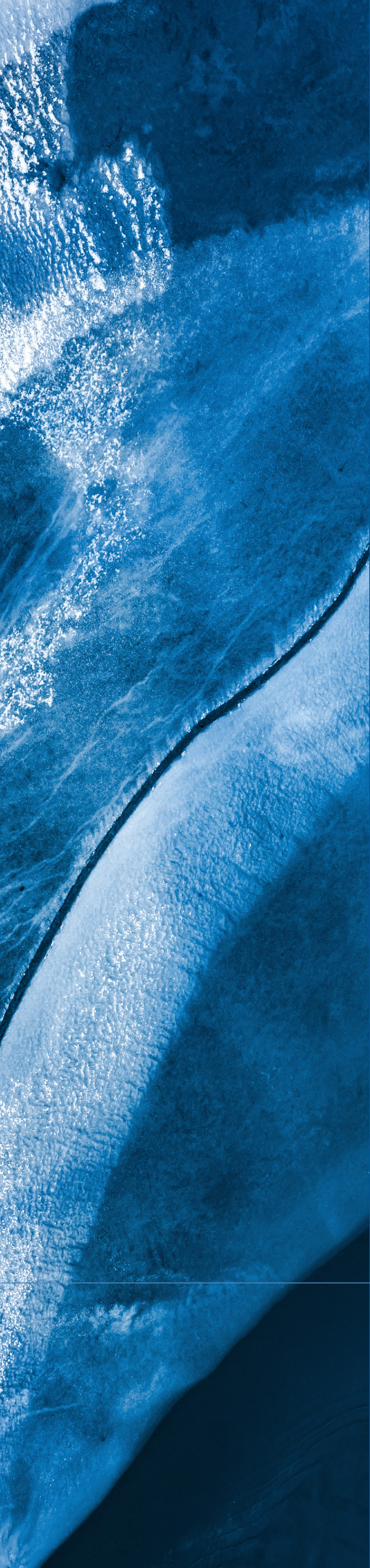

FIXED INCOME

• ABSOLUTE RETURN

A Strategy for Navigating Uncertainty

Although markets have shown a positive trend in recent months, data indicates that 2025 is likely to end with a global economic slowdown. Uncertainty remains high, as trade and geopolitical tensions are still unresolved, and the world's largest economy is already showing signs of weakness. In this environment, we anticipate a strong likelihood of increased volatility across asset classes.

To navigate these challenges, one potential solution for investors is to consider absolute return strategies, known for their agility and flexibility. At Lazard Frères Gestion, we bring extensive expertise in this area, leveraging it across various segments of the bond market. Our goal is to deliver positive performance each year, regardless of market conditions, while maintaining a disciplined approach to risk management.

LAZARD
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Part I: Volatility Ahead

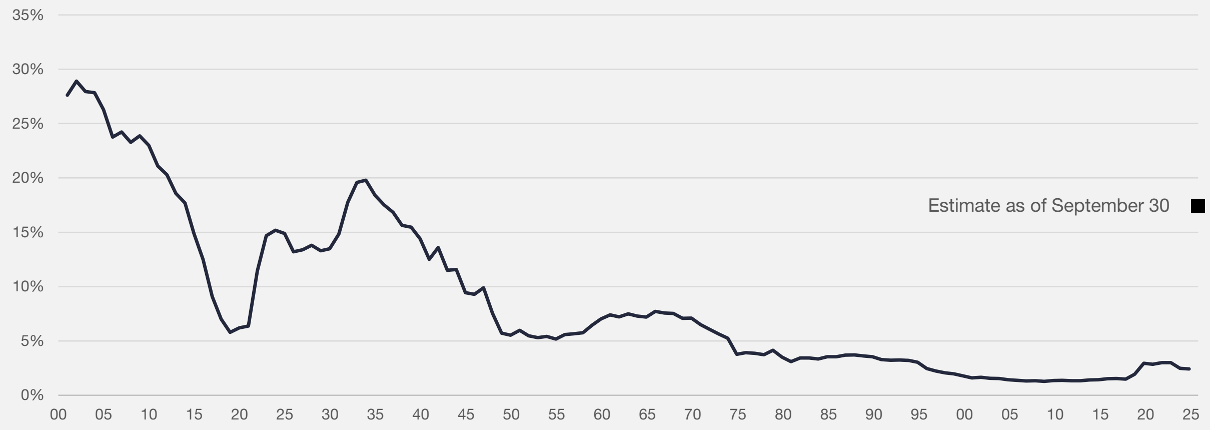
A. United States: the impact of tariffs is yet to come

Since the start of the year, equity and bond markets have been highly sensitive to developments surrounding U.S. tariffs. Following the initial concerns triggered by "Liberation Day," markets regained a sense of optimism as fears of a tariff escalation between the United States and its key trading partners started to ease.

Market optimism remains fragile. As negotiations continue, the average tariffs on goods imported into the US are expected to climb to nearly 20%, up from just 2.5% previously (see chart 1).

Exhibit 1

United States | Average effective tariff rate
Percentage of import value



Source: Yale Budget Lab

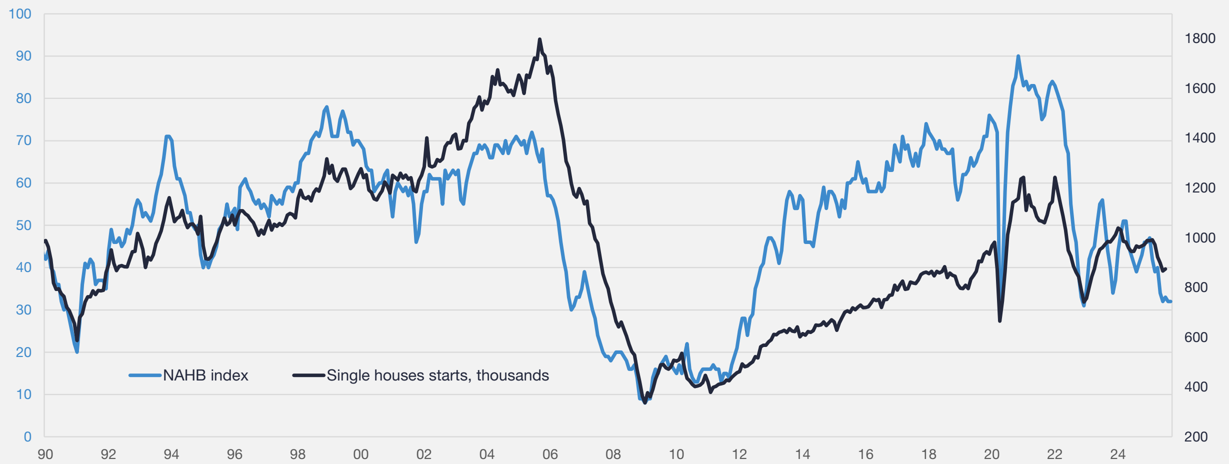
This exceptionally high level — the highest since the 1930s — is likely to impact inflation figures and significantly weigh on US consumption. This suggests that the full economic consequences of these tariffs, which could further strain economic activity, are still ahead, especially as the job market shows signs of weakness.

Household consumption has already begun to decline, mainly due to the slowdown in household income. Consumer confidence indices are following the same trend.

Other signals suggest that we should remain vigilant about the US economy. In the real estate sector, sales volumes have reached a nine-month low due to high mortgage rates (7% for 30-year mortgages), leading to a decline in building permits (see chart 2).

Exhibit 2

United States | NAHB homebuilders confidence and building permits



Source: Bloomberg

The Fed is in a delicate position. Inflation appears to be showing upward signals in both goods and services, while domestic demand and the job market are slowing without pushing the economy into a recession. In this context, the Fed is likely to act cautiously in the months ahead, making any potential cuts to key interest rates contingent on progress in controlling inflation. Moreover, the persistently high U.S. public deficit continues to drive upward pressure on long-term rates, further tightening financial conditions for households and businesses.

B. Europe: a brighter outlook, but still fragile foundations

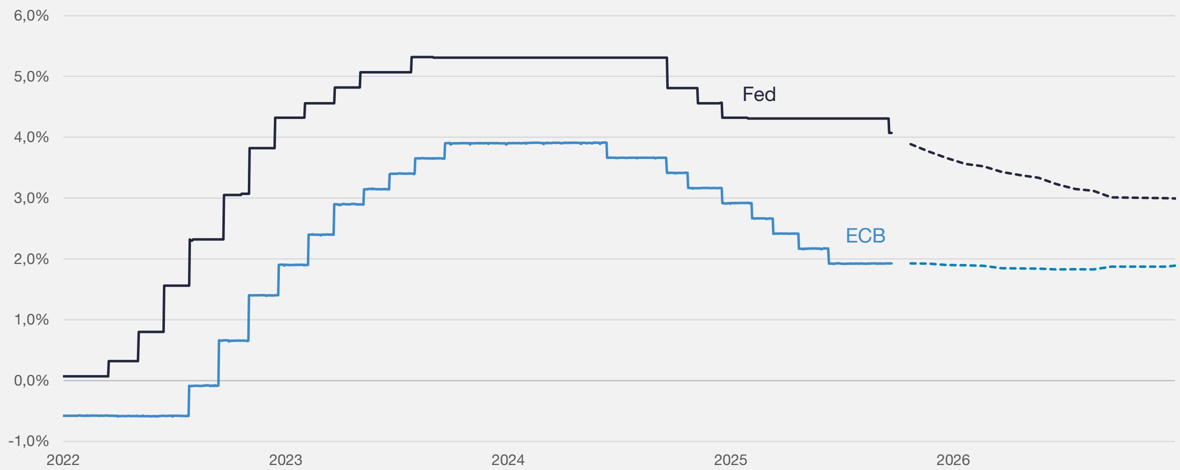
The economic situation in Europe differs significantly from that of the United States. While Europe experienced solid growth in the first quarter due to exceptional exports linked to the anticipation of tariffs, its momentum has slowed.

Looking ahead, reduced exports to the U.S. are expected to continue weighing on Europe's economy, though not severely. Exports to the U.S. made up just 2% of European GDP in 2024 — a relatively small share. More importantly, Germany's upcoming investment plan is set to boost eurozone growth starting later this year. This may explain the recent improvement in key economic indicators, such as Germany's IFO index and the eurozone's composite PMI.

Another noteworthy difference from the U.S. is Europe's inflation trajectory, which is trending in a favorable direction. This gives the European Central Bank (ECB) some flexibility to respond if the economy slows more than anticipated. However, it's worth noting that the ECB has already advanced further than the Federal Reserve in its rate-cutting cycle (see chart 3). This limits the room for additional cuts, but European companies have been benefiting for several quarters from a much more favorable interest rate environment compared to their U.S. counterparts, providing an extra layer of support to the economy.

Exhibit 3

US vs. Eurozone Short-Term Rate Expectations



Source: Bloomberg

That said, European markets remain sensitive to potential downturns in the U.S. economy. On the European bond markets, as in the US, attention remains focused on the issue of public deficits in certain countries, particularly France, which is struggling to return to a healthier trajectory.

C. Persistent geopolitical tensions

Finally, the global economy continues to be heavily influenced by geopolitical tensions. The conflicts between Russia and Ukraine, as well as Israel and Palestine, remain at the forefront of the news, and resolving them remains particularly complex. These wars not only have a heavy humanitarian and economic impact, but also significant political repercussions, polarizing public opinion beyond the conflict zones. This environment heightens the risk of unexpected political events, which in turn generate market uncertainty. While the electoral calendar appears relatively calm for 2026, several notable events are expected in 2027.

Part II: The appeal of the “Absolute Return” approach

A. Generating positive performance in all market cycles

The current environment makes it essential to explore strategies that can deliver positive returns independently of market trends. Absolute return strategies are a prime example. Unlike traditional strategies tied to a benchmark, these approaches focus on building a highly flexible portfolio to perform in all market cycles without being constrained by predefined sector/asset class allocations. This flexibility allows absolute return strategies to capitalize on a wide range of market opportunities.

This is a resolutely active approach, where convictions and management choices are the real drivers of fund performance. For this reason, it’s crucial to provide managers with ample flexibility to execute their strategy effectively and make swift adjustments to the portfolio in response to market shifts.

B. The Advantages of Absolute Return in the Fixed Income Markets

In bond markets, the absolute return approach provides unique advantages that traditional long-only strategies cannot offer.

On the credit side, this strategy can adapt to shifting economic conditions by diversifying across various market segments. The concept is straightforward: prioritize high-yield sectors (such as high yield bonds or emerging markets) during favorable conditions, while focusing on more defensive areas (like investment-grade bonds, sovereign debt, or money markets) during periods of uncertainty. The approach also enables customized exposure to different levels of subordination depending on economic conditions — senior debt is typically favored in challenging conditions, while subordinated debt (such as AT1 or Tier 2 instruments from bank issuers) becomes more attractive when the outlook improves.

For instance, 2018 highlighted the importance of reducing risk by focusing on government bonds, whereas 2013, 2017, 2019, and 2024 proved to be exceptional years for high-yield credit and subordinated financial debt (see chart 4).

Exhibit 4

Performances by fixed income asset class from 2013 to 2024

Past performance is not indicative of future performance. The below performance data is for information purposes only and should be assessed over the recommended investment period.

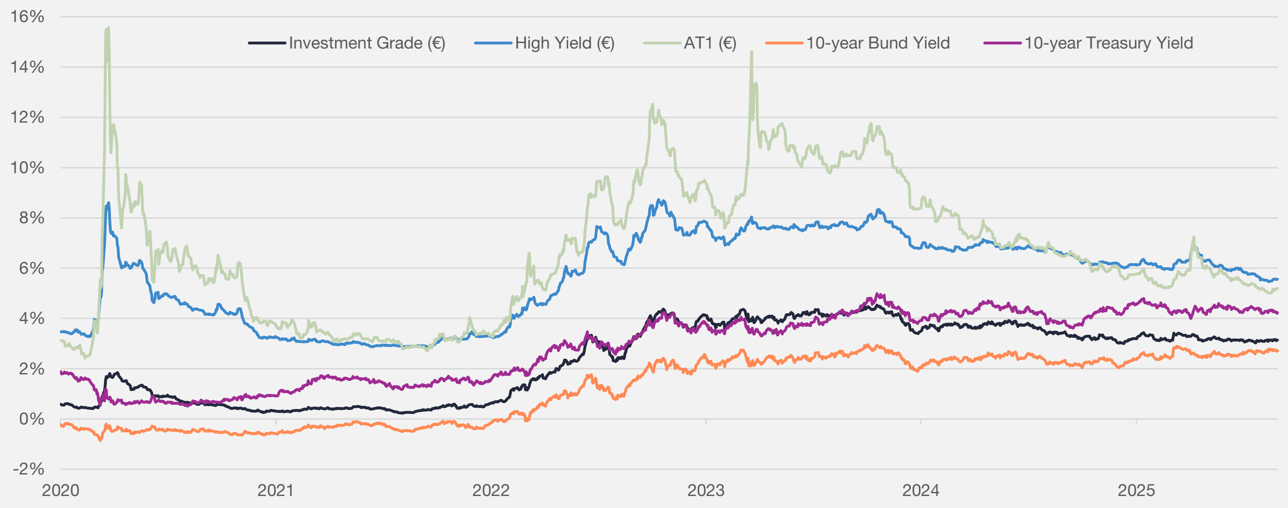
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Min	Max
Global Govies	-1%	8%	1%	2%	0%	0%	4%	4%	-3%	-14%	4%	0%	-14%	8%
Euro Govies	2%	13%	2%	3%	0%	1%	7%	5%	-3%	-18%	7%	2%	-18%	13%
Euro - Investment Grade	2%	8%	0%	5%	2%	-1%	6%	3%	-1%	-14%	8%	5%	-14%	8%
Financial Subordinated - Investment Grade	7%	9%	2%	5%	8%	-3%	10%	3%	0%	-13%	9%	7%	-13%	10%
Euro - Corporate High Yield	9%	5%	1%	10%	6%	-4%	10%	3%	3%	-11%	12%	8%	-11%	12%
US - Investment Grade	-2%	7%	-1%	4%	4%	-5%	11%	8%	-2%	-18%	6%	1%	-18%	11%
US - High Yield	7%	2%	-5%	16%	5%	-5%	11%	4%	4%	-13%	11%	6%	-13%	16%
Hybrid Corporate - Investment Grade	6%	8%	-2%	8%	10%	-4%	12%	3%	2%	-13%	10%	9%	-13%	12%
Hybrid Corporate - High Yield	13%	8%	1%	11%	10%	-5%	13%	3%	2%	-16%	10%	14%	-16%	14%
AT1	14%	9%	5%	7%	13%	-6%	16%	6%	4%	-13%	5%	11%	-13%	16%

Source: Bloomberg. Total Return performance hedged in euro.
Index: W0G1, EG00, ER00, EBSU, HEAE, HEB0, C0A0, H0A0, GNEC, HNEC, Bloomberg Global Contingent Capital.

One of the standout features of Absolute Return funds is also their ability to take negative duration positions, enabling them to benefit from rising interest rates rather than being adversely affected by them. This capability proved particularly valuable in 2022 and 2023, as rates climbed sharply (see chart 5).

Exhibit 5

Yield-to-Maturity for selected segments of the bond markets



Source: Bloomberg as of August 31, 2025

Additionally, these funds can capitalize on differences between short-term and long-term rates from the same issuer, offering further opportunities for returns. Such strategies often leverage derivatives to actively manage exposures in response to market dynamics.

C. Turning market uncertainty into opportunity

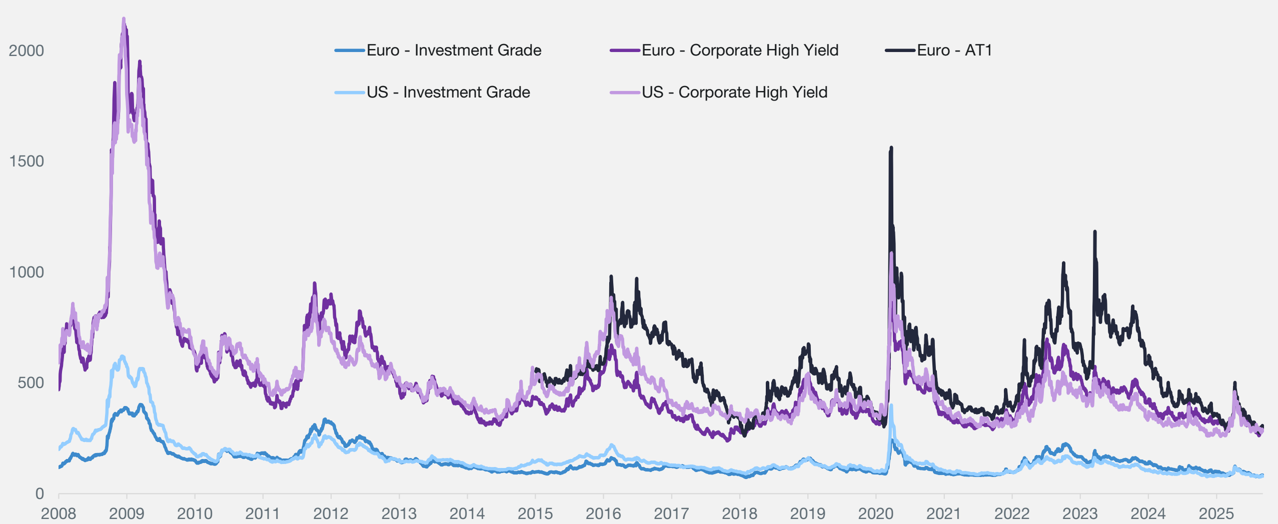
In short, absolute return strategies enable investors to capitalize on market volatility by taking advantage of rising or falling interest rates, as well as widening or narrowing credit spreads.

Currently, diverging monetary policies are creating interesting opportunities that align well with an absolute return strategy. The Federal Reserve has resumed cutting rates, while the European Central Bank is nearing the end of its easing cycle. Meanwhile, the Bank of Japan is taking a different path and is expected to continue tightening its policy in the coming quarters. These contrasting approaches create a dynamic environment full of opportunities.

More broadly, credit fundamentals remain solid, but spreads have tightened to historically low levels (see chart 6), leaving little room for further decline. There is now a significant risk of spread widening, especially given the economic uncertainties.

Exhibit 6

Credit spreads for selected segments of the bond markets



Source: Bloomberg as of August 31, 2025

Holding high-yield securities remains attractive, and their positive outlook is still worth leveraging in the current environment. However, the flexibility and leverage provided by the Absolute Return approach will be particularly valuable in the coming months to navigate anticipated volatility. The goal will be to build tactical positions to benefit from any spread widening and then quickly revert to a more traditional stance during periods of stability.

Flexibility will be key in navigating U.S. markets in the coming months. While short-term rates are likely to benefit from the Federal Reserve's easing, the broader U.S. yield curve could see significant fluctuations if inflation were to spike sharply.

Conclusion

We believe that absolute return strategies are among the most compelling investment approaches in today's environment. These strategies are especially well-suited to periods of uncertainty, as they are designed to take advantage of market volatility rather than be negatively impacted by it. Their flexibility makes them an excellent choice for investors looking for returns that are uncorrelated with their other investments.

Our Absolute Return strategies

At Lazard Frères Gestion, our Absolute Return approach is implemented through a range of strategies:

- **A global solution invested across all bond segments.** This strategy is primarily invested in subordinated financial debt and high-yield securities, aiming to deliver the performance of a high-yield fund during favorable market conditions. In times of market turbulence, it has the flexibility to mitigate the negative impact of interest rate and credit momentum that often affects long-only strategies.
- **Three specialized approaches targeting specific investment universes.** These include strategies focused on green bonds, sovereign issuers, and short-term high-yield credit. Each portfolio is diversified within its respective market segment to gain exposure across various sectors, geographies, and rating levels.

Strategy	Segment	Duration	Risk
Absolute Return Credit	All segments of the bond market	-5 to +10	3/7
Absolute Return Global Bonds	Sovereign and quasi-sovereign	- 5 to +10	2/7
Absolute Return Global Green Bonds	Green Bonds	- 3 to +12	2/7
Short Duration High Yield	Short-dated High Yield bonds	-1 to +3	2/7

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