

# Big Beautiful Bunds

- Fiscal and trade policies driving bond prices
- Push for European cohesion supports EGB spreads
- We prefer bonds in the belly of the curve

Most developed government bond markets posted positive returns in the second quarter. There were notable differences between markets, though, with German Bunds up 1.2%, while returns for US Treasuries (0.2%) and Japanese government bonds (0.1%) were close to zero. Many euro government bond markets outperformed Germany; Italian BTPs, for example, were up as much as 2.8% over the April to June period. The steepening in German and euro curves has been driven by the long end, and we expect that to continue. Fiscal spending on infrastructure and defense will lead to an increase in longer-dated issuance. At the same time, the ECB has been cutting rates, supporting short-dated paper. Looking ahead, the ECB seems close to pausing its easing cycle. Peripheral markets had another strong quarter with spreads versus Bunds declining. If no major shocks hit, we see more compression ahead and possibly new post-2012 Euro crisis lows in spreads.

## Market developments

The second quarter was characterized by significant political uncertainty. It started with the US trade tariff announcements on 2 April. The trade unrest was followed by concerns related to the US fiscal bill, which initially contained a section (899) on taxing foreign investors from specific countries. In June, geopolitical uncertainty jumped, after a war started between Israel and Iran and the US bombed Iran's nuclear facilities. With uncertainties piling up, one would expect a strong demand for safe haven assets. Indeed, German Bunds probably profited from such demand, although that is not the full story. The German returns of the past months can also be seen as a recovery from March, when agreements on large additional fiscal spending on German infrastructure and defense hurt Bunds. Euro government bonds in general were also supported by continued ECB policy easing. Official rates were cut both in April and June, bringing the deposit facility rate to a level of 2.0%. This rate was still 4.0% in June last year. The combination of expected larger bond issuance and ECB easing resulted in a steepening of the German yield curve.

Euro government bonds also benefited from a continued convergence of bond markets within the monetary union. Growing external pressures have triggered a greater urgency to work together on defense and competitiveness. In the case of Italy, credit rating dynamics have been supportive as well, with a rating upgrade by S&P (BBB+) and an outlook upgrade by Moody's. For France, the outlook for the credit rating is more worrisome, but French OATs (+1.6% in Q2) benefited from a period of relative political calm.

## PORTFOLIO MANAGER'S UPDATE Q2 2025

Marketing material for professional investors, not for onward distribution



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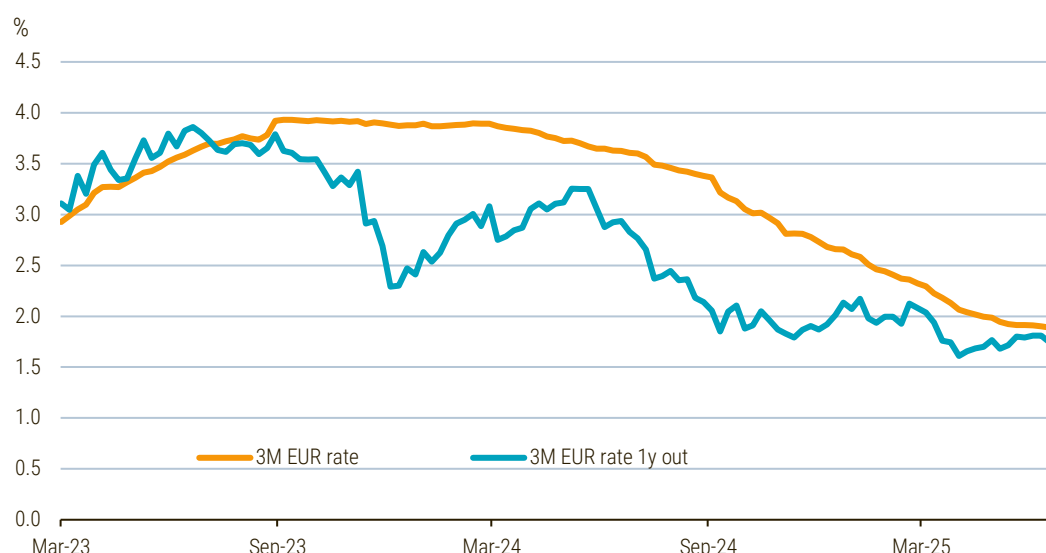
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### ECB

The European Central Bank (ECB) is widely expected to pause its easing cycle at the July meeting, following eight consecutive 25 bps rate cuts. This anticipated pause would mark a shift in the current policy trajectory, although the ECB remains well positioned to cut rates further if necessary.

With the deposit facility rate at 2.0% the ECB is “well positioned” to face current uncertainties. That was the clear message from ECB President Christine Lagarde at the June governing council meeting. Headline inflation has fallen back to the 2% target and core numbers are close as well (2.3%). For 2026 the ECB staff now expects 1.6% inflation (core 1.9%). President Lagarde downplayed its importance, stating that it is mainly the result of lower energy prices and the strong euro. Still, modest inflation expectations matter, as they give the ECB room to ease policy further if needed. That remains a realistic scenario. With trade tensions remaining high and the trade-weighted euro up more than 6% year-to-date, it is easy to imagine a scenario where growth falls back to 0%. This could trigger further monetary stimulus. Cutting the depo rate to 1.75% should not be a major decision. Going below 1.75% will be seen as a bigger step. This would bring rates below the 1.75-2.25% neutral range, as identified by ECB staff. The market now prices in an ECB depo rate of close to 1.75% for both the end of this year and June 2026. In our view this is the minimum of cuts that should be priced in. There are many uncertainties to overcome before arriving at a growth climate that will be supported by spending on defense and German infrastructure.

**Figure 1** – Short term rate and market expectation

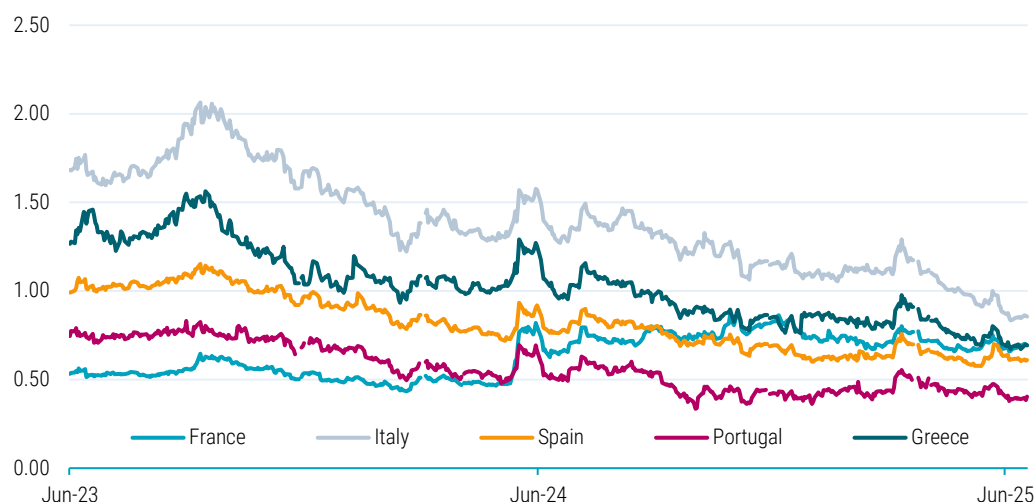


Source: Bloomberg, Robeco, July 2025

### Country spreads

The second quarter started with a severe risk off episode due to the tariff announcement by President Trump. Country spreads also widened, but to a lesser extent than can be expected based on historical correlations with other risk markets. While the IG credit index widened around 40 bps, Italian 10-year government bonds for example only widened 20 bps. As risk markets recovered from the second half of April onwards, country spreads not only completely reversed the widening move, but continued to tighten to new decade lows versus Germany. At the end of the quarter 10-year Italian government bond spreads had tightened to 87 bps, a level not seen since the start of the Euro crisis. The trade tariff and defense policy from the US administration has led to a more cooperative stance within the EU, creating conditions in which Eurozone country spreads can continue to gradually tighten. The one outlier this quarter has been France, where spreads remain at elevated levels, as the political situation is very fragile and upcoming budget negotiations will be extremely tough. Without painful measures the deficit is expected to rise to 6% of GDP, meaning debt/GDP continues its deteriorating path, likely forcing rating agencies to downgrade the country to below AA.

Figure 2 – 10-year country spreads vs Germany (bps)

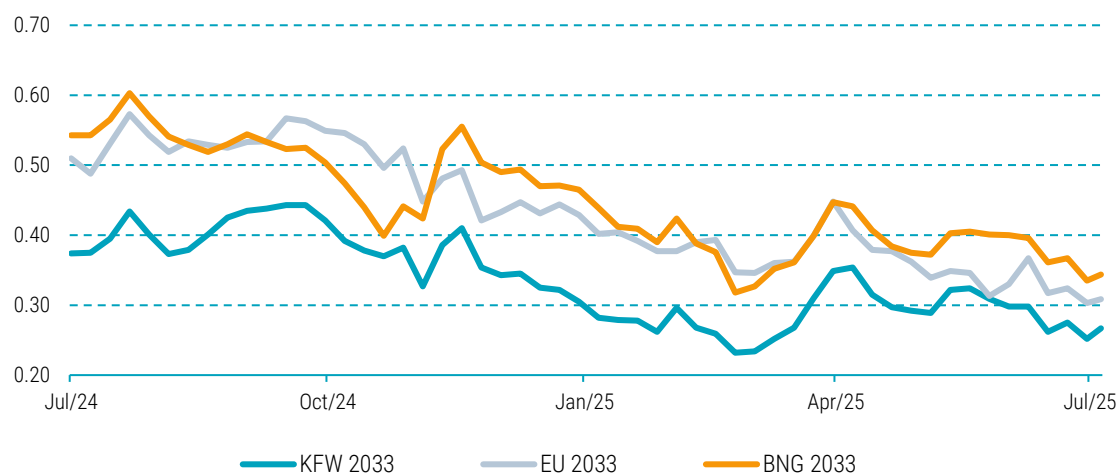


Source: Bloomberg, Robeco, April 2025

#### Supranational, sub-sovereign and agencies (SSA)

Government-related bonds initially widened in April after the tariff announcement, but completely tightened back during May and June, thereby outperforming swaps, which did not fully recover. The spread on the Bloomberg Euro Aggregate Government-Related subindex rose from 55 bps at the start of the quarter to 67 bps mid-April, after which it tightened back to 52 bps at quarter end. Issuers have used this favorable market condition in H1 to frontload issuance significantly, with issuers like EIB and BNG already close to 80% of their annual target. We expect issuance will be less of a hurdle in H2, meaning we think spreads can gradually tighten further. The EU will launch its 10-year future contract in September, which would further increase bond liquidity. We remain of the opinion that EU bonds should be included in sovereign indices, and believe this will happen in time, but it seems to be a very slow-moving process. With negotiations about the very ambitious EUR 2 trillion EU budget proposal for 2028-2034 about to start, it is likely the EU will remain an integral part of budget funding for common purposes beyond just defense spending.

Figure 3 – SSA spreads to Germany (bps)



Source: Bloomberg, Robeco, July 2025

### Green bonds

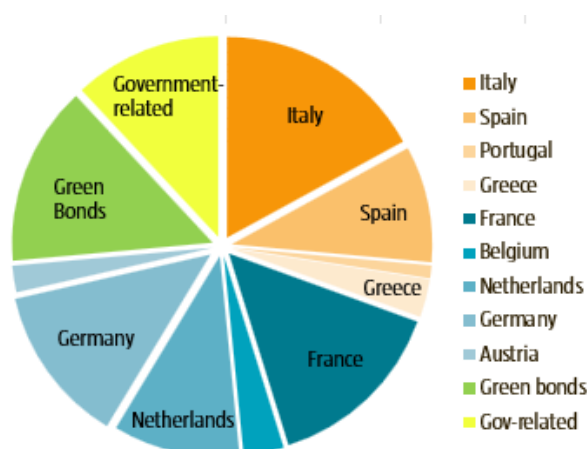
A strong second quarter brought the issuance of ESG labeled bonds to a level of USD 314 bln for the first half of 2025. This was only 4% shy of the record levels reached in H1 last year. Among the labelled categories green bonds remain the largest group (USD 140 bln), but sustainability bond issuance has been growing and is now at levels close to green bonds (USD 110 bln). The euro remained the dominant currency of issuance (46%). US dollar issuance (21%) has been facing headwinds, but international institutions (e.g. IBRD) and Asian issuers (e.g. KHFC) keep it at a considerable level. In euros there was sizeable issuance from among others EIB, IBRD and KfW. Within corporate bonds there was a noteworthy difference visible in issuance between corporates (-23%) and financials (+26% ytd). Among sovereigns it was notable that Italy issued a new 2046 BTP earlier in the year. Other sovereign issuance came from amongst others France and Germany.

### Activity and positioning

During the quarter, the fund held a small overweight duration position, which can be seen as a precautionary long with all the risk events that have passed this quarter. Thus far, these events have had limited impact on safe haven yield levels, but Europe still awaits the final decision on tariffs, while tensions in the Middle East could easily flare up again. We maintain a curve steepener position as there are several arguments for the steepening trend to continue; additional fiscal spending by Germany, tariffs imposed on Europe and the fact that many Dutch pension funds will shift to the new pension system in the coming two years, meaning less need for ultralong swaps and bonds.

In April, after the tariff shock, the underweight position in Italian BTPs was reduced, making use of better valuations. During the remainder of the quarter, the fund gradually increased the position to an overweight position, as we maintain our positive view on periphery spreads over the summer. For the same reason, a small overweight in Portuguese government bonds was initiated. On the other hand, the fund increased the underweight position in French OATs. Although French government bonds have benefited from a relatively quiet period absent of political headlines, we expect risks to French spreads to return over the next quarter as the parliament is set to enter tough budget negotiations after summer. In the non-EMU allocation, the fund closed a long position in euro-denominated Hungarian government bonds, taking profit after significant spread tightening in May and June. Moreover, the fund initiated a long position in euro-denominated Bulgarian government bonds, anticipating further idiosyncratic outperformance as Bulgaria is set to enter the Eurozone and consequently the Euro Government Bond index. Where possible, the fund aims to prefer green, social, and sustainable bonds over regular bonds.

Figure 4 – Positioning Robeco Euro Government Bonds



**Source** Bloomberg, Robeco, 30 June 2025. Green bonds consist of government bonds and government-related bonds. For illustrative purposes only.

## Outlook

Looking forward, we expect trade uncertainty to remain a key issuetopical. Regardless of where trade tariffs settle, much damage has already been done to producer confidence. This will probably result in a reduction in business investments, in addition to the hit on trade. The US is expected to see more damage to the economy than the countries which the US is targeting with tariff policies. Relative to the US, the outlook for Europe appears somewhat brighter. The region benefits from the implementation of the announced fiscal stimulus and retains the ability to deploy additional measures if needed. The inflationary impact from tariffs imposed by the EU should also be relatively limited. The ECB appears to be approaching a pause in its easing cycle, while the Fed could end its pause and resume easing later this year. These expectations are starting to show up in rates markets. Front-end euro rates reached a low in mid-April and have been moving sideways ever since. As a result, the steepening of the German and euro curves has recently been driven by the back-end. We would expect this trend to continue.

Within euro government bonds, we expect the favorable climate for spread compression to continue. Over the summer period, we would expect a slowdown in new issuance. In addition, talks on the issuance of more common debt are continuing, as a sign of more intense cooperation. More news could come out of France, where the government is heading towards tough negotiations on the 2026 budget. There remains a risk of new snap elections in France after summer. While we expect ongoing risk of negative political news and credit rating pressure for France, our overall view on EGB spreads is positive.

## Performance

The portfolio had a relative return of +0.54% versus the benchmark over the second quarter of 2025. Year-to-date the portfolio outperformed with +1.13%.

The key driver of outperformance over the quarter was the curve steepener in the fund. The risk of sustained high fiscal deficits and economic uncertainty is leading to steeper curves. Duration positioning contributed slightly. The current environment warrants a more tactical approach to duration due to volatile markets.

In addition, country positioning in EMU countries added to performance, as the fund was holding long positions in Spain and Greece versus Germany. SSA allocations also helped, as government-related bond spreads were dragged tighter. Allocations to non-EMU bonds significantly added to performance, primarily driven by long positions in Euro-denominated Bulgarian and Hungarian government bonds. We expect idiosyncratic spread convergence as Bulgaria is set to enter the Eurozone in 2026 and consequently also the Euro Government Bond indices.

Annualized performance Robeco Euro Government Bonds						30 June 2025
	Jun/25	3-month	YTD	1-year	3-year	5-year
<b>Robeco Euro Government Bonds (D EUR)</b>	<b>-0.11%</b>	<b>2.39%</b>	<b>1.65%</b>	<b>6.06%</b>	<b>1.68%</b>	<b>-1.78%</b>
Benchmark (EUR)	-0.23%	1.85%	0.52%	4.46%	0.65%	-2.33%
Relative performance	0.11%	0.54%	1.13%	1.60%	1.03%	0.55%

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Source: Robeco. Robeco Euro Government Bonds D EUR share class, gross of fees, based on gross asset value. Benchmark: Bloomberg Euro Aggregate: Treasury

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