CIO View

CIO Special

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Marketing material

German Bunds with renewed appeal

They have a balanced risk/return profile and look attractive compared to U.S. Treasuries

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IN A NUTSHELL

- German government bonds have been highly nervous at times since the beginning of the year, as reflected in comparatively high yield volatility.
- Their solidity, the steepness of the Bund curve compared to U.S. Treasuries and the generally higher yield level all argue in favour of Bunds in our opinion.
- Uncertainty surrounding the fiscal policy of the new U.S. administration is also contributing to Bunds once again being seen as a potential safe haven.[1]

German government bonds are expected to perform well in the medium term

German government bonds have been highly volatile since the beginning of the year, at least in some periods. Political decisions on both sides of the Atlantic have made investors nervous, with Donald Trump's significant tariff announcements in early April probably having the greatest negative impact. Nevertheless, the yield on ten-year German government bonds remains in a relatively narrow, slightly upward-trending range, and is likely to continue doing so in the medium term. We expect Bunds to perform well in the foreseeable future, particularly given the European Central Bank's (ECB) continued interest rate cuts. In direct comparison with U.S. Treasuries, we also consider German government bonds to be attractive.

1 / Political decisions on both sides of the Atlantic fueled short-term volatility in Bunds

1.1 Since 2023, ten-year Bund yields have largely remained within a slightly upward trading range

In recent years German federal bonds have largely performed calmly, with low volatility, and therefore yields have remained within a relatively narrow range. Since the beginning of 2023, for example, the yield on ten-year Bunds has remained within a slightly upward sideways range of around 80 basis points. This range was only broken once, in September/October of the same year, when fears of “higher for longer” with central bank interest rates and therefore global yields threatened to prevail. However, just a few weeks later, Bund yields fell sharply, briefly breaking through the two percent mark.[2]

Bunds have gradually regained their appeal, both in absolute terms and in comparison, with their U.S. counterparts after a long, rather neutral phase. Politics on the other side of the Atlantic have played a key role. German and European government bonds have outperformed U.S. Treasuries in recent weeks, as evidenced by the substantial widening of the ten-year Treasury/Bund spread. Safe-haven flows and technical factors are also playing a supporting role.

[1] Financial safe havens are investments or assets that are expected to retain or increase in value during times of market turbulence.
[2] All financial and market data – unless otherwise stated – from Bloomberg Financial L.P. as of 5/22/25

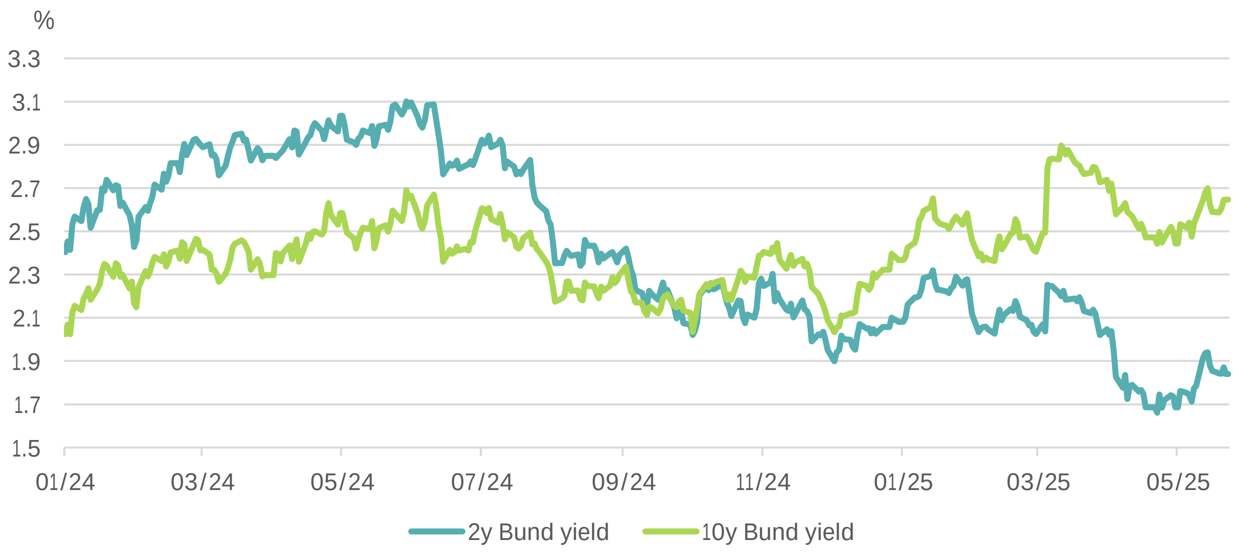
With the German government's announcement that it would relax its debt brake, federal bond yields temporarily jumped sharply ...

In March this year the new German government announced that it would relax the previously very strict interpretation and application of the statutory debt brake so that it could increase investment in defense and infrastructure. The federal bond market immediately realized that this would only be possible with significantly higher borrowing on the capital market, prompting yields to jump sharply. It was also feared that the upward trend could continue, as it seemed to be gaining momentum. But then came “Liberation Day.”

... but “Liberation Day” has once again drastically changed the perception of Bunds

On April 2 this year, however, President Donald Trump's drastic tariff announcements once again significantly altered the risk perception of German government bonds, this time for the better. As expectations for Eurozone growth were revised down, the market began to anticipate more interest rate cuts by the ECB, a weaker dollar and falling energy prices, driving bund yields sharply down. At one point, the yield on ten-year Bunds fell to just 2.4%.

Significant movement since the beginning of the year in two-year and ten-year German Bund yields (%)



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/22/25

Although we have since seen levels rise somewhat again, mainly due to renewed risk appetite after the U.S. appeared to make some concessions in the trade dispute, we expect Bunds to remain well supported in the medium term. However, peace negotiations in the Ukraine conflict, continued inflows into Eurozone assets, and the prospect of a stronger euro also suggest that the euro yield curve should steepen further. Overall we believe that the outlook for Bunds is relatively balanced.

A look at swap spreads also indicates a slight easing recently, even though ten-year spreads, for example, are still trading in negative territory. However, in our view, this development, which has been observed since the beginning of the year, is not primarily due to genuine doubts about the security and solidity of German government bonds. Rather, it is technical factors that have led us to a situation that has been considered largely normal for years in the swaps market in the U.S. and the UK. These factors include a slightly changed assessment of Germany's credit quality, a changing market structure in the swap market, and classic supply and demand mechanisms. In addition, the end of quantitative easing and reinvestment by the ECB has increased the free flow of Bunds, thereby reducing the “scarcity premium.” This is also likely to have been an important factor in pushing swap spreads into negative territory.

1.2 Spreads of other Eurozone government bonds relative to Bunds have tended to narrow since the beginning of the year

Bonds from other Eurozone countries have also seen considerable volatility since the beginning of the year, although on balance the yield spreads against German government bonds have tended to narrow. It is interesting to note that when German government bond yields rise, bonds from France, Italy, and Spain tend to underperform, as their yields rise even more sharply in these periods. However, these bonds usually perform better when Bund yields fall, as investors seek to secure the higher yields they offer amid prevailing risk-on sentiment.

2 / What factors influence the current status quo for Bunds?

2.1 Capital flows from the U.S. to Europe, and in particular to Germany

An important argument that has been cited since the beginning of April for the outperformance of German government bonds relative to U.S. Treasuries is capital outflows from the U.S. to the Eurozone, and into Bunds in particular. In our view, this reasoning is probably correct, even if the scale of the capital flows should not be overestimated. It is difficult to find concrete figures but the general picture that emerges is that there has been at least a temporary shift away from U.S. assets, even if this is likely to have been primarily out of U.S. equities. However, since these withdrawn funds are unlikely to have flowed entirely into European equities, at least some may have been diverted into Eurozone government bonds. According to press reports, Chinese investors in particular have contributed to the capital flows from the U.S. to the single currency area.[3]

An important factor is that the volume of outstanding U.S. government bonds is many times larger than the outstanding volumes in the Eurozone or, specifically, in Bunds. While the volume of U.S. government bonds amounts to 20,000 billion U.S. dollars according to Bloomberg, outstanding Bunds total the equivalent of “only” 1,500 billion U.S. dollars. Against this backdrop alone, it is clear that, in theory, only a relatively small proportion of Treasuries would need to be sold or shifted in order to have a noticeable impact on the market for Bunds.

With issuance volumes likely to rise in the coming years due to investment plans in Germany, the Bund market should be well positioned to absorb longer-term capital flows from the U.S. if necessary. In addition, investments in euro-denominated German government bonds are currently particularly attractive for dollar investors, as the forward premiums paid on the foreign exchange market for euro investments can significantly increase the overall return.

2.2 Inversion of the yield curve ends, former investment strategies regain traction

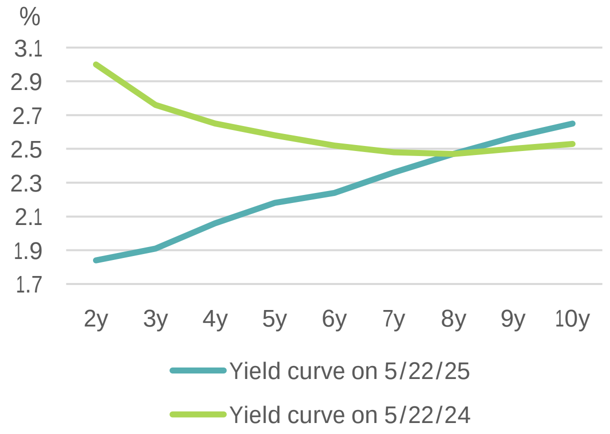
After 22 months of yield inversion, the yield curve for German government bonds with maturities of two to ten years ceased to be inverted in September 2024 – in other words, higher yields are once again being paid on longer maturities. From November 2022 until September 2024 the yield curve had been steep and negative, triggered primarily by massive purchases by the European Central Bank during the coronavirus pandemic. Investors generally view an upward-sloping yield curve as the “normal” pattern of yield distribution, with longer-term capital commitments rewarded with higher yields.

An investment strategy that results from an upward-sloping yield curve is known as “rolling down the curve.” This strategy involves buying longer-term bonds, which in this scenario offer higher yields. Investors benefit from the fact that the yield on the bonds falls (and their price rises) as they “roll down” the curve and approach their maturity date. When rolling down the yield curve, investors sell the securities before their final maturity. The strategy can offer investors additional income without significantly increasing interest rate risk, as price volatility decreases the closer the bond gets to maturity.

[3] Money & Banking Online as of 5/18/25

Bund yield curve: From deep inversion to pronounced steepness

Bund yield curve one year ago and today (%)



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/22/25

Steepness of the Bund curve (bps)

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/22/25

2.3 Higher yields generally increase the attractiveness of Bunds

In general it can be said that higher yields increase the attractiveness of German government bonds. And at least from a shorter historical perspective, the ranges in which the market has been moving since around September 2022 appear quite interesting again in view of the yields offered.

Since the beginning of the 1990s, yields on ten-year German government bonds have been on a steady downward trend. This trend peaked during the coronavirus crisis, when yields fell into negative territory. Since the beginning of 2022, however, we have seen a strong counter-movement, which has ultimately pushed yields back up to the level at which we are currently still trading. The average yield on ten-year maturities since the beginning of 1990 has been around 3.5%. However, from the beginning of 2012 for ten years this maturity yielded less than two percent. Against this backdrop, the yields of around 2.6% currently on offer appear in a completely different, very positive light.

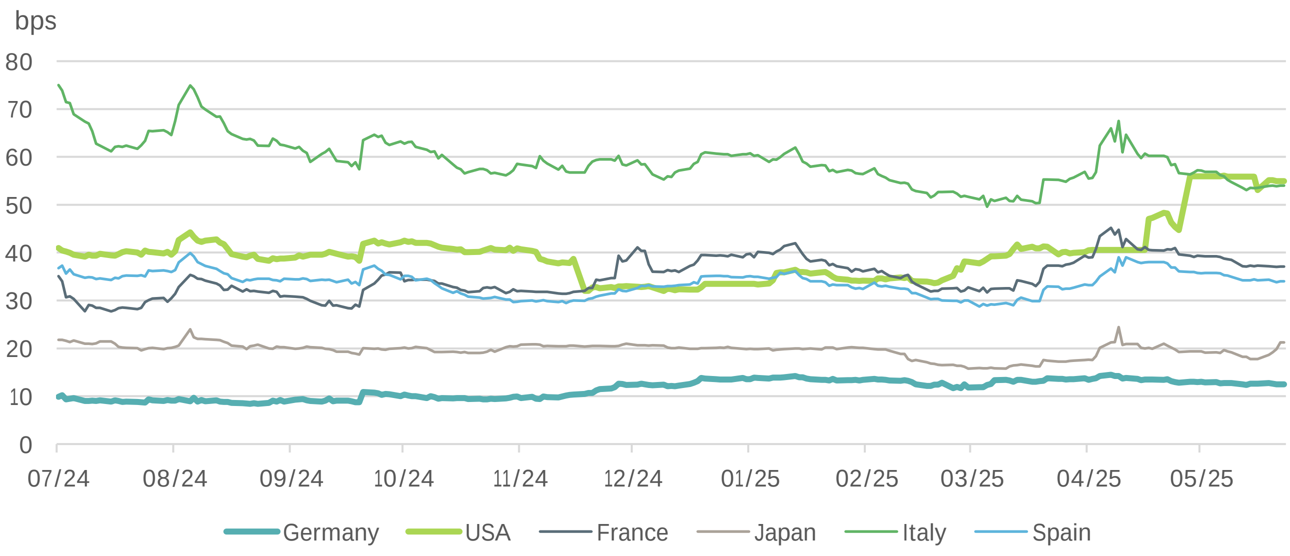
2.4 Geopolitical situation likely to continue supporting safe haven flows

Shortly after Donald Trump announced his dramatic tariff increases, yields on ten-year U.S. Treasuries shot up and the opposite trend was observed on the other side of the Atlantic. If there are doubts about the solidity of U.S. Treasuries as the world's largest bond market, the focus quickly shifts to German government bonds, whose financial solidity is widely regarded as beyond doubt.[4] This view, however, was, at least for a short time, seriously tested by the ambitious investment programs for Germany over the next twelve years as announced by the new government this spring. But the prevailing opinion now in the market is that Germany will not go too far. We are not alone in assuming that the German government bond market should be able to cope with the necessary new borrowing, with the twelve-year time period helping to keep the burden on Bunds within reasonable limits.

A look at the credit default swaps (CDS) of selected countries shows that Germany's creditworthiness and risk of default has been seen by investors as very stable in the recent past. By contrast, the trend in the U.S. is particularly negative, with CDS in the U.S. shooting up after Donald Trump announced his tariff plans and settling at roughly the same level as Italy since.

[4] Janse, K.A. (2023). Developing European Safe Assets. www.intereconomics.eu, [online] 2023(6), pp.315–319

Germany's creditworthiness continues to be rated by far the best (five-year Credit Default Swaps)



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/22/25

In the current geopolitical turmoil German government bonds appear to be an undisputed safe haven; they should continue to attract capital flows from the U.S. and other parts of the world in the future.

But the following still applies: the dollar will remain the undisputed global reserve currency for at least the next few years and, technically speaking, it is virtually impossible for the United States to default on its debt, as the necessary capital can always be printed. U.S. Treasuries are therefore likely to remain popular with investors, notwithstanding temporary fluctuations. German government bonds usually fulfill their role as a safe haven when the U.S. is the source of geopolitical problems rather than the hoped-for solution. Discussions about the impact of the new U.S. administration's policies will continue to occupy market participants and investors for some time to come now causing unrest and nervousness that is likely to benefit German government bonds.

3 / Summary and outlook

German government bonds currently appear significantly more attractive than they have in recent years. They have been outperforming U.S. Treasuries which are being viewed in a more critical light as a result of recent U.S. policies. We believe this trend is likely to continue for some time. Safe-haven flows from the U.S. into European government bonds may be overestimated but investors seem to be increasingly convinced that a certain degree of diversification[5] away from U.S. Treasuries into German government bonds looks an attractive portfolio strategy.

German government bonds benefit from their solidity, steeper curve compared to their U.S. counterparts, and yield level that is attractive again compared to the recent past. Even though we do not expect sharp declines in yields, particularly in longer maturities, there are, as we have outlined, many grounds to favor investment in German government bonds. Looking ahead, the risk/reward ratio for these bonds appears balanced and they are likely to remain attractive, especially when compared to U.S. Treasuries.

[5] Diversification neither assures a profit nor guarantees against loss.

Glossary

DWS Glossary

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

Credit default swaps (CDS) is a financial derivative that allows an investor to swap or offset their credit risk with that of another investor.

The Credit quality represents the credit worthiness of corporate or government bond.

Credit spread is the difference between the yield (return) of two different debt instruments with the same maturity but different credit ratings.

The debt brake limits the German federal government to new borrowing of no more than 0.35% of gross domestic product.

Diversification refers to the dispersal of investments across asset types, geographies and so on with the aim of reducing risk or boosting risk-adjusted returns.

The European Central Bank (ECB) is the central bank for the Eurozone.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

FX or foreign exchange is the currency — literally foreign money — used in the settlement of international trade between countries.

The forward premium refers to the situation in the foreign exchange market where the forward exchange rate of a currency is higher than its spot exchange rate.

The final payment date of a financial instrument is its maturity.

A reserve currency is a foreign currency held in significant quantities by central banks and international financial institutions. Foreign currency reserves allow a country to pay off its international debt obligations or boost its currency's value.

A safe-haven investment is an investment that is expected to retain or even increase its value in times of market turbulence.

Swaps are financial contracts that involves the exchange of various financial instruments between two parties, often businesses, and can be anything with monetary value such as contract start and end dates, nominal amount, and interest rates.

Swap spreads are the difference between the fixed interest rate of a swap and the yield of a comparable maturity government bond, used as a benchmark for the swap's relative value.

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

A yield-curve inversion is when the yields on bonds with shorter duration are higher than the yields on bonds that have a longer duration.

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