
Global Flexible Bond Funds Held Their Own in 2024...

But tighter credit spreads and an uncertain rate outlook create challenges ahead.

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All ratings mentioned in the text refer to the fund's representative clean share class.

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This article looks at how global flexible bond funds have performed over the past year and where their managers are turning to find value. We examine portfolio positioning from three main angles: key fixed-income sector allocations, duration, and corporate bond sectors.

In the last section, we comment on the challenges and risks when investing in global flexible bond funds and provide key guidelines on fund selection.

Key Takeaways:

- A risk-on stance paid off for global flexible bond managers in 2024 as corporate credit and high-yield bonds outperformed over the year.
- Many global flexible bond fund managers avoided making large duration bets in 2024, instead focusing on relative value plays between regions and sectors, as well as popular trades like US agency mortgage-backed securities.
- As 2024 ended with corporate credit spreads reaching their tightest levels in several years, many bond managers argued that investment-grade bonds were looking increasingly unattractive, particularly in the US.
- Dispersion across corporate sectors is expected to remain, as many managers argue there is still value in financials, while sectors like autos and real estate face durable headwinds.
- Choosing a global flexible bond fund calls for a careful assessment of several factors, including the investment team's expertise, their track record across market cycles, and their ability to balance top-down and bottom-up considerations.

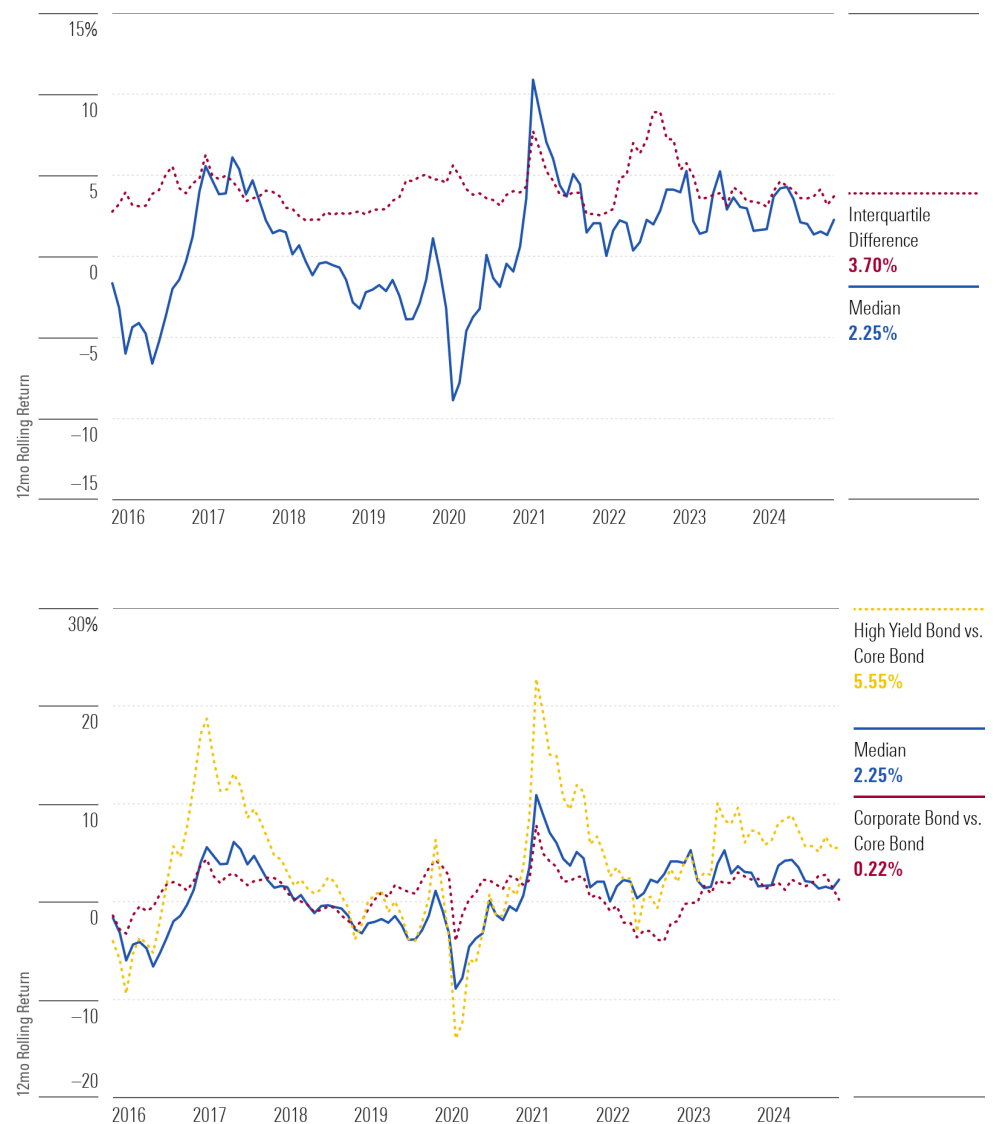
A Risk-On Stance Paid Off in 2024 as High-Yield Bonds Outperformed Amid a Shifting Rate Outlook

Fixed-income markets in 2024 were driven by two key themes. Investors initially anticipated significant rate cuts, but economic strength and stubborn inflation led central banks to scale back monetary easing in the second half of the year. This pushed government bond yields higher and challenged managers positioned for rate cuts. Meanwhile, investors' strong risk appetite catapulted high-yield bonds, with the Morningstar Global High Yield Bond Index (on a USD-hedged basis) returning 8.7%, boosted by elevated starting yields and tightening spreads.

Against this backdrop, global flexible bond funds outperformed in 2024, with the EAA Global Flexible Bond USD Hedged category averaging 5.5% versus 3.2% for the Morningstar Core Bond Index. Credit exposure, particularly in higher-yielding segments, drove returns. Performance dispersion narrowed compared with 2022 when duration positioning created wider return gaps. The chart below shows this reduced dispersion through the interquartile range (difference between 25th and 75th percentile returns) in the global flexible bond Morningstar Category.

Managers who excelled in 2024 largely did so through a dynamic approach and ability to capture relative value opportunities as these emerged across various sectors, regions, and maturities.

Exhibit 1 Global Flexible Bond Funds' Relative Returns on a Rolling 12-Month Basis



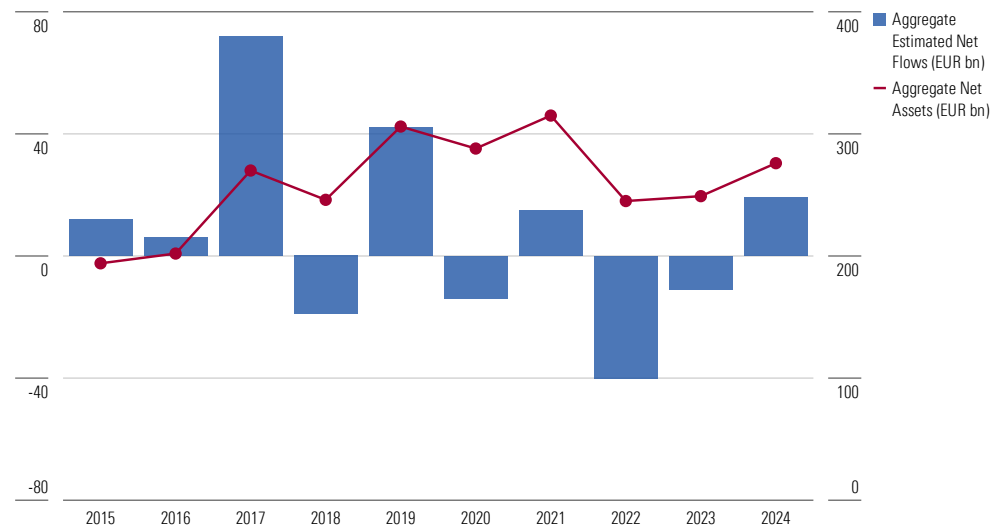
Source: Morningstar Direct. Data as of Dec. 31, 2024.

The overall improvement in performance paid off in terms of flows in 2024. Global flexible bond funds in the various Morningstar EAA categories (unhedged and foreign exchange hedged) attracted EUR 19 billion in 2024, reversing the outflows in 2023 and 2022. **Pimco GIS Income** captured the most flows, remaining a popular choice among European and Asian investors seeking high income with moderate credit risk.

Several other funds saw strong flows in 2024. Despite modest returns in 2024, **DNCA Invest Alpha Bonds** attracted significant interest, likely thanks to its strong performance in 2023 and particularly 2022, when the managers had taken its duration into negative territory (up to negative 2 years). Other top-gathering funds included **Schroder ISF Global Credit Income**, **Vontobel TwentyFour Strategic Income**, and **Algebris Global Credit Opportunities**, all with top-quartile 2024 returns.

By contrast, funds struggling with rate positioning faced outflows. **Allianz Strategic Bond** lost more than GBP 1 billion in 2024 following bottom-decile performance since 2021 and underwent a management change. **Janus Henderson Strategic Bond** also experienced significant outflows, hurt by its long-duration stance and limited credit exposure.

Exhibit 2 Global Flexible Bond Category's Aggregate Flows and Net Assets



Source: Morningstar Direct. Data as of Dec. 31, 2024.

Now we delve into a select group of analyst-rated managers positioning through different lenses: preferences across key fixed-income sectors, duration management against the backdrop of an uncertain rate environment, and corporate sectors' "winners and losers" during the year.

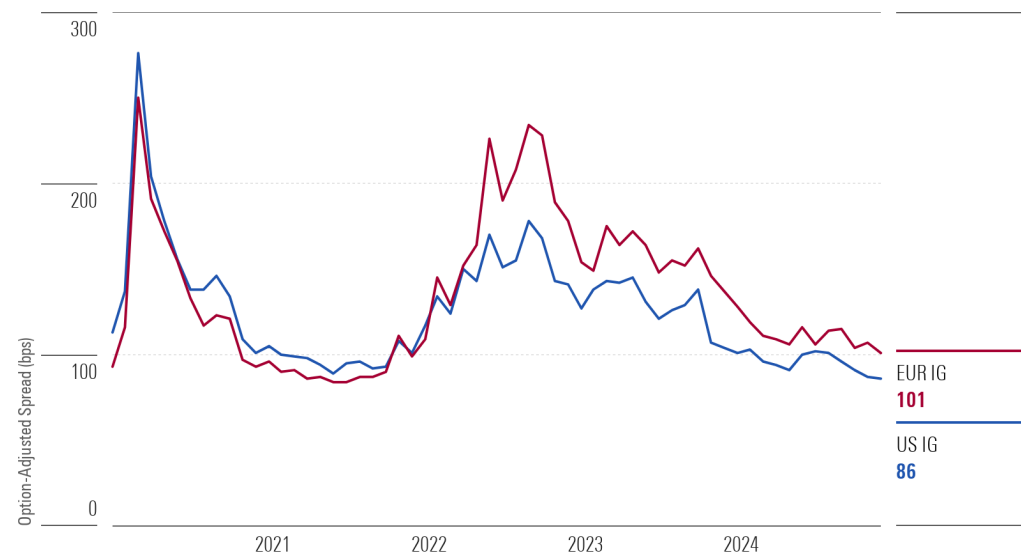
Section 1 – Overview of Key Fixed-Income Sector Exposures

Managers Find Value in Agency MBS and Emerging-Markets Local Debt Amid Tight Credit Valuations

Credit markets present a mixed picture. Fundamentals remain solid across sectors, but tight spreads offer limited upside and significant downside risks if economic conditions worsen. Bargains are therefore not easy to find, and many argue corporate credit offers a fairly asymmetric profile at the moment (limited upside coupled with significant downside risk should the economy experience a material slowdown).

Among major developed markets in investment-grade credit, managers found better valuations in Europe given the higher likelihood for further interest-rate cuts. European credit has maintained a spread premium over US counterparts since 2022, deepened by geopolitical events—namely, Russia's invasion of Ukraine and subsequent energy supply concerns. While this valuation gap narrowed in 2024, many managers still favor European exposure given better valuations and higher rate-cut expectations. For example, **BGF Fixed Income Global Opportunities** (which earns People and Process ratings of High), reduced its exposure to global investment-grade credit in 2024, but the managers retained a bias for European over US credit on comparatively more attractive valuations.

Exhibit 3 Fixed-Income Sectors' Option-Adjusted Spreads



Source: Morningstar Direct. Data as of Dec. 31, 2024. Figures based on month-end data for equivalent ETFs.

High-yield bonds share similar dynamics with investment-grade, though with some nuances. On the positive side, their shorter maturity profile provides some buffer against rate movements, fundamentals remain historically sound, and yields continue to offer attractive entry points. In contrast, the higher credit and default risk, coupled with relatively tight valuations on aggregate, imply that the sector

remains vulnerable to spread widening during economic weakness. This backdrop has led managers to favor defensive positioning

BSF Sustainable Fixed Income Strategies strategy (which earns a People rating of Average and a Process rating of Above Average), maintained conservative exposure, holding 12% in high-yield bonds as of December 2024, despite having the leeway to own up to 25%. The team preferred to keep its corporate credit portfolio higher in quality, and its only exposure to high-yield bonds consisted of either subordinated bonds issued by strong companies (with investment-grade issuer ratings) or “rising stars” — high-yield bonds likely to be upgraded to investment-grade.

Meanwhile, credit-focused funds like **Capital Group High Income Opportunities** (which earns People and Process ratings of Above Average), whose high-yield allocation hovered around 40% in recent years, emphasized defensive sectors like financials and pharmaceuticals over cyclicals.

Emerging-markets debt performance fell short of expectations in 2024 following a robust 2023, in part hampered by US dollar strength. Although fundamentals remain robust across the spectrum — from hard-currency sovereigns to corporates and local-currency bonds — manager sentiment has increasingly favored the latter, attracted by potential currency recovery and favorable local rates, as some markets begin their easing cycles. However, given the sector’s vulnerability to tail risks, the managers have stuck to a highly selective approach and a focus on compelling idiosyncratic stories.

JPM Global Bond Opportunities (which earns People and Process ratings of Above Average), for example, held 8.3% of assets in local-currency emerging-markets debt as of December 2024, with a further 8.4% in hard-currency sovereign debt and 2.1% in emerging-markets corporate bonds. The team’s investment rationale was based on the commencement of monetary policy easing in the US and news of a fresh economic stimulus package in China. Within local-currency sovereigns, the firm added to its positions in the third quarter of 2024, increasing exposure to Poland and adding Indonesia and South Africa.

The securitized market, specifically agency MBS, is a sector that managers viewed as a key area of opportunity. After underperforming since 2023, the sector has cheapened significantly, offering attractive valuations relative to some segments of the investment-grade spectrum. But managers also valued allocations to agency MBS for their diversification benefits.

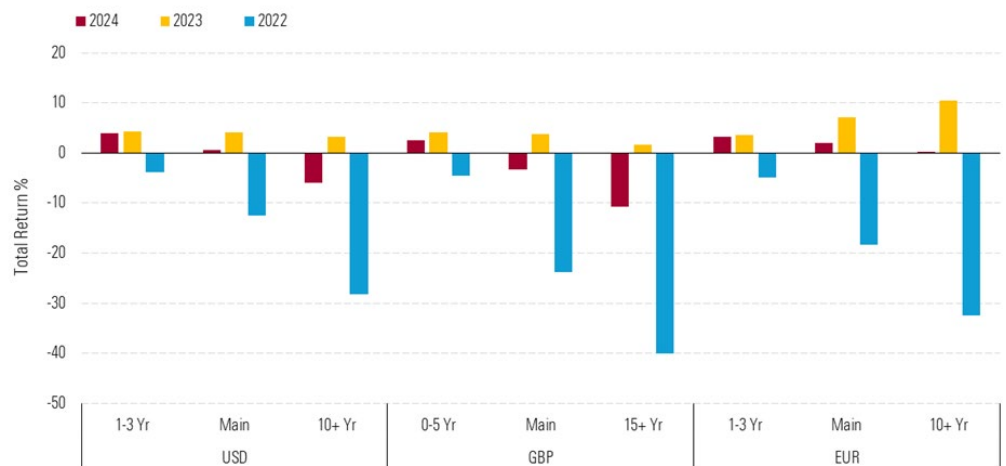
For example, **Pimco GIS Dynamic Bond** (which earns a People rating of High and a Process rating of Above Average) has long relied on in-house securitized specialists to generate ideas for this flexible portfolio. In recent years, the strategy has downplayed the corporate-credit-heavy approach employed by some peers, instead focusing on agency mortgages. The managers thought that agency MBS were particularly cheap following a US Federal Reserve decision to sell agency mortgages from its balance sheet, as part of its quantitative tightening efforts, and ramped up exposure to the sector over 2023 and 2024; it ended December 2024 with 76% of assets invested in securitized debt (primarily agency mortgages) on a market value basis.

Section 2 – The View on Duration

Uncertainty Surrounding Rates' Outlooks Favored Managers Taking a More Tactical Approach During 2024

Rate cut expectations moderated in 2024 as economic resilience and stickier-than-expected inflation in the US and UK challenged the disinflationary narrative. Unlike the relatively coordinated rate hikes since 2022, managers in 2024 started to anticipate more dispersion in monetary policy actions across regions. This fluid market backdrop favored short-term tactical trades, with managers being more reactive to economic data releases to identify opportunities arising across specific maturities and countries.

Exhibit 4 Government Bond Indexes' Calendar-Year Returns Across Maturity Ranges



Source: Morningstar Direct. Data as of Dec. 31, 2024.

T. Rowe Price Dynamic Global Bond (which earns a People rating of Average and a Process rating of Above Average) has used its wide duration band of 0 to 6 years dynamically over the years. It pushed toward the upper limit of 6 years in mid-2023 when the managers expected recessionary economic conditions and shifted to a long US duration posture. For most of 2024, the portfolio was positioned for inflation to remain stubborn with resilient growth, but it maintained its overall long-duration stance. However, this was swiftly neutralized by the end of 2024. By the end of November 2024, effective duration stood at 0 and dropped to negative 1.6 years in December.

Janus Henderson Strategic Bond (which earns a People rating of Above Average and a Process rating of Above Average) took a different view: While the fund's duration was as low as 3 years at the beginning of 2022, the managers sharply increased it to 9 years as of December 2024, predominantly by adding US, UK, and Australian interest-rate exposures, and more recently switching some duration into the eurozone from the US. This reflects the managers' expectations of a deteriorating economic outlook, an environment in which they would also expect their defensive stance and, more broadly, higher-quality bonds to start performing well.

Jupiter Strategic Bond (which earns a People rating of High and a Process rating of Above Average) also kept duration on the long side (10.3 years as of December 2024), reflecting manager Ariel Bezalel's view that economic growth will weaken and we are approaching a recession. He also believes the probability of a hard landing is higher than the market expects. Most of its government bond holdings are in US and Australia, while there is also exposure to New Zealand and the UK.

The team behind **Dodge & Cox Worldwide Global Bond** (which earns People and Process ratings of High), meanwhile, continued to believe that interest rates are likely to decline in several key global markets and maintained the fund's duration near 6 years. The managers slightly reduced the fund's US duration exposure as the gap narrowed between market forward rate expectations and the team's own estimates. Meanwhile, they added duration in the UK, where sticky inflation has kept long-term interest rates elevated relative to the team's medium-term outlook.

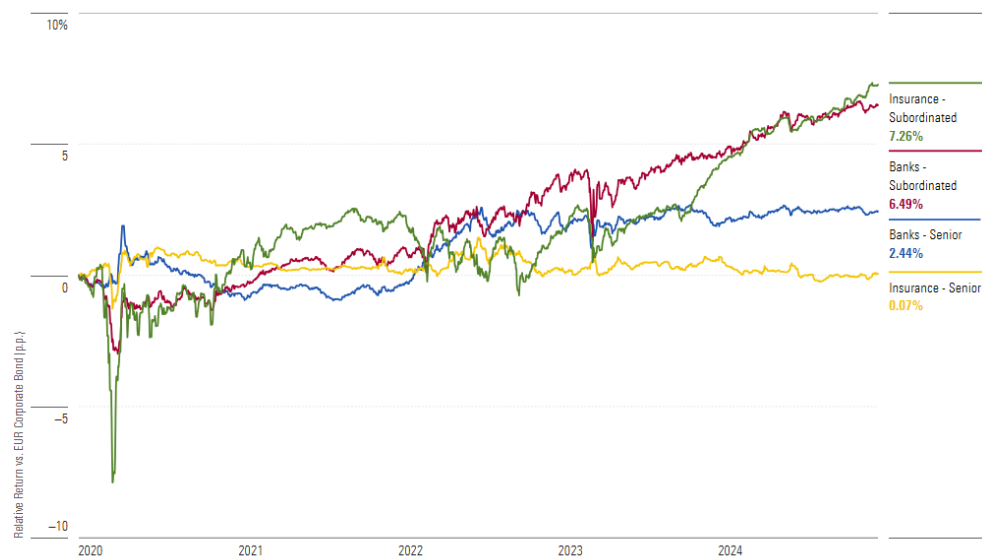
Section 3 – Delving Into Corporate Bond Sectors

Financials Continue to Outperform Amid Signs of Recovery in Real Estate and Pressure on Automakers

Financials eked out gains relative to the index in 2024. In particular, subordinated bonds were a key area of opportunity, posting solid returns in 2024 relative to their senior-rated counterparts. However, a narrowing of the spread differential against other corporate sectors indicates that the valuation gap has diminished significantly. Nonetheless, many portfolio managers remain supportive of the sector.

Artemis Strategic Bond (which earns People and Process ratings of Average) has kept a relatively large exposure to the sector: 31.6% of the portfolio as of the end of December 2024. The team believes fundamentals in financials remain robust with evidence of solid consumers' finances and a low rate of bank loan defaults. On a regional basis, the team shows a preference for US banks and is avoiding French and German banks, which may continue to be affected by geopolitical noise in 2025. Toward the end of 2024, the fund started to marginally switch out of some of the subordinated bank bonds into senior bank debt as the valuation differential between seniorities compressed.

Some managers are beginning to think that financials are starting to exhaust their potential. The team behind **Dodge & Cox Worldwide Global Bond** (which earns People and Process ratings of High) further trimmed the fund's exposure to the sector in the third quarter of 2024 amid tight credit spreads. The team preferred higher-quality sectors (agency mortgages, US Treasuries, and pure cash) to amass dry powder as it expects better buying opportunities to materialize.

Exhibit 5 Performance of Euro-Denominated Financials

Source: Morningstar Direct. Data as of Dec. 31, 2024.

Real estate bonds showed signs of a recovery in 2024. The sector faced significant pressure through 2022 and 2023 as the rapid rise in interest rates raised concerns on the companies' ability to refinance their debt. This led to weaker sentiment and a consequent significant widening in spreads, with European names proving particularly vulnerable. More favorable valuations, coupled with the prospect of falling interest rates, led some managers to find opportunities in the sector, with subsectors such as logistics and data centers favored over the more traditional office and retail names.

Schroder ISF Global Credit Income (which earns People and Process ratings of Average) continues to focus on the real estate sector as a combination of attractive credit spreads and the start of the monetary easing cycle should underpin total returns. The team prefers logistics owing to strong demand and the benefit from multisecular trends, especially in Europe, such as e-commerce and deglobalization. As of the end of December 2024, the fund's exposure to real estate stood at 6.5%, versus its benchmark's exposure of 5.3%.

In contrast, the managers of **Robeco SDG Credit Income** (which earns People and Process ratings of Above Average) continued to be cautious of property markets, citing concerns over vacancies and higher refinancing costs, resulting in a relatively low exposure to the sector (1% as of mid-2024 versus roughly 4% in commonly used global corporate indexes).

The automotive sector is experiencing a set of unique challenges. Sales have fallen sharply, and both European and US auto companies are grappling with the rise of Chinese competitors in the electric vehicles space. The additional looming risk of US import tariffs on European automakers sets the sector for a bumpy ride. The weaker sentiment led to a significant widening in spreads during the second half of 2024.

Muzinich Global Tactical Credit (which earns People and Process ratings of High) took advantage of this spread widening through higher-quality US issuers while remaining “market weight” in the European automotive sector. This is underpinned by the view that the US manufacturers are best placed given the stronger domestic demand in the US and natural insulation from anticipated US tariffs. As of the end of December 2024, the fund’s exposure to the sector stood at 6.4% compared with an exposure of 3.5% in its reference index.

Challenges and Risks to Consider When Investing in Global Flexible Bond Funds

Global flexible bond funds differ from their global diversified bond counterparts primarily through their larger remit and, as their name implies, extra flexibility. Many are absolute-return-oriented instead of being managed in relation to a traditional market index, and many present themselves as “all-weather” strategies that are expected to do well independently of the market cycle. Their flexibility is an enticing feature, as it allows the managers to (in theory!) express their views without constraints and to freely allocate to the bond market sectors that offer the best value over short, medium, and longer time frames. At the same time, their wide leeway makes such funds difficult to use in the context of a broader portfolio: By definition, the risk profile of a global flexible bond fund can change rapidly. For example, the manager could decide to go all-in on high-yield, emerging-markets debt or other spread sectors, to a degree dictated by the fund’s investment guidelines. Investors having bought a global flexible bond fund to use as ballast in relation to their equity portfolio might find themselves with unintended biases and an unbalanced total portfolio allocation.

When choosing a global flexible bond fund, investors should thus ask key questions such as:

- How experienced are the teams behind it, and is there evidence of these teams getting tactical market calls right? Do these teams have relevant expertise in all of the different bond market subsectors they purport to scour for opportunities? Have these teams experienced a full bond market cycle, including down markets, and how have they reacted when their strategy was out of favor?
- Does the strategy combine top-down plays with more bottom-up, relative value trades? Market timing is notoriously difficult to execute over the long term, and funds that rely on only a handful of top-down calls are particularly vulnerable. Combining top-down plays (on duration or credit beta, for example) with more granular, uncorrelated, idiosyncratic trades can be a more reliable, and more predictable, path to deliver alpha.
- Global flexible bond funds tend to use derivatives (such as credit default swaps, futures contracts, and interest-rate swaps) more heavily than those in other, more traditional fixed-income categories. Does the investment team have appropriate experience using derivatives, and are its risk management systems robust enough to monitor and stress-test these derivative exposures?
- What is a fair price to pay for potential alpha generation? The average fund in the EAA Global Flexible Bond category charges 0.91% in annual fees (1.22% for distribution share classes). That’s higher than its typical counterpart in the EAA Global Diversified Bond category (0.65%

per year). But most importantly, as investors can increasingly choose from a menu of low-cost passive options tracking the global bond market for as little as 0.1% per year, the value-add from many flexible bond managers might not be entirely compelling after accounting for fees.

Finally, investors seeking a global flexible bond fund should arm themselves with patience. These funds may occasionally experience bouts of spectacular underperformance (for example, by getting caught on the wrong side of a duration trade) but can also record astounding rebounds over short time frames. Such a boom-or-bust performance pattern requires a strong stomach, and investors should not try to time their entry and exit points but rather keep a long-term investment horizon and incorporate their bond fund choices in their strategic asset allocation framework. ■■■

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