The flexiweekly that reaches new heights - published on 28 July 2025

"SHOULD FRANCE BE WEARING A DUNCE CAP?"

- French bond yields are among the highest in the Eurozone
- Does the risk of public finances going off the rails justify such a premium?
- There are several tools for assessing the risk of default
- Barbell strategies and negative basis could come back into fashion

CHART OF THE WEEK: "French debt is at the top of a sad podium"

	2-Year	3-Year	5-Year	7-Year	10-Year	15-Year	30-Year	CDS 5Yr
France	2.12%	2.34%	2.70%	2.90%	3.32%	3.74%	4.14%	35
Italy	2.04%	2.25%	2.69%	3.08%	3.49%	3.96%	4.42%	44
Lithuania	2.02%	2.09%	2.65%	2.99%	3.46%	n.a.	4.01%	60
Greece	1.94%	2.17%	2.57%	2.94%	3.32%	3.63%	4.21%	47
Slovakia	2.01%	2.17%	2.45%	2.96%	3.39%	3.87%	4.08%	42
Latvia	1.97%	2.14%	2.74%	2.94%	3.10%	3.40%	n.a.	58
Belgium	1.95%	2.11%	2.48%	2.80%	3.19%	3.66%	4.08%	24
Euro Area	2.05%	2.18%	2.48%	2.71%	2.98%	3.38%	3.90%	19
Croatia	n.a.	n.a.	2.47%	2.77%	3.03%	n.a.	n.a.	73
Spain	1.97%	2.15%	2.45%	2.68%	3.25%	3.71%	4.08%	30
Finland	1.95%	2.13%	2.43%	2.72%	3.03%	3.40%	3.67%	17
Portugal	1.86%	2.03%	2.36%	2.67%	3.07%	3.54%	3.92%	25
Slovenia	1.80%	1.92%	2.34%	2.70%	3.04%	3.43%	3.82%	39
Austria	1.91%	2.03%	2.33%	2.63%	2.97%	3.41%	3.66%	16
Cyprus	1.76%	2.16%	2.31%	2.58%	2.91%	n.a.	n.a.	59
Ireland	1.81%	1.95%	2.30%	2.52%	2.89%	3.32%	3.56%	20
Netherlands	1.88%	2.02%	2.30%	2.54%	2.82%	3.14%	3.31%	11
Germany	1.86%	1.97%	2.22%	2.37%	2.66%	3.00%	3.18%	10

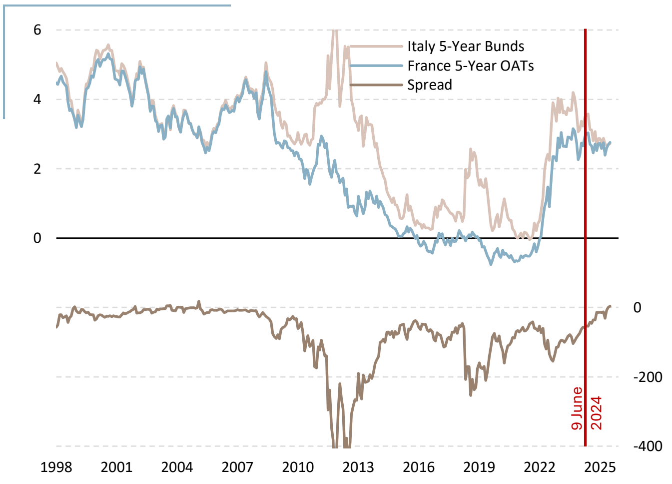
Source: Bloomberg, Altitude IS

FIXED INCOME MARKET ANALYSIS

France is causing concern. More and more investors are doubting the Treasury's ability to repay its debt. The premium they are demanding to lend to the French government has just reached one of the highest levels in Europe. The Agence France Trésor (AFT) must offer between 2.12% and 4.14% to finance budget deficits and roll over maturing debt. Investors are now demanding **higher compensation to finance France than for Italy or Greece** (see Fig. 2). This has not been seen since 2008 (see Fig. 3), when investors realised that having a common currency did not necessarily mean having a common risk of default.

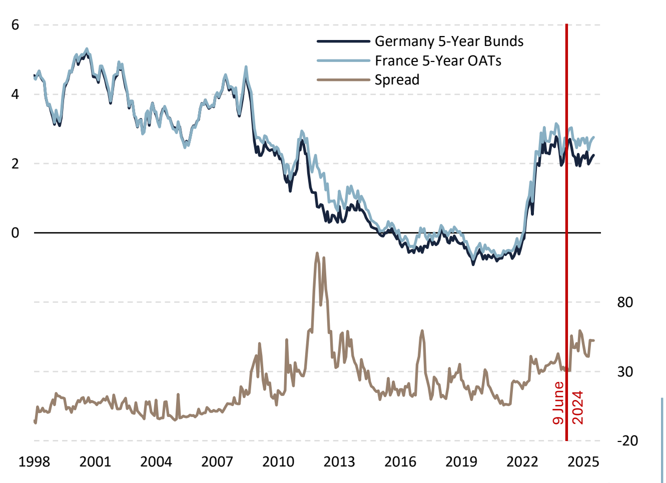
For these risks to truly converge, countries would have to guarantee each other, and for that to happen, Europe would have to establish a fiscal union. This is the case in the United States, for example, where Washington has a budget representing about a quarter of the national wealth and the full capacity to levy taxes on all American taxpayers. It relies on a significant automatic transfer mechanism, which acts as a stabiliser. Thus, when a state falls into recession, it receives more than it pays, without any ad hoc political negotiations being necessary. And vice versa. Unlike in the Eurozone, US sovereign debt is issued by a single entity, the Federal Treasury. It is used to finance California and Alabama alike. The 50 states only issue municipal bonds, which would not affect the Treasury's solidity were they to default.

Fig. 3 – Yield spread between France and Italy



Source: Bloomberg, Altitude IS

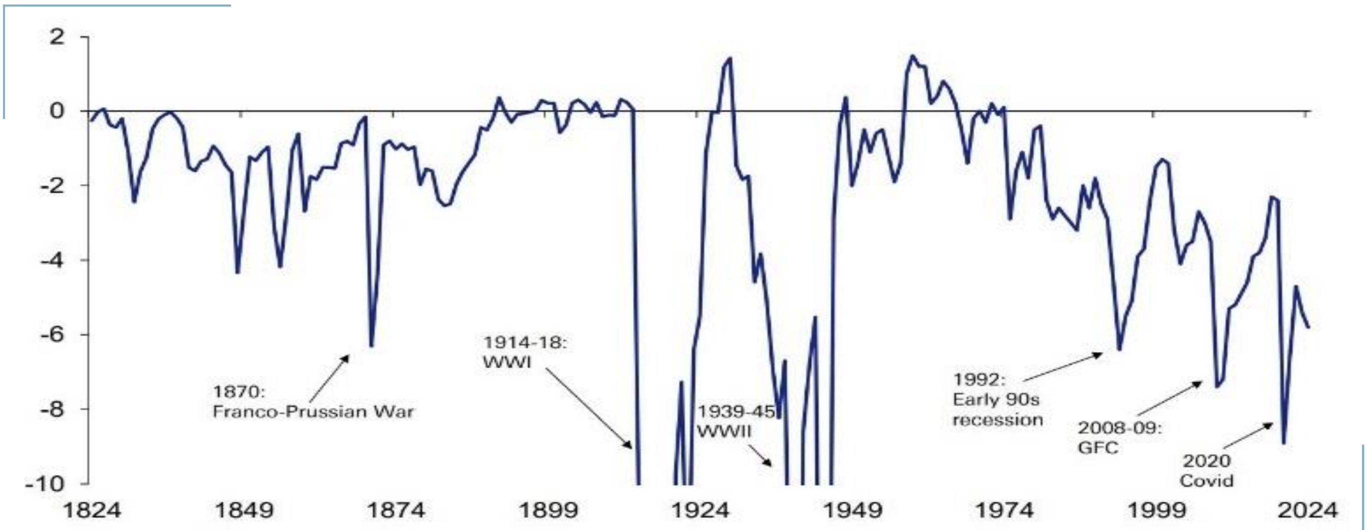
Fig. 4 – Yield spread between France and Germany



Source: Bloomberg, Altitude IS

Although France ranks among the countries with the most worrying debt levels, this information should be viewed in context. On the one hand, the premium demanded by investors has not reached its 2012 peak. At that time, during the European debt crisis, the situation was "twice as bad" (see Fig. 4). On the other hand, the cost of insurance against a French default, the famous Credit Default Swap (CDS), remains within the average for Eurozone countries, at 35 basis points.

Fig. 5 – French budget deficit over the last 200 years

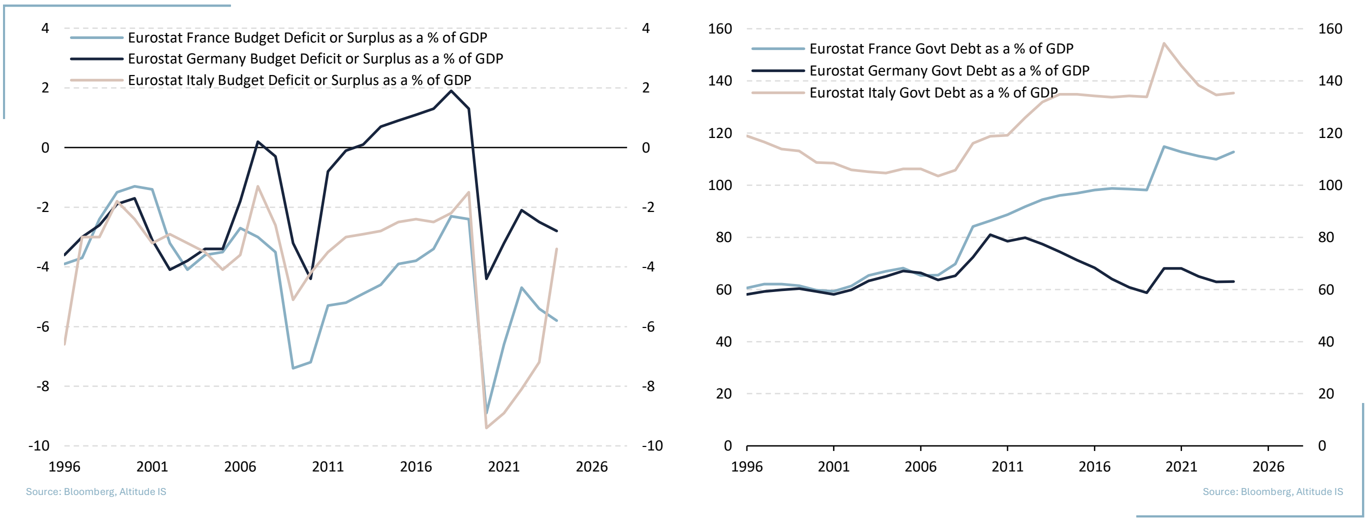


Source: Deutsche Bank, Finaeon, Haver Analytics, Altitude IS

To say that France's public accounts are not reassuring is a mild understatement. **<u>The budget has not been balanced once in France since 1975 (see Fig. 5) and has rarely been balanced in the last 200 years</u>!**

This structural slippage has tended to accelerate over the past 20 years. **Comparison with Europe's strongest link, Germany, but also with one of its weakest links, Italy, is doubly disadvantageous for France.** Last year's budget deficit was no exception to the rule. It was twice as high in France as in its two neighbours (see Fig. 6). It is therefore perfectly logical that France's public debt ratio has moved away from that of Germany and closer to that of Italy (see Fig. 7).

Fig. 6 & 7 – Budget deficit & public debt in France, Germany & Italy

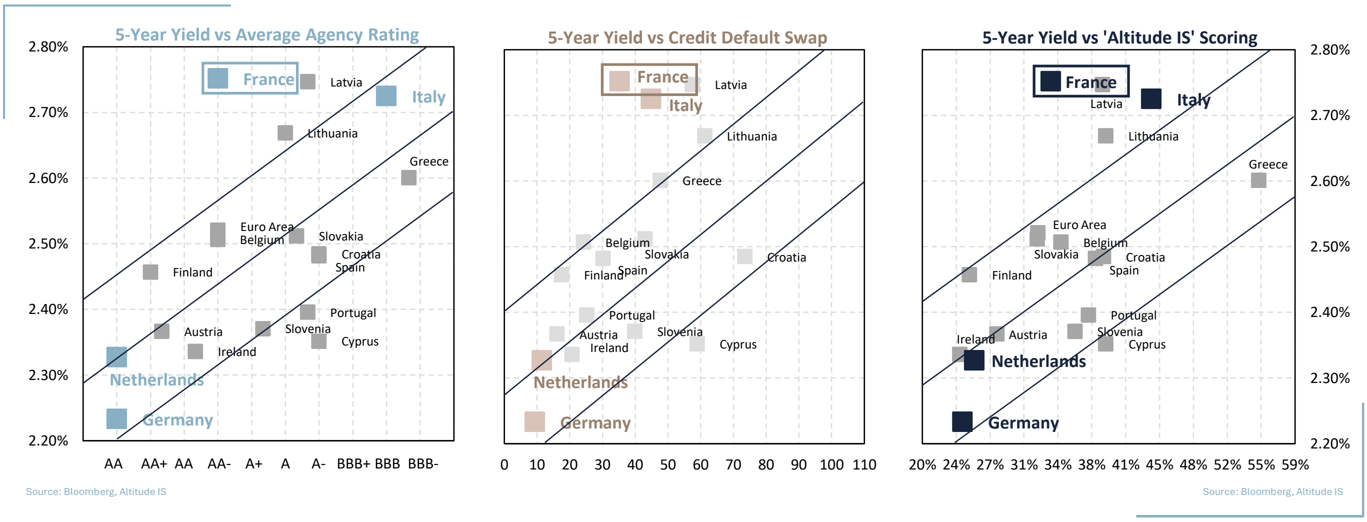


In his office at the Hôtel Matignon, Prime Minister François Bayrou continues to draw up the outlines of France's budget for next year. The equation looks very difficult to balance for a country where excessive debt does not appear to be a problem for its citizens and where political instability remains high. **The next government censure and new strikes are already in the pipeline.** Tension could therefore rise to a breaking point, as it did in Greece in 2012 and in Italy and the United Kingdom in 2022. At that point, the government will have no choice but to opt for fiscal prudence, and even austerity if it needs to call on the European Central Bank (ECB) for support to calm the financial markets. We discussed this aspect in detail in a previous article (see WIF of 7 October 2024). **There is therefore a real risk that the price of Treasury-assimilated bonds (OATs) will fall, but this would only be temporary.**

<u>From this perspective, the premium currently offered by French bonds seems sufficient to compensate for the risk involved</u>. There are several ways to see that this strategy could be advantageous:

- The first is to **compare the yields offered by different eurozone countries based on their ratings from** Standard & Poor's, Moody's and Fitch (see Fig. 8). The conclusion is clear: either France's rating must be downgraded to BBB, or 5-year OAT yields have the potential to fall by 20 basis points (from 2.75% to 2.55%). Latvia and Lithuania are in the same situation, albeit to a lesser extent. However, it should be noted that these two countries are paying an additional risk premium directly linked to the rapid increase in their military spending and their border exposure with Russia, which justifies slightly higher yields, all other things being equal.

Fig. 8, 9 & 10 – Bond yields by rating, CDS & risk score



- The second method involves **cross-referencing yield levels with the price of contracts covering the default risk of the countries studied** (see Fig. 9). Once again, French sovereign bond yields should be 20 to 25 basis points lower than their current level. Otherwise, the premium for insuring against a credit event in France appears particularly cheap, at 35 basis points compared with the 90+ basis points that would normally be required. Interestingly, Italian bonds also appear to be "cheap". Although BTPs no longer offer any particular premium over OATs, their yields have certainly been abnormally pushed up by the rise in French rates. Some investors, particularly institutional investors, are arbitraging between the bonds of these two countries. Consequently, if the rates of the former rise for an exogenous reason, the latter are abandoned until their rates adjust upwards.

- The third seeks to **compare yield levels with a proprietary assessment of bond risk.** This score, constructed using thirteen factors, does not represent a probability of default. It ranks the various Eurozone countries according to the quality of their debt. The higher the score, the greater the risk (see Fig. 10). The conclusion is very similar. Excluding Latvia and Lithuania due to inherent fiscal and geopolitical risks, France and, to a lesser extent, Italy are paying too much interest to their creditors.

Bond investors are adequately compensated for the risk they incur by holding various Eurozone sovereign bonds. The yield hierarchy appears consistent for most countries. Thus, there seems to be little point in buying Belgian or Spanish debt, and even less in buying Portuguese or Greek papers. On the other hand, Italian BTPs and, even more so, French OATs offer an unusual premium relative to their economic fundamentals. At the other end of the spectrum, the top performers are clearly identified by bond investors. Germany and the Netherlands, which still hold the top "triple A" rating (see WIF of 26 May 2025), will continue to attract capital from investors seeking stability.

The barbell strategy usually consists of holding short- and long-term bonds, avoiding medium-term bonds, in order to benefit from both high yields and reduced interest rate risk. **This time around, it seems that specialists will try to build a different kind of barbell, with France and Italy on one side and Germany and the Netherlands on the other.** As for maturity, given the shape of the curve and the position in the economic cycle, a 7-year position seems to be a good compromise.

<u>Other experts will certainly be tempted to buy a French OAT and its default risk insurance (CDS) at the same time</u>. This will allow them to earn a premium corresponding to the difference between the bond's yield spread (and the risk-free rate) and the price of the credit default swap. In financial jargon, this is known as benefiting from a "negative basis". This strategy was very popular with hedge funds and prop traders before the European debt crisis. This was the strategy employed by Boaz Weinstein, Deutsche Bank's star manager in 2008. It had almost disappeared by the 2010s, as it was no longer applicable. At that time, the zero-interest rate policy pursued by central banks and the resulting rush to bond assets had caused an abnormal fall in interest rates. The cost of buying an insurance contract had become higher than the spread on government bonds. This is known as a "positive basis". Everything is now back to normal, and the simultaneous purchase of a bond and its CDS could become popular again in the coming years.

Conclusion:

Repeated budget deficits, a lack of will to address them and the current political paralysis have ultimately led investors to doubt France's ability to honour its debts. They are not wrong, but now the premium offered by Agence France Trésor to invest in its bonds, compared to that of other Eurozone countries, is starting to look attractive.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2025 Year-to-Date (%)	2024 (%)	2023 (%)
Equities							
World (MSCI)	941.4	76.48	1.6%	4.4%	13.2%	18.0%	22.8%
USA (S&P 500)	6 376	74.37	1.1%	4.5%	9.0%	25.0%	26.3%
USA (Dow Jones)	44 821	60.97	0.5%	3.8%	6.1%	15.0%	16.2%
USA (Nasdaq)	21 108	73.85	0.8%	5.8%	9.5%	29.6%	44.7%
Euro Area (DJ EuroStoxx)	567.8	55.79	0.4%	2.0%	15.9%	10.2%	19.5%
UK (FTSE 100)	9 107	74.70	1.9%	4.4%	14.2%	9.6%	7.7%
Switzerland (SMI)	11 922	52.96	0.7%	0.5%	7.0%	7.5%	7.1%
Japan (Nikkei)	41 456	71.20	4.8%	8.0%	6.0%	21.3%	31.0%
Emerging (MSCI)	1 267	73.44	2.1%	5.0%	20.1%	8.0%	10.2%
Brasil (IBOVESPA)	133 567	39.32	-1.3%	-2.4%	11.2%	-10.4%	22.3%
Mexico (IPC)	57 009	52.56	0.6%	0.8%	18.0%	-11.0%	22.4%
India (SENSEX)	81 463	40.83	0.0%	0.5%	6.2%	9.6%	20.3%
China (CSI)	4 127	74.45	3.0%	7.3%	7.5%	18.2%	-9.1%
Com. Services (MSCI World)	144.6	71.54	2.5%	4.9%	16.7%	31.9%	38.1%
Cons. Discretionary (MSCI World)	434.4	65.23	2.5%	4.2%	3.8%	20.7%	29.5%
Cons. Staples (MSCI World)	293.9	48.52	0.5%	-0.6%	9.5%	4.7%	3.2%
Energy (MSCI World)	254.5	57.00	1.2%	2.8%	8.3%	2.9%	6.0%
Financials (MSCI World)	212.1	69.51	1.9%	3.9%	20.2%	25.1%	16.4%
Health Care (MSCI World)	355.4	59.06	2.8%	2.1%	3.0%	1.5%	4.1%
Industrials (MSCI World)	454.9	76.50	2.1%	5.7%	22.2%	12.8%	22.5%
Info. Tech. (MSCI World)	864.9	70.91	0.3%	6.5%	13.0%	31.9%	51.4%
Materials (MSCI World)	351.0	66.88	3.5%	5.5%	16.3%	-7.7%	12.6%
Real Estate (MSCI World)	1 023	67.69	2.4%	1.4%	7.5%	-0.4%	5.3%
Utilities (MSCI World)	185.7	61.22	2.1%	2.4%	18.1%	13.0%	1.6%
Bonds (Bloomberg)							
World (Aggregate)	3.58%	54.70	0.8%	-0.1%	6.6%	-1.7%	5.7%
USA (Sovereign)	4.20%	51.27	0.3%	-0.3%	3.1%	0.6%	4.1%
Euro Area (Sovereign)	2.80%	45.90	0.0%	-0.6%	0.1%	1.9%	7.1%
Germany (Sovereign)	2.38%	44.14	-0.2%	-0.8%	-1.1%	0.6%	5.6%
UK (Sovereign)	4.57%	49.81	0.2%	-0.8%	3.0%	-3.0%	5.6%
Switzerland (Sovereign)	0.57%	48.64	0.2%	-0.3%	-0.3%	5.4%	7.9%
Japan (Sovereign)	1.35%	34.43	-0.4%	-1.1%	-2.3%	-2.1%	0.9%
Emerging (Sovereign)	6.60%	66.35	0.5%	0.9%	5.8%	7.0%	11.0%
USA (IG Corp.)	5.10%	56.92	0.3%	0.2%	3.8%	2.1%	8.5%
Euro Area (IG Corp.)	3.05%	55.66	0.1%	0.4%	2.2%	4.7%	8.2%
Emerging (IG Corp.)	6.34%	74.54	0.3%	0.8%	4.6%	7.0%	6.7%
USA (HY Corp.)	7.02%	78.83	0.4%	1.0%	5.1%	8.2%	13.4%
Euro Area (HY Corp.)	5.36%	82.53	0.3%	0.8%	3.6%	8.2%	12.1%
Emerging (HY Corp.)	7.99%	73.33	0.7%	1.3%	6.2%	14.9%	13.1%
World (Convertibles)	503.6	84.33	0.6%	4.2%	14.4%	9.4%	12.3%
USA (Convertibles)	660.9	74.27	-0.1%	4.4%	10.4%	10.1%	14.6%
Euro Area (Convertibles)	289.6	67.09	0.7%	1.8%	24.4%	14.7%	7.3%
Switzerland (Convertibles)	280.3	46.10	-0.7%	-0.2%	16.4%	-10.5%	5.8%
Japan (Convertibles)	236.8	73.31	0.7%	2.6%	4.5%	6.4%	7.6%
Hedge Funds (Bloomberg)							
Hedge Funds Industry	1 676	79.48	n.a.	2.2%	4.1%	11.1%	7.8%
Macro	1 347	64.77	n.a.	1.6%	0.3%	7.4%	1.6%
Equity Long Only	2 324	68.12	n.a.	3.7%	5.1%	12.0%	15.9%
Equity Long/Short	1 780	77.75	n.a.	3.4%	6.2%	14.0%	7.7%
Event Driven	1 774	77.43	n.a.	1.4%	2.8%	8.7%	7.3%
Fundamental Equity Mkt Neutral	1 738	94.11	n.a.	2.5%	5.3%	12.4%	6.6%
Quantitative Equity Mkt Neutral	1 718	82.14	n.a.	-0.7%	3.3%	9.8%	7.8%
Credit	1 656	96.71	n.a.	1.2%	3.8%	8.5%	8.1%
Credit Long/Short	1 688	100.00	n.a.	0.6%	3.7%	10.0%	11.2%
Commodity	1 903	92.33	n.a.	2.1%	6.4%	14.7%	7.3%
Commodity Trading Advisors	1 280	48.64	n.a.	0.8%	-4.6%	7.9%	-3.6%
Volatility							
VIX	15.12	39.10	-6.8%	-12.0%	-11.3%	39.4%	-42.5%
VSTOXX	18.04	47.21	1.7%	-6.0%	4.2%	25.3%	-35.0%
Commodities							
Commodities (CRB)	571.2	n.a.	1.1%	1.3%	6.5%	5.1%	-8.0%
Gold (Troy Ounce)	3 335	n.a.	-0.4%	0.1%	27.1%	27.2%	13.1%
Silver (Troy Ounce)	38.60	n.a.	1.1%	6.5%	33.6%	21.5%	-0.7%
Oil (WTI, Barrel)	67.23	n.a.	-0.2%	2.8%	-6.3%	0.1%	-10.7%
Oil (Brent, Barrel)	70.70	n.a.	-0.6%	2.3%	-4.6%	-4.6%	-4.5%
Currencies (vs USD)							
USD (Dollar Index)	97.72	47.08	-0.8%	0.0%	-9.9%	7.1%	-2.1%
EUR	1.1732	57.98	0.9%	0.6%	13.3%	-6.2%	3.1%
JPY	147.61	43.26	0.8%	-1.6%	6.5%	-10.3%	-7.0%
GBP	1.3437	43.08	0.2%	-1.7%	7.4%	-1.7%	5.4%
AUD	0.6564	54.12	0.8%	0.8%	6.1%	-9.2%	0.0%
CAD	1.3700	48.11	0.2%	0.2%	5.0%	-7.9%	2.3%
CHF	0.7967	56.32	0.6%	1.0%	13.9%	-7.3%	9.9%
CNY	7.1674	54.39	0.1%	0.1%	1.8%	-2.7%	-2.8%
MXN	18.566	63.29	1.0%	2.0%	12.2%	-18.5%	14.9%
EM (Emerging Index)	1 850.3	60.44	0.5%	0.5%	7.1%	-0.7%	4.8%
XBT	115 197	n.a.	-2.5%	6.8%	22.9%	120.5%	157.0%

Source: Bloomberg, Altitude Investment Solutions — Total Return by asset class (Negative \ Positive Performance)

DISCLAIMER

This document is issued by Altitude Investment Solutions (hereinafter "Altitude IS"). It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a document.

This document is provided for information purposes only. It does not constitute an offer or a recommendation to subscribe to, purchase, sell or hold any security or financial instrument. It contains the opinions of Altitude IS, as at the date of issue. These opinions and the information herein contained do not take into account an individual's specific circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes a personal recommendation to any investor. Each investor must make his/her own independent decisions regarding any securities or financial instruments mentioned herein. Tax treatment depends on the individual circumstances of each client and may be subject to change in the future. Altitude IS does not provide tax advice. Therefore, you must verify the above and all other information provided in the document or otherwise review it with your external tax advisors.

Investments are subject to a variety of risks. Before entering into any transaction, an investor should consult his/her investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. The information and analysis contained herein are based on sources considered to be reliable. However, Altitude IS does not guarantee the timeliness, accuracy, or completeness of the information contained in this document, nor does it accept any liability for any loss or damage resulting from its use. All information and opinions as well as the prices, market valuations and calculations indicated herein may change without notice. Past performance is no guarantee of current or future returns, and the investor may receive back less than he invested. The investments mentioned in this document may carry risks that are difficult to quantify and integrate into an investment assessment. In general, products such as equities, bonds, securities lending, forex, or money market instruments bear risks, which are higher in the case of derivative, structured, and private equity products; these are aimed solely at investors who are able to understand their nature and characteristics and to and bear their associated risks. On request, Altitude IS will be pleased to provide investors with more detailed information concerning risks associated with given instruments.

The value of any investment in a currency other than the base currency of a portfolio is subject to the foreign exchange rates. These rates may fluctuate and adversely affect the value of the investment when it is realized and converted back into the investor's base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset. If opinions from financial analysts are contained herein, such analysts attest that all of the opinions expressed accurately reflect their personal views about any given instruments. In order to ensure their independence, financial analysts are expressly prohibited from owning any securities that belong to the research universe they cover. Altitude IS may hold positions in securities as referred to in this document for and on behalf of its clients and/or such securities may be included in the portfolios of investment funds as managed by Altitude IS.