need only look to recent history to find clear evidence of significant volatility in rates. Over the past two years, the U.S. 10-Year Treasury rate has experienced multiple bouts of volatility, ranging from as low as approximately +3.5% and as high as +5%. One of the most recent bouts of volatility was after President Trump was elected and tariffs entered the headlines. The newly announced tariffs, along with their potential broad-ranging impact on corporate and consumer balance sheets, supply chains, and global trade, shook up markets and triggered significant volatility.

Credit spreads have also exhibited short term volatility. At the end of 2024, investment grade corporate spreads narrowed significantly, reaching the tightest levels observed in over a decade. This was driven by strong investor demand, anticipation of interest rate cuts and reduced supply. However, earlier this year, spreads widened due to U.S. tariff announcements and heightened concerns related to how they would impact potential future Fed rate cuts, inflation, and economic growth. These dramatic market swings over the course of just a few months confirm our stance that it is important to have conviction but remain flexible in the face of market dislocations stemming from policy announcements and economic data.

Adapting to shifting market dynamics

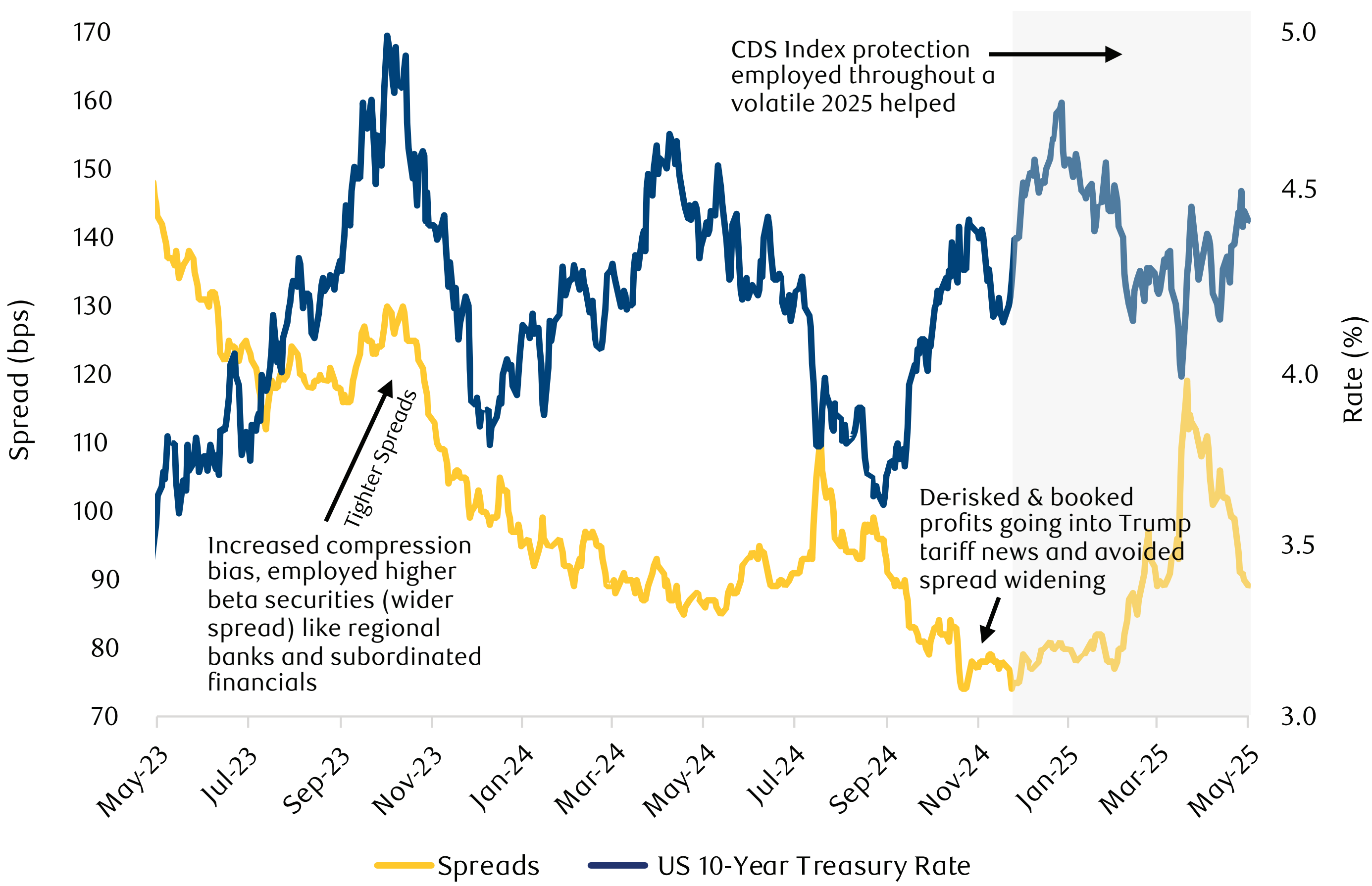
Our unconstrained strategy aims to generate alpha **by leaning into high-conviction positions** and being opportunistic across **sectors, subsectors, geographies, credit quality, and even duration bands** as opportunities arise. As we leverage multiple alpha sources, we may allocate dynamically between investment grade (up to 50%) and high yield issuers (20-30%) while adjusting duration exposure between 0 and 4 years (at times we may even go negative). This approach can incorporate higher beta segments of the investment grade market and high yield allocations, potentially generating returns with **lower correlation** to the Bloomberg U.S. Aggregate Bond Index. Complementing our flexibility is the deliberate size of our fixed income platform which enables us to act nimbly in shifting markets, while leveraging the breadth of a top global financial institution. We are able to gain exposure to attractively priced segments of the markets and emerging investment areas, which many of our peers may not be able to access. Examples of this could include investments within the securitized space; the mezzanine tranche of unsecured consumer deals as well as data center and fiber securitizations to name a few.

Additionally, we can allocate up to 25% to non-U.S. domiciled risk in developed markets while maintaining largely USD-denominated currency exposures. So, although our product design is primarily U.S.-focused, we have the liberty to exploit opportunities globally as well. This flexibility empowers us to capitalize on changing dynamics in fixed income, including varying inflationary environments, rate regimes, growth outlooks, and spreads throughout broader markets. **Figure 1** below illustrates how this type of investment approach can respond to potential market scenarios that may unfold in 2025, while **Figure 2** demonstrates real time examples of the different tools the strategy has employed in the past to successfully take advantage of opportunities as they present themselves in the marketplace.

Figure 1: How an unconstrained approach can react to market movements

1-Spreads decrease	2-Rates increase
▪ If spreads tighten, signaling support for risk assets, investors may capitalize on this by engaging in compression trades. ▪ Successful strategies that may be employed could involve investing in securities such as Subordinated Financials (including AT1s) and Corporate Hybrids, which are higher beta securities and can potentially benefit from spread compression.	▪ If rates rise due to adverse conditions such as tariffs or a dismantling of supply chains, an unconstrained strategy can position itself to preserve capital and potentially generate gains. ▪ The ability to adjust duration flexibly and nimbly, including shifting to zero or negative duration, is an advantage. ▪ Additionally, investments in floating rate loans and certain asset-backed securities (ABS) may benefit from rising rates due to their spread carry.
1-Spreads increase	**2-Rates decrease**
▪ Managers can also rapidly adjust to adverse market conditions by shortening duration and elevating credit quality as a defensive measure. ▪ If spreads widen amidst market volatility and investor concerns, an agile approach can enable managers to employ credit derivatives, like purchasing CDS protection, to hedge positions. ▪ Skilled in utilizing best-in-class trading techniques like Portfolio Trades (PT), to efficiently adjust portfolio positioning in a single transaction - whether to increase risk exposure or reduce it.	▪ If rates fall, which typically benefits risk assets, an unconstrained strategy can increase duration exposure through futures as well as long-duration assets, such as 30-year fixed-rate corporate bonds.

Figure 2: US 10-year treasury yield & Bloomberg US IG Corp spreads with annotations



Source: Bloomberg as of May 2025

Navigating continued turbulence ahead

RBC Global Asset Management is a globally recognized fixed income specialist with decades of experience navigating complex market dynamics. Our team structure is designed to maximize global, firm-wide research and risk management, ensuring a comprehensive and disciplined approach to investment decisions. As an active, nimble manager with high conviction views, we believe we are well-positioned to capitalize on opportunities and adapt swiftly to changing market conditions, delivering value to clients with precision and confidence.

The current volatile and policy-driven environment underscores the need for adaptability in fixed income allocations. We will remain vigilant as we continue to navigate the domestic political and economic landscapes and have a detailed playbook ready for execution that utilizes the flexibility of our strategic income (unconstrained bond) strategy. As a result, we are ready to act swiftly for our clients regardless of any shifts ahead.

Portfolio Manager Perspectives

Our experts offer their perspectives on the latest developments in global credit and the state of the markets.

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