

Why now is the sweet spot for active bond management

JULY 2025

The global bond market is in flux. Yield curves are steepening, volatility remains elevated, and policy decisions are moving markets in ways that upend some of the more reliable patterns of the last decade. In this environment, active management and selective risk positioning across the curve isn't just preferable - it's essential.

By Phil Strano, Head of Australian Credit Research

The volatility currently seen in bond markets is being fuelled by a combination of macroeconomic forces. In the U.S., ballooning fiscal deficits and a new \$3.8 trillion tax bill are putting upward pressure on long-term interest rates. At the same time, foreign demand for U.S. Treasuries appears to be weakening. Central banks are reducing interest rates, yet are constrained in their influence over longer-dated bonds. Meanwhile, Australia faces a decade of projected deficits of its own, and our yield curve continues to respond more to global forces than domestic settings.

These pressures are driving significant steepening in the yield curve - the difference between short- and long-dated bond yields. Steepening curves allow skilled credit managers to adjust risk exposure and capitalize on price differences.

In this environment, extending the maturity of our bond holdings has become more appealing, particularly given longer-term bonds can offer stronger price gains as they approach maturity – a dynamic we term “rolldown.” At the same time, we’re also seeing anomalies in credit spreads, where less sophisticated investors are prioritising yield over relative value, creating pockets of possible mispricing. This is where active management proves its worth. Passive bond funds are bound by index rules. They cannot reposition for anticipated curve moves, nor can they selectively add risk when prices dislocate.

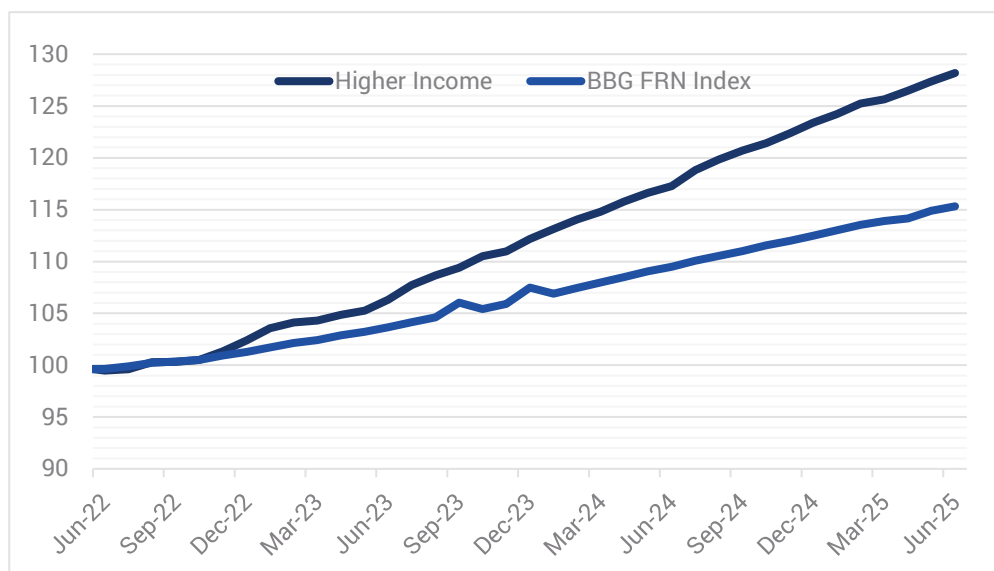
Given the Bloomberg FRN Index is more highly rated (average AA- compared to BBB) with shorter spread duration (~two years compared to ~three), the Yarra Higher Income Fund (HIF) is well placed to outperform during risk-on periods (refer Chart 1). However, HIF’s outperformance during certain risk-off periods demonstrates the potential benefits of active management. HIF outperformed the index through 2022 in an environment of both higher bond yields and credit spreads and more recently in April 2025.

Outperformance in April provides a recent example of how nimble decision-making up and down the curve may contribute to risk adjusted returns. While the FRN Index posted a negative excess return of 11bps compared to the RBA Cash Rate, HIF posted a positive 32 bps excess return despite credit spreads widening by 20-30bps over the month.

In April, we started the month expecting volatility around geopolitical events, which prompted us to lift cash levels and position our portfolios with higher overall interest rate duration. Crucially, we also implemented this with a steepening bias or, in other words, a view that long-term interest rates would rise faster than short-term rates. By focusing our exposure on the front of the curve,

or short-term bonds, and being underweight long-term bonds at the back end, we were well-positioned when the long end sold off sharply while the short end remained stable.

Chart 1 – Cumulative Return – Yarra Higher Income Fund v. Bloomberg FRN Index



Source: YCM/BBG, June 2025.

In terms of stock selection, April also presented some fantastic buying opportunities for us to take advantage of spread widening and add high-quality credit exposures at discounted levels. One such name was the USD-denominated Perenti 2029 bonds, an issuer we had previously sold at tight spreads of BBSW+180bps and were able to buy back ~200bps wider (BBSW+380bps). Credit spreads have since contracted ~100bps from these wides, providing a tidy return on investment.

While our portfolio positioning has not changed markedly from 12 months ago, these two recent examples show how we're actively managing nimble, benchmark-unaware portfolios that are more 'all-weather' credit in nature. Our April performance, in which both Yarra's Enhanced Income Fund (EIF) and Higher Income Fund (HIF) posted positive absolute returns, underscores the value of our approach. Our strategy came together as a result of preparation, speed, and conviction, none of which are available to passive strategies.

Looking beyond the tactical wins, and the case for active credit is supported by the broader macro context. While spread volatility continues, outright yields in the front and mid-parts of the curve have held steady. That means the income on offer remains attractive - and investors are simply being rewarded through a different mix of risk premia. The flexibility to shift between spread and rate risk allows us to preserve capital and position for growth, depending on where the market is offering best value.

It's a powerful setup. Investment-grade credit today is offering yields that, on a 12-month view, look comparable to long-term equity market returns - but without the same drawdown risk. Across the spectrum, private credit looks less compelling: the illiquidity and default risk required to justify allocations to private credit simply aren't being compensated in this environment.

Looking ahead, we see the drivers of this opportunity set - fiscal overreach, inflation variability, and steepening curves - as persistent features of the bond market over the next 6 to 12 months. We believe this is a sweet spot for credit investing. High running yields and steeper curves, allowing active positioning across durations are compelling and signal the era of 'buy everything and wait' in fixed income is over. Today's market rewards clarity of view, agility of execution, and a willingness to lean into volatility when others step back.

About the Yarra Higher Income Fund

The Yarra Higher Income Fund's flexible and strategic approach to asset allocation and active management enables it to quickly adapt to changing market conditions. It aims to deliver superior risk-adjusted returns and regular, stable income.

[Find out more about the Fund>](#)



Contact us

If you require further information, please contact your relevant [Business Development Manager](#).



Now is the time for investors to seek an active bond allocation.

Yarra Funds Management Limited (ABN 63 005 885 567, AFSL 230 251) ('YFM') is the issuer and responsible entity of a range of registered managed investment schemes, which includes those named in this document ('Funds'). YFM is not licensed to provide personal financial product advice to retail clients. The information provided contains general financial product advice only. The advice has been prepared without taking into account your personal objectives, financial situation or particular needs. Therefore, before acting on any advice, you should consider the appropriateness of the advice in light of your own or your client's objectives, financial situation or needs. Prior to investing in any of the Funds, you should obtain and consider the product disclosure statement ('PDS') and target market determination ('TMD') for the relevant Fund by contacting our Investor Services team on 1800 034 494 or from our website at www.yarracm.com/pdsupdates/. The information set out has been prepared in good faith and while Yarra Funds Management Limited and its related bodies corporate (together, the "Yarra Capital Management Group") reasonably believe the information and opinions to be current, accurate, or reasonably held at the time of publication, to the maximum extent permitted by law, the Yarra Capital Management Group: (a) makes no warranty as to the content's accuracy or reliability; and (b) accepts no liability for any direct or indirect loss or damage arising from any errors, omissions, or information that is not up to date. No part of this material may, without the Yarra Capital Management Group's prior written consent be copied, photocopied, duplicated, adapted, linked to or used to create derivative works in any form by any means.

YFM manages the Fund and will receive fees as set out in the PDS. To the extent that any content set out in this document discusses market activity, macroeconomic views, industry or sector trends, such statements should be construed as general advice only. Any references to specific securities are not intended to be a recommendation to buy, sell, or hold such securities. Past performance is not an indication of, and does not guarantee, future performance. Information about the Fund, including the relevant PDS, should not be construed as an offer to any jurisdiction other than in Australia. With the exception of some Funds that may be offered in New Zealand from time to time (as disclosed in the relevant PDS), we will not accept applications from any person who is not resident in Australia or New Zealand. The Fund is not intended to be sold to any US Persons as defined in Regulation S of the US federal securities laws and has not been registered under the U.S. Securities Act of 1933, as amended.

References to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only and do not imply that the portfolio will achieve similar results. Holdings may change by the time you receive this report. Future portfolio holdings may not be profitable. The information should not be deemed representative of future characteristics for the strategy. There can be no assurance that any targets stated in this document can be achieved. Please be advised that any targets shown are subject to change at any time and are current as of the date of this document only. Targets are objectives and should not be construed as providing any assurance or guarantee as to the results that may be realized in the future from investments in any asset or asset class described herein. If any of the assumptions used do not prove to be true, results may vary substantially. These targets are being shown for informational purposes only.

© Yarra Capital Management, 2025.