NORDKINN

ASSET MANAGEMENT

Market Review & Outlook

May 2025

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Market overview

Global overview

Geopolitical risks continued having significant impact on financial markets also in May. On May 12th both the U.S: and China confirmed a reduction in the tariffs they imposed on each other for an initial period of 90 days: The extra U.S. tariff imposed on Chinese imports in April was dropped from 145% to 30%, while recently hiked Chinese tariffs on U.S. imports fell from 125% to 10%. The Trump Administration's U-turn from its hard-line stance against China was interpreted by financial market participants as a potentially broad de-escalation in the trade war, as reflected by the sharp rebound in risk assets.

With recession risks declining following the 90-day tariff truce between the U.S. and China, fixed income investors significantly cut back the probability of aggressive Fed policy easing. To be sure, incoming "hard" macro data have not revealed any clear hints of a looming slowdown in the U.S. economy anyway, as for instance reflected by stronger than expected rise in Non-Farm Payrolls during April and a still very low level of initial jobless claims during May. This contrasts with survey data signalling weaker sentiment among consumers and home builders.

Against this backdrop, the yield on 2-year U.S. treasury bonds rose more than 30 basis points during May. The slope of the yield curve flattened initially owing to repriced Fed expectations, yet later in the month the curve steepened again but instead lead by higher 10-year and 30-year bond yields as investors demand higher risk premia on U.S. Treasury bonds. Republicans in the U.S. House of Representatives narrowly passed President Trump's "Big, Beautiful Bill" just a few days after Moody's downgraded its rating on U.S. government bonds from Aaa.

Meanwhile, incoming data in Europe paints a more pessimistic picture, as reflected by weak Euro area PMIs and declining employment in the UK. However, a spike in UK CPI inflation in April (see chart) adds to the Bank of England's nervousness about inflation persistence, and to its reluctancy towards cutting rates.

Our global theme *"Geopolitical tensions impacting growth"* subtracted from performance as the 90-days truce on China tariffs in combination with incoming macro data triggered a larger than expected increase in short-term interest rates in the U.S. and UK in May.

While intramonth volatility in FX markets were significant, the EUR/USD ended May where it started. Also, the global rates developments had limited net impacts on European yield curves in the month in review Consequently, our theme *"Rebuilding Europe"* remained broadly stable in May.

Nordic overview

In Sweden, while CPIF excluding energy edged higher to 3.1% year-on-year in April, the figure came in below expectations for the second consecutive month. Meanwhile, Swedish Q1 GDP-data disappointed even before tariffs hit, supporting the Riksbank's view that the inflation uptick at the beginning of 2025 will be temporary. On May 8th, the Riksbank held rates steady as expected, but the Board was notably explicit in stating that the outlook for lower inflation could warrant an easing of monetary policy going forward. Minutes released on May 14th indicated that several Board members are open to adjusting policy based on incoming data.

Against this backdrop, Swedish short-term interest rates remained well supported in the first half of the month, lagging the rise in rates seen internationally. However, Break-Even Inflation rates declined massively following the marginally lower-than-expected inflation print. These developments weighed on our Swedish theme, *"After cuts come growth,"* which detracted from performance.

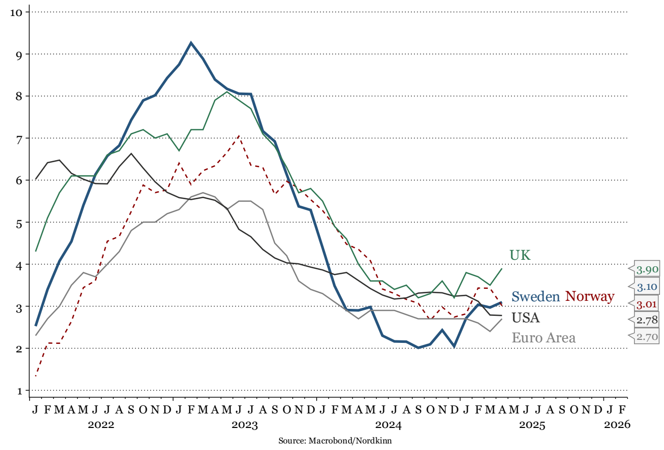
Later in the month, the Swedish National Debt Office raised its forecast for the budget deficit in 2025 and 2026, pointing to a yet significantly larger bond supply ahead. As a result, Swedish government bond yields rose relative to European yields, but the SGB spread versus swaps has so far not yet been impacted, see chart. Consequently, our theme *"Bond supply set to expand"* was at the end of May broadly stable for the month.

In Norway, core CPI eased to 3.0% year-on-year in April, in line with our forecast but below both consensus market expectations and Norges Bank's projections. However, the market impact of this downside surprise was overshadowed by the sudden 90-day truce on China tariffs, which triggered a sharp rise in short-term interest rates as global recession fears receded. The yield curve flattened, and the spread between Norwegian and Swedish bond yields widened. These developments weighed on our Norwegian theme *"Path to policy easing*".

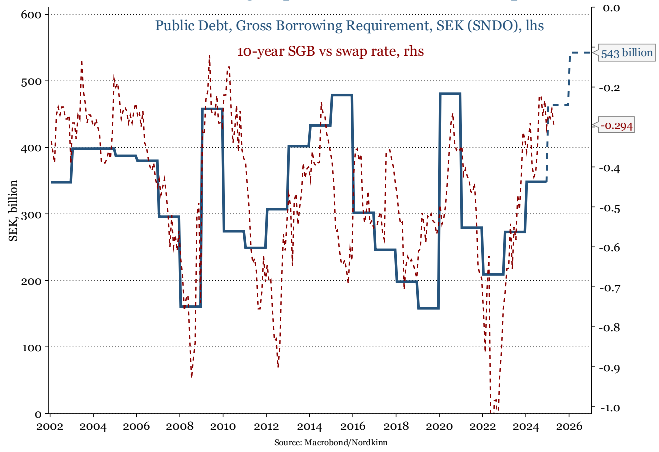
Norges Bank's reopening of the 10-year benchmark government bond via syndication on May 20th attracted strong demand, but this appetite for NGBs came after bonds had already repriced lower. As a result, the relative value of our Norwegian government bond holdings detracted from performance in May as a whole.

Despite a continued fall in the oil price, the NOK appreciated over the month as markets took the benefit of the doubt regarding an optimistic outcome to trade tensions.

Core CPI inflation, y/y %



SNDO borrowing requirement and SGB ASW spread



Outlook

Global outlook

The broad imposition of tariffs by Trump continues to reverberate through the global economy. The tariffs and the uncertainty they create remain a significant drag on growth and a persistent key source of risk.

Central banks are now confronted with an inevitable slowdown in economic activity. At the same time, some are constrained from acting until inflation is clearly on a sustainable path toward their 2% inflation targets. In the U.S., the recent easing in inflation data prints will be disrupted by the new tariffs. Given the lingering memories of the pandemic-era inflation surge, there are understandable concerns that tariff-induced inflation may prove more persistent than transitory.

While such caution will likely limit the extent to which the Fed can act pre-emptively, we remain optimistic about medium-term inflation risks in the U.S. Our view is underpinned by expectations of subdued growth leading to higher unemployment and a decline in job openings, both of which should restrain wage growth. This contrasts sharply with 2022, when the labour market was historically tight, fuelling rapid wage growth (see chart).

With wage growth likely to remain contained amid mediocre economic momentum, we anticipate only moderate increases in service prices—which comprise a much larger portion of the CPI basket than goods. This dynamic should help guide inflation lower again by 2026, once the one-off price level effects of the tariffs roll out of the year-on-year comparisons. Nonetheless, given the high starting point the Fed may need to wait until later this year—or perhaps into next year—before gaining sufficient confidence that inflation is sustainably returning to target.

Outside the U.S., the picture diverges. In the absence of retaliation, the economic slowdown and the strengthening of the euro simplify the ECB's decision-making as inflation is likely to continue lower. While inflation in countries such as UK and Sweden remain too high, the outlook for inflation appears less concerning in the context of weaker growth, which should support further monetary policy easing. These perspectives are reflected in our global theme *"Geopolitical tensions impacting growth."*.

Within our second global theme, *"Rebuilding Europe"* we focus both on the shift in U.S. policy direction and the longer-term optimism for Europe, which we believe will continue the structural reallocation of assets from the U.S. to Europe (and elsewhere). This, in turn, should also support the EUR/USD. Additionally, prospects for further policy easing and rising bond issuance are likely to contribute to steepening pressures along European yield curves.

Nordic outlook

Developments abroad have weakened the economic outlook for Sweden. Meanwhile, the Riksbank appears relatively unconcerned about the rise in underlying inflation during Q1, attributing it to transitory factors. Indeed, recent inflation readings have come in below expectations, and the outlook remains benign, particularly considering weaker-than-expected Q1 GDP growth and a much stronger SEK.

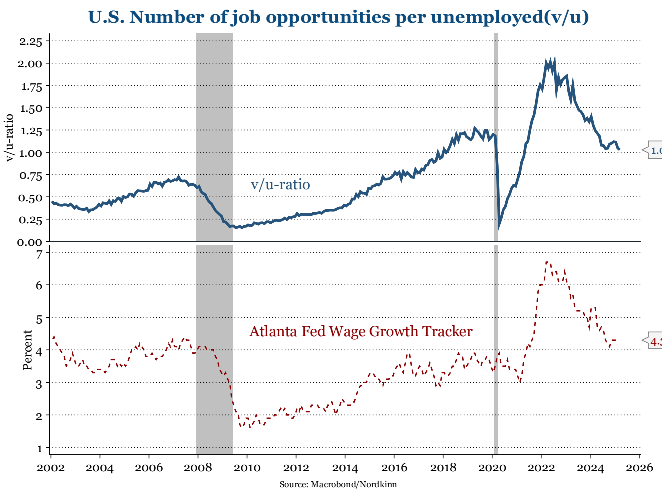
Given the downside risks to both growth and inflation, the Riksbank Board has so far signalled that a "slight" easing of monetary policy could be warranted. Taking all of these factors together, we anticipate a 25 bps rate cut to 2.00% in June, which will be supportive for shorter-maturity bonds. In line with this view and considering the weakening growth outlook, we closed our Swedish theme *"After cuts come growth"* in May.

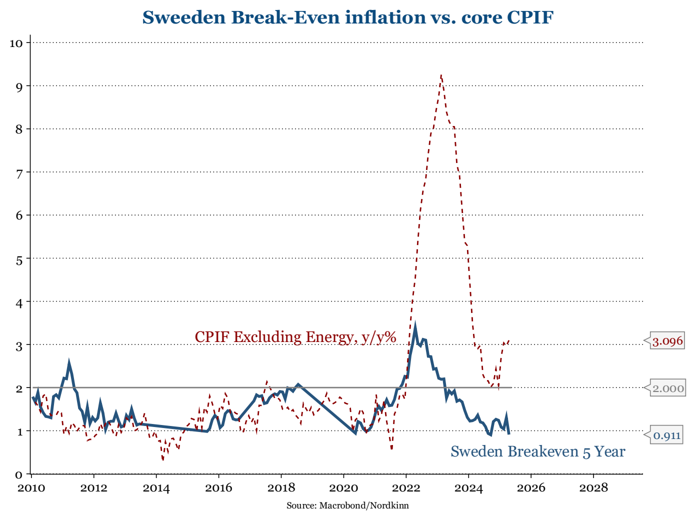
Instead, we now see the attractive longer-term opportunities in the inflation-linked bond market, taking advantage of modestly priced Swedish Break-Even rates, both in absolute terms and relative to peers. Break-Even Inflation rates are currently trading well below both the inflation target and prevailing underlying inflation levels (see chart). Beyond their strong risk-reward profile, they also offer inexpensive protection against the possibility that inflation proves stickier than expected or reaccelerates. To capitalise on this, effective from June 1st we launched our new theme *"Sweden: Revival of the inflation hedge."*

Turning to Norway, Norges Bank has held its policy rate steady at 4.50% since December 2023 and is likely to maintain this level for some time to ensure inflation returns to target. Recent data provides little impetus for an early rate cut. That said, Norway is certainly not immune to the global economic slowdown.

Our baseline scenario sees Norges Bank initiating a gradual easing cycle starting in September 2025, in line with its own projections. However, there is a risk that the central bank remains on hold throughout the year to gain further confidence in the inflation trajectory, opting to deliver more substantial cuts in 2026 as the effects of global weakness become more apparent. These dynamics are being actively monitored within our theme *"Norway: Path to policy easing."*

In parallel, we identify compelling relative-value opportunities across instruments and maturities in the Norwegian fixed income market. These are being explored through a new theme *"Norway: Lags in yield and curve dynamics."* For example, we believe the slope of the Norwegian yield curve lags global trends and has room to catch up. Moreover, demand for Norwegian government bonds may rise as investors look to diversify away from countries with elevated fiscal deficits.





About Nordkinn

Nordkinn Asset Management is a fixed income specialist based in Stockholm and Oslo. We invest in the global fixed income and currency markets – with a particular focus on our home markets Norway and Sweden.

Our focus is to generate stable absolute returns that exhibit low correlation to other assets. Our Nordkinn Fixed Income Macro Fund was launched in 2013.

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