

Monthly commentary / 31.12.2025

Vontobel Fund – Euro Corporate Bond

Marketing document for institutional investors in: AT, CH, DE, ES, FI, FR, GB, IE, IT, LI, LU, NL, NO, PT, SE, SG (Professional Investors only).

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Market developments

Welcome to 2026, and our best wishes for the New Year to our readers. May it bring peace, good health, and good fortune to everyone.

The excitement of Christmas has now passed. Wish lists have, in most cases, been fulfilled, family visits have come to an end, and children may even have started to tire of the many gifts they received. As a result, the week following Christmas offers a quieter, more tranquil period, and an opportunity to withdraw, reflect, and thoughtfully ponder the events of 2025, an extraordinary year by any measure. Indeed, 2025 was a year of surprises, and it would almost have been surprising had it not been so. We should likely expect the same as we move into 2026, at least during the first part of the year. That said, 2025 stood out as a year of resilience, a year of buying the dips and yet another year of spread tightening. The technical situation was very supportive throughout the year, with the engaging and continuing narrative that US households accumulated some 31% more cash or cash-like assets than pre-pandemic trends, amounting to nearly USD 19 trillion. The Bank of America Institute highlighted that these balances increased considerably post-Covid, driven by rising interest rates and the highest yields since the dot-com era.

As US rates began to decline, and with the rate-cutting cycle likely to extend into 2026, a good proportion of these assets should continue to migrate back into more traditional asset classes. This should still continue to support investment-grade (IG) corporate bond markets across the developed world. Developments in Europe would have been similar, following the 100 basis points (bps) of rate cuts implemented by the European Central Bank's (ECB) Governing Council in 2025. We also note anecdotal evidence suggesting that some of the largest buyers of Additional Tier 1 instruments over the past year were Italian fixed-maturity funds, seeking more sustainable yield alternatives than shorter-dated BTPs.

There will undoubtedly be further surprises as we begin 2026. Nevertheless, the technical picture should remain well supported by several factors: the latest liquidity injection by the US Federal Reserve (Fed) (see below), a potential surprise US productivity boost that could lead to a rise in unemploy-

ment and cause the Fed to respond with more monetary easing (Europe is leading the way on AI adoption due to challenging demographics), and the fact that the S&P 500 Index closed the year on a strong note for its third consecutive year of double-digit gains. These elements point to potential for another good year ahead, according to analysts, especially given the modest near-term earnings expectations (notwithstanding the anticipated tax reimbursements under the "One Big Beautiful Bill Act") and the supportive framework highlighted above.

In December, euro credit spreads had a strong end to the year, recouping the weakness experienced in November, in line with the regained momentum in equity markets, which benefited from Fed Chair Jerome Powell, who proved less hawkish than expected, as well as the traditional Christmas tailwind. The main European IG index (Bank of America ER00) finished the year at a spread level of 78 bps, down from 82bps at the end of November, narrowing 4bps. The improvement was broad-based, with most sectors tightening by an average of 5bps. Telecoms and senior banking lagged at just -2bps. Subordinated instruments, insurance subs, and Lower Tier 2s performed 5bps on average. Corporate hybrids performed better at -7bps, while CoCos outperformed within this complex at -12bps. It was a similar story for European industrial BBs (-16bps), with overall total return performance unfortunately suffering slightly due to wider government benchmark yields during the final month of the year.

Turning to US developments, the final Fed meeting of the year was about as good as it could have been and less hawkish than anticipated. We got a balance-sheet expansion that is set to continue for several months as we transition into the new year, and the Federal Open Market Committee voted 9 to 3 to lower the target range by 25bps to 3.50 – 3.75%. During the press conference, Powell said that the Committee had made no decision regarding January, though he did not rule out another cut. He also suggested that even if inflation were to remain above target, a policy rate as low as 3% could be appropriate if risks to both sides of the Fed's dual mandate were equal. As he stated, when the objectives on both sides of the mandate "are broadly equally threatened or equally at risk, you should be kind of neutral...and we have been sort of moving in the direction of neutral. Now we are in the range of

neutral. We are in the high end of the range of neutral.” We believe the Fed will remain very attentive to incoming inflation and employment data, and risks surrounding the labor market continue to suggest that the target range could fall as low as 3% this year, especially given Powell’s concerns about a labor market that is still cooling. Regarding balance-sheet policy, the announcement came as a positive surprise and was introduced earlier than market participants had anticipated given the tightening in money-market interest rates relative to administered rates, and the decline in their reserves ahead of year-end.

The purchases will start in December and are expected to total about USD 40 billion per month in T-bills over a five-month period, with the option, if needed, of up to three years fixed-coupon Treasury bonds. This is in addition to the previously announced reinvestment of all principal payments from Agency holdings into T-bills, projected at around USD 15 billion per month. Morgan Stanley forecasts secondary-market purchases of up to USD 275 billion through the end of April, forming part of a framework that is generally supportive of riskier assets, as mentioned earlier.

Powell appears more concerned about the jobs situation now, especially given the data released on December 16, which showed the unemployment rate rising to 4.6%. He stated that “the gradual cooling in the jobs market has continued,” with payroll growth averaging about 40,000 jobs per month since April. But he added that these figures may be overstated by some 60,000, implying a net decline of roughly 20,000 jobs per month. He also said that the supply of workers has fallen sharply, which has limited the rise in the unemployment rate, and characterized the labor market as one that “seems to have significant downside risks.” Powell appeared less concerned about inflation, while simultaneously acknowledging that inflation remains above target. He pointed to evidence of ongoing disinflation in services, such as indices of new tenant lease rents, while adding that goods inflation is essentially concentrated in tariff-affected areas. He also said that measures of longer-term expectations remain consistent with the Fed’s target.

Finally, US President Donald Trump interviewed Christopher Waller for the Fed Chair’s position in December, praising him as “a man who has been there for a long time.” A decision is expected over the coming weeks, and a Waller appointment would likely be viewed positively by markets and provide reassurance. Waller has advocated pre-empting further weakness in the labor market and believes there is still room to lower rates to more neutral levels (50bps to 75bps above neutral currently) as he expects tariff-related inflation pressures to subside.

In Europe, the final month of the year was a bit less eventful, aside from inflation data that now point to a softer underlying dynamic. At their last meeting, ECB officials left rates unchanged at 2%, in line with market expectations. ECB President Christine Lagarde’s press conference was a bit of a challenge as the ECB’s inflation outlook undershoot now extends to 2027, along with a slightly revised upward growth outlook of 1.2% for 2026 (+0.2% percentage points (pp) from the previous projection) and 1.4% for 2027 (+0.1 pp). The gradual decline in food, alcohol, and tobacco prices in November (the fourth consecutive monthly decline) together with lower infla-

tion in core goods and falling momentum in underlying services such as accommodation and transportation, likely prompted the ECB to revise its headline inflation forecast lower, to 1.8% for 2027.

All told, we believe Lagarde did a good job of offering no clear indication on the future direction of rate decisions, reinforcing the message that policy will continue to be set on a meeting-by-meeting basis. The ECB has also made progress in returning to their customary price stability threshold in the last few months, with risks now assessed as being two-sided. Both Oli Rehn of Finland and François Villeroy of France see a high degree of economic uncertainty. In line with the meeting-by-meeting approach, they both echoed Lagarde’s emphasis on the need to remain agile when setting rates, keeping full optionality. We have previously said that the impact of higher US tariffs is likely to be felt more fully in early in 2026, potentially weighing on wage growth and, in turn, inflation. This is why we believe there is still room for one additional rate cut to 1.75%, until quarterly growth picks up from the second quarter and onward.

We conclude this market review with a comment on AI and the potential surprises it may bring in 2026. European companies appear to be more advanced AI adopters than their US counterparts (nearly 70% versus the low 40% range in the US, according to a year-end report from Morgan Stanley Equity Research.) As these technologies are increasingly deployed to improve productivity, they could contribute to further service disinflation without necessarily triggering outright employment weakness. Europe has quite a challenging demographic outlook, and such a development could lead the ECB to reassess policy. We have long maintained that the digital revolution would generate disinflationary pressures, provided supply chains remain undisrupted, and we continue to uphold this belief with the witnessed AI developments. This would also fold well into the supportive riskier-asset narrative and framework for 2026.

Portfolio review

In December, activity ran at a seasonally lighter pace given the holidays and subsiding liquidity, with a focus on flow management and a few targeted primaries. We participated in two new EUR issues: a senior preferred note from a leading German auto bank and a corporate hybrid note from a large European utility launched alongside a tender, both offering attractive carry versus peers. Additionally, we trimmed a diversified set of tight-trading names across several sectors.

Performance analysis

The Vontobel Fund – Euro Corporate Bond (I Share Class) outperformed its benchmark during December and for the year. In December, performance was driven primarily by positive security selection, with a smaller positive contribution from allocation.

In terms of selection, gains were led by higher-beta positions in banking (notably subordinated AT1/T2), insurance (T2), and telecommunications (Hybrids), alongside strong BB-rated auto suppliers in the automotive sector. Additional support came from transportation and, to a lesser extent, utilities. Detractors were minimal during the month.

In terms of allocation, positives from our overweights in insur-

ance and transportation were partly offset by drags from underweights in utilities, consumer goods, and healthcare, leaving allocation effects modestly positive for the month.

Outlook

With the OBBB tax reimbursements expected from next spring in the US, German fiscal expansion, and increased defense spending across the euro area, conditions appear supportive for an acceleration in growth in 2026, as reflected in the revised ECB growth forecasts released in December. The economy certainly remains key to credit markets, but we would also point to the other aspects of the supportive framework outlined in this piece: there is excess cash or cash-like assets, lower borrowing costs, and greater productivity that should push companies to continue to upgrade guidance. And there is an absence of major re-leveraging. This means that the benign picture is unlikely to shift meaningfully in the first few months of the year. This could push spreads to converge slightly lower, or to the low 70s, which was another low experienced in 2018.

Tighter spreads do not preclude further improvement. The ECB's terminal rate should stay high enough to keep overall credit yields attractive for some time, and retail investors are likely to continue to look for alternatives to money-market instruments. This could keep spreads tight for longer, or even cause them to narrow further, given healthy yield-driven demand.

From a supply perspective, analysts forecast gross supply of EUR IG non-financial issuance to rise about 5% to EUR 380 billion. However, total redemptions are poised to increase to EUR 280 billion in 2026 (EUR 250 billion in 2025), which

would imply an unchanged net supply picture of about EUR 100 billion relative to 2025 – not extreme relative to levels experienced over the last couple of years. At the sub level, the outlook should continue to be quite supportive, with forecast net issuance of around EUR 12 billion in AT1s, EUR 10 billion in corporate hybrids, EUR 8 billion in insurance subs, and negative net new issuance in lower Tier 2s (- EUR 10 billion). We therefore remain comfortable staying down in seniority when starting the year, where we continue to see good carry value and maintain our current overweight exposures in subordinated structures such as hybrids and AT1s. For AT1s, the ECB has indicated that it may propose making them more equity-like in the future, reducing the complexity of the capital stack. A report to the European Commission is expected in 2026. We believe that any attempt to make AT1s more equity-like would face resistance from banks due to higher funding costs, and that any such process would likely take a very long time. We do not believe that regulators would permit par calls in such a scenario. In fact, we believe that if any changes materialize, they could increase the likelihood of first-calls, which would be positive for valuations.

More generally in our fund, we continue to favor the belly of the curve (6-10 years) and non-cyclical industrials, but we have started looking selectively into the automotive sector through auto-parts manufacturers and the financial services segment since summer, especially as BBs have become better value. We remain alert to potential pockets of volatility and would add some temporary downside protection if required, especially in periods of likely negative surprises.

Fund characteristics

Fund name	Vontobel Fund – Euro Corporate Bond
ISIN	LU0278087860
Share class	I EUR
Reference index	ICE BofAML A-BBB Euro Corporate Index
Inception date	13.7.2007

Historical performance (net returns, in %)

Time period	Fund	Ref. index	Time period	Fund	Ref. index
MTD	-0.1%	-0.2%	2024	5.2%	4.8%
YTD	3.2%	3.1%	2023	8.5%	8.2%
1 year	3.2%	3.1%	2022	-15.2%	-14.0%
3 yrs p.a.	5.6%	5.4%	2021	-0.6%	-0.9%
5 yrs p.a.	-0.1%	-0.1%	2020	3.9%	2.8%
10 yrs p.a.	1.7%	1.5%	2019	8.8%	6.6%
ITD p.a.	3.2%	2.9%	2018	-2.9%	-1.3%
			2017	4.1%	2.6%
			2016	4.4%	4.8%
			2015	0.9%	-0.4%

Past performance is not a reliable indicator of current or future performance.

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