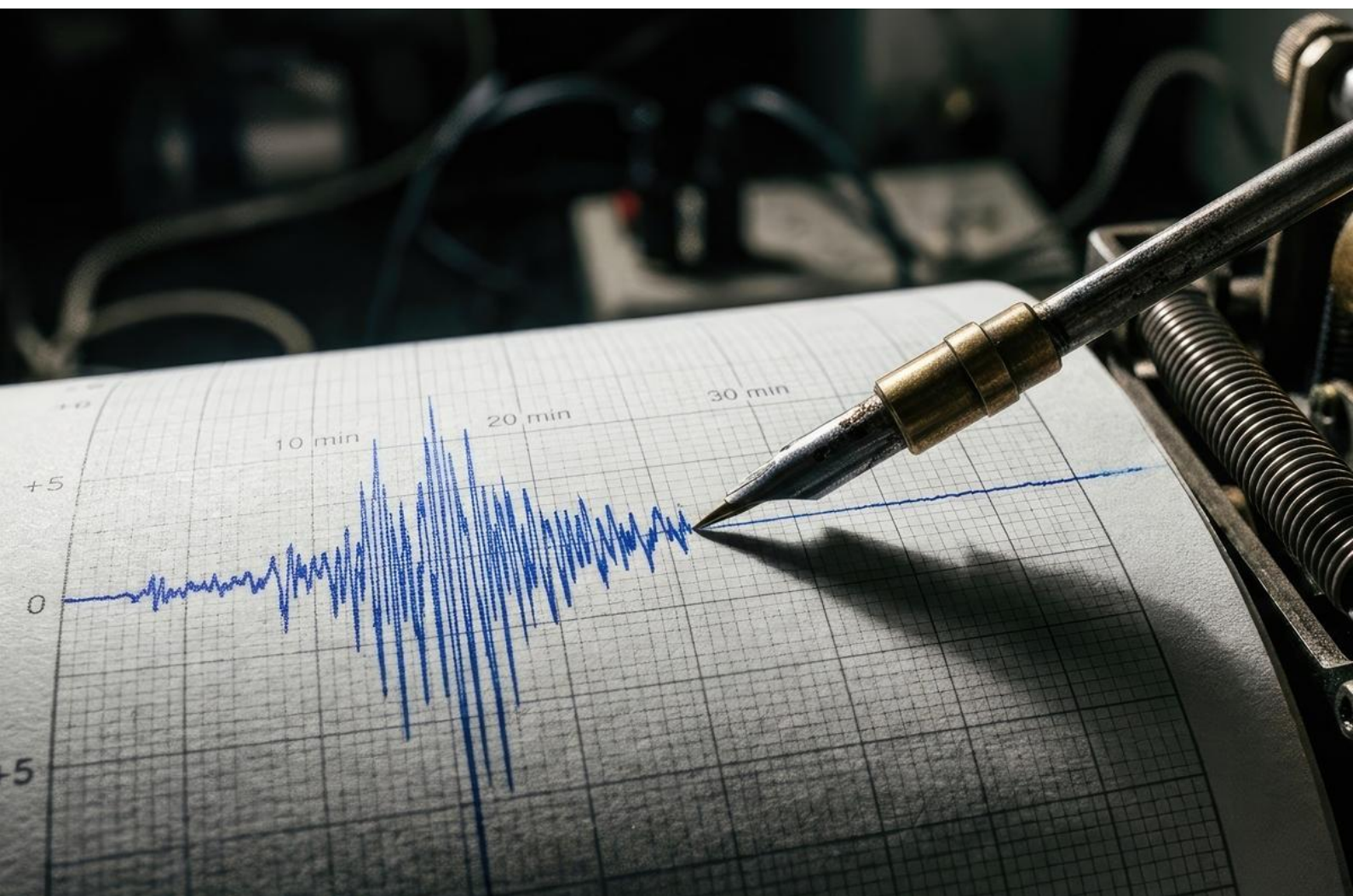


» *Fisch View*

*June's topic:
„Government bonds under pressure“*



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Beat Thoma
Chief Investment Officer



Krishna Tewari
Investment Strategist

Government bonds under pressure

- The long-observed decline in global financial market liquidity has accelerated in recent weeks, not least because of sharply reduced liquidity injections by the Chinese central bank, the PBoC.
- A persistently solid global economic backdrop and a renewed rise in inflation rates are also adding to the liquidity shortage in financial markets overall.
- Risks in equity and government bond markets are therefore increasing.

Overall economic situation

The global economy continues to benefit from a shift in financial market liquidity into the real economy, elevated investment in the technology sector and rising government spending. At the same time, however, these growth impulses are also leading to a renewed increase in inflationary pressure and higher yields on long-dated government bonds. This highly concerning development for financial markets is being further exacerbated by persistently high energy prices as the war with Iran drags on.

Recent developments: Financial market liquidity is falling

- The decline in global financial market liquidity that has been under way for some time has intensified in recent weeks. The main driver has been an unexpected reduction in liquidity injections by the Chinese central bank. Until recently, the PBoC had been flooding the financial system with liquidity, but it has now shifted to a more restrictive stance, with consequences for global financial markets. Likely reasons for this policy shift include higher inflation in China and a desire for a stronger yuan against the US dollar.
- Another reason for the decline in financial market liquidity is the continued resilience of the global economy, which is being strongly supported by high investment by US technology companies in the real economy and by substantial government spending worldwide. In the United States, government spending is also being financed via the issuance of short-dated Treasury bills rather than long-dated government bonds, leading to a monetisation of public debt and therefore an increase in US bank reserves. This, in turn, enables banks to extend more credit, providing a further boost to economic activity.
- Taken together, these factors are generating significant inflationary and interest-rate pressure.

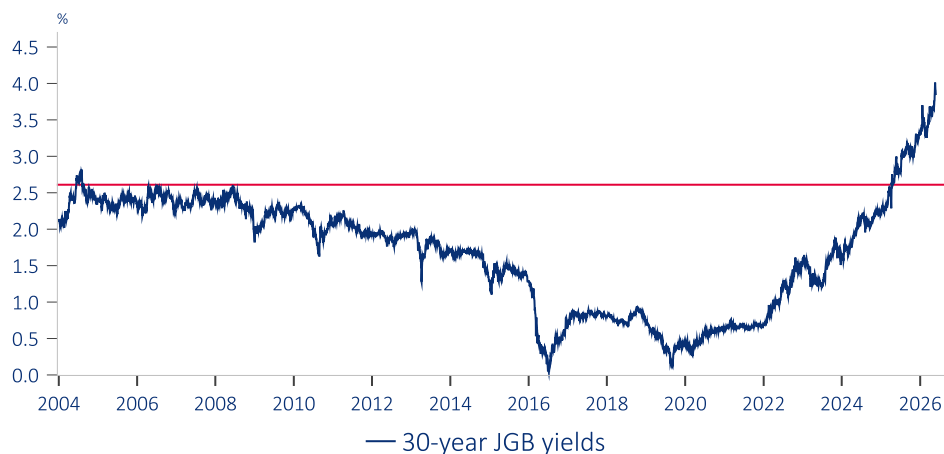
➔ **On the radar: Bitcoin as a leading indicator for the equity market** (page 6)

Overview & outlook: Solid growth and inflation pressure

» US government spending is being financed via T-bills

- The decline in financial market liquidity outlined above represents a warning signal for highly valued equity markets and other risky assets such as Bitcoin. The Bitcoin price has long been a reliable liquidity indicator and is therefore potentially vulnerable at present.
- Since liquidity is not disappearing but rather being redirected into the real economy, global growth is receiving a strong positive impulse. This reallocation is happening, on the one hand, because central banks remain relatively restrictive and are shrinking their balance sheets to combat inflation, thereby withdrawing money from financial markets. On the other hand, the US Treasury has for some time financed rising government spending primarily via T-bills, thereby sparing the long end of the yield curve. In effect, public debt is being monetised to a degree, as T-bills are money-like instruments. In the short term, this allows the fiscal deficit to expand without causing immediate upward pressure on rates, thereby stimulating the real economy. Current GDPNow estimates, robust PMIs and rising copper prices all point to a solid global real economy.
- High levels of government spending and the monetisation of the fiscal deficit via T-bills are not sustainable, however, and are inflationary. T-bills must be refinanced continuously, which can cause stress in money markets and undermine confidence in the financial system. Rising core inflation, in both producer and consumer prices, confirms growing inflationary pressure.
- This combination of falling financial market liquidity, solid growth, high monetised public debt and rising inflation is directly negative for global government bond markets. Yields have risen sharply in recent weeks, and this has been a global move. This is particularly evident in Japan and the UK, where yields on long-dated government bonds have climbed to their highest levels in 20 to 30 years. Corporate bonds, by contrast, are benefiting from the supportive economic backdrop.

Chart: Government bond yields are also rising in Japan



Sources: Macrobond, Fisch Asset Management

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	<ul style="list-style-type: none"> – IT (AI beneficiaries) – Semiconductor (AI-related) – Healthcare – CBs with high convexity – Bond-like CBs with quality credits and attractive yields – Balanced deep investment grade Chinese tech with high convexity 	<ul style="list-style-type: none"> – Consumer discretionary – Unprofitable, early stage, expensively valued IT and biotech – Weak credit quality and/or liquidity – Cryptocurrency-related names
Global IG Corporates	<ul style="list-style-type: none"> – Healthcare, financial services and banking – BBB-rated bonds – Maturities 5-10 years 	<ul style="list-style-type: none"> – Technology, capital goods, transportation – GBP- and CAD-denominated issues – Maturities > 15 years
Global Corporates	<ul style="list-style-type: none"> – Healthcare, financial services, energy – BBB- and BB-rated bonds – North America 	<ul style="list-style-type: none"> – Basic industry, transportation, utilities – A- and B-rated bonds – Emerging Markets
Global High Yield	<ul style="list-style-type: none"> – Telecommunications – Basic industry – Retail 	<ul style="list-style-type: none"> – Financial services – Utilities – Insurance
Emerging Markets - Defensive	<ul style="list-style-type: none"> – LatAm (Mexico, Brazil), Eastern Europe, Saudi Arabia – Utilities, energy – Maturities 7-10 years 	<ul style="list-style-type: none"> – Asia (India, Hong Kong) – Industrials
Emerging Markets - Dynamic	<ul style="list-style-type: none"> – LatAm (Mexico, Brazil, Colombia), Eastern Europe – High-yield bonds – Utilities, supranationals, oil & gas 	<ul style="list-style-type: none"> – Asia IG (China, Hong Kong) – A-rated bonds – Maturities > 15 years

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

On the radar: Bitcoin as a leading indicator for equities

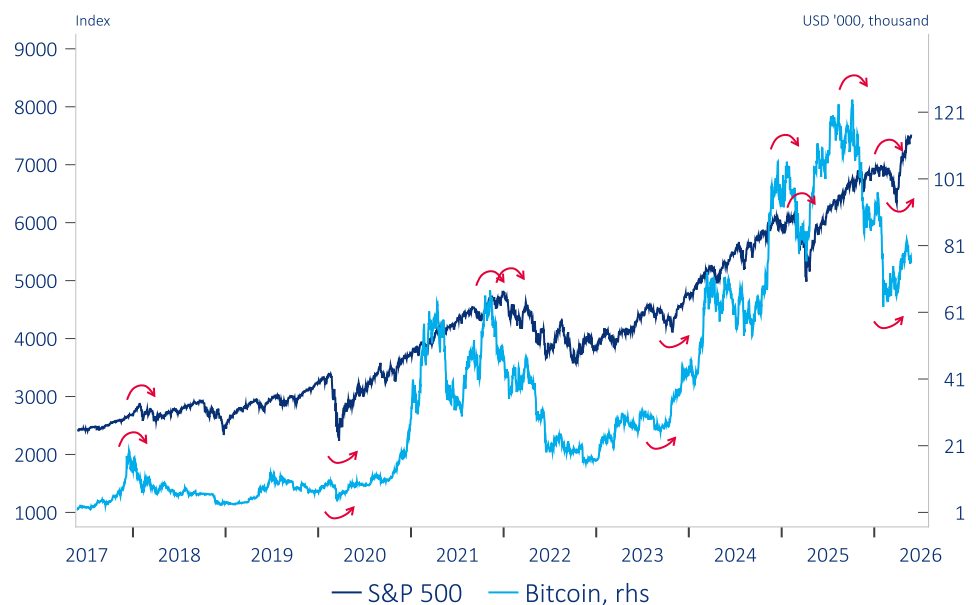
Global financial market liquidity has been losing momentum for quite some time. The reason is a reallocation of liquidity away from financial markets and into the real economy. Investments such as the Mag7's USD 700 billion in AI infrastructure, equivalent to 2.5% of US GDP, require substantial liquidity that has to be raised in the markets. Another factor is that central banks remain relatively restrictive and are shrinking their balance sheets in order to fight inflation.

Bitcoin is a reliable indicator of developments in global financial market liquidity. The chart shows that Bitcoin has for years led the US equity market. Bitcoin is not an inflation indicator; rather, it reflects speculative money flows into or out of equity markets. The chart also shows clearly that a significant divergence has opened up between Bitcoin and the equity market since October last year: Bitcoin has fallen from USD 120,000 to below USD 80,000. This is a warning signal and points to increasingly fragile foundations beneath equity markets. The divergence has also widened further in recent weeks.

» **Central banks remain restrictive worldwide**

This outflow of liquidity also has significant consequences for the interest-rate outlook and for government bond markets. In particular, the reduction of central bank balance sheets can lead to stress in money markets and, as a result, place upward pressure on the long end of the yield curve. Current market developments confirm this very clearly. Particularly dangerous is the fact that yields in the United States are rising despite large-scale intervention and support measures by the US Treasury, namely buy-backs of long-dated government bonds financed via short-dated T-bills, which may indicate a potential loss of control by both the Fed and the Treasury. Government bonds are also under pressure globally. The resulting higher volatility in government bond markets could then lead to dangerous feedback loops and, as already noted, to an unwinding of the basis trade in the United States.

Chart: Bitcoin leads the equity market



Sources: Macrobond, Bloomberg, Fisch Asset Management

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