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Why trade finance and short-dated credit now



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An income-focused, lower-volatility approach designed for today's yield-curve environment

1. External risks – from the Strait of Hormuz to tariffs – appear manageable, in our view

Our base case is that global growth remains resilient for now, but momentum is slowing. That backdrop is generally supportive for corporate credit: economic activity has been good enough for all but the most levered issuers, and global diversification can help navigate increasingly decoupled cycles.

Key messages

- **Attractive carry without stretching for duration:** even as yield curves have steepened versus 2023–24, front-end yields in USD and GBP remain competitive versus intermediate maturities, allowing investors to earn income with less day-to-day price volatility than longer-dated bonds.
- **Public market spreads are near tights:** with less scope for further tightening, the upside from extending spread duration is more limited, while a move back toward long-term average spreads would favour more defensive, short spread-duration exposures.
- **Add diversification with trade finance:** trade finance aims to deliver income from short-term, self-liquidating exposures that can behave in a less correlated manner than public credit markets.
- **A blended approach can be resilient:** combining liquid short-dated credit with trade finance seeks to balance flexibility and liquidity while producing a lower volatility carry.

On inflation and rates, uncertainty is being driven in part by oil prices. Geopolitics and AI remaining key longer-term risks. In rates markets, we see scope for divergence across regions as policy settings and inflation dynamics differ. Rather than anchoring the strategy on a single path for policy rates, we focus on what diverging rate paths can offer: selective spread and carry opportunities, while maintaining vigilance as valuations leave less margin for error.

2. The hurdle for longer duration: yield, volatility and compensation

Even with yield curves returning to a more normal upward sloping pattern (rather than the inversion seen recently), the core hurdle for extending duration remains the same: you need to be paid for taking additional price volatility. If longer-tenor government bonds cheapen (yields rise) as policy expectations and term premia adjust, adding duration can detract from returns. When the yield pick-up from moving beyond the front end is modest, investors can find themselves taking materially more duration risk for only incremental carry—so a short-duration stance can remain sensible until the reward for duration becomes clearer.

An opposing view argues that with bond yields near multi-decade highs, investors should lock in yields. That can be sensible if one believes the low-yield regime of the pre-GFC period will not return. But it comes with two practical challenges: (1) if yields rise further, longer duration assets are more exposed to mark-to-market losses; and (2) if the market expectations for one-year yields, in one year’s time, is roughly comparable to today’s five year yields, investors may not need to rush into adding duration. This reinforces the value of flexibility and optionality in the near term.

Comparative returns

Security	Currency	Price Change	Total Return	Difference	Annual Eq
1) ALLWAH2 LX Equity	USD	0.80%	9.26%	1.07%	6.10%
2) CB2V Index	USD	8.19%	8.19%	--	5.40%
3) USDF Index	USD	7.03%	7.03%	-1.16%	4.65%
4) C1A4 Index	USD	7.64%	7.64%	-0.55%	5.05%
5) H640 Index	USD	6.96%	6.96%	-1.23%	4.60%

Source: Bloomberg, 31 October 2024 to 30 April 2026. Daily, No. of periods: 546 day(s)

3. Why add credit risk at the front end

For some investors, front-end sovereign yields may still be insufficient to meet return objectives. Adding credit risk can enhance yield, but the decision should be framed in terms of compensation for both spread risk and duration risk.

When credit spreads are tighter than long-run averages, the expected return cushion from further spread tightening is limited. Intuition suggests a higher probability of widening than tightening due to mean-reversion as the credit cycle advances. In this setup, extending spread duration can be unattractive: the portfolio earns little extra carry for meaningfully higher mark-to-market sensitivity. Short-dated credit seeks to retain corporate credit exposure while reducing both interest-rate duration and spread duration, thereby targeting a more resilient profile if volatility rises.

4. Why trade finance alongside short-dated credit

4.1 Diversification versus public credit

Trade finance has historically exhibited lower correlation to public-market credit and rates than many traditional fixed income sectors, offering a potential diversification benefit within broader credit portfolios. Because transactions are short term and often tied to the completion of trade flows, performance may be less driven by secondary-market liquidity conditions than longer spread-duration assets.

The tables below show the USD shareclass of a trade finance strategy compared with other short-dated USD asset public fixed income asset classes. As can be seen returns are attractive and the correlations low, showcasing how a portfolio efficient frontier can be expanded by a judicious combination of different short-dated assets.

WHY TRADE FINANCE AND SHORT-DATED CREDIT NOW



Correlation matrix

Security	ALLWAH	CB2V	USDF	C1A4	H540
11) ALLWAH	1,000	-0.037	0.382	0.023	0.108
12) CB2V	-0.037	1,000	0.187	0.023	0.682
13) USDF	0.382	0.187	1,000	0.304	0.544
14) C1A4	0.023	0.939	0.304	1,000	0.821
15) H640	0.108	0.682	0.544	0.821	1,000

Source: Bloomberg, 31 October 2024 to 14 May 2026. Daily

4.2 Default, recovery and defensive features

Empirical studies frequently cite trade finance as having lower default rates and higher recovery rates than many other credit instruments with similar long term corporate credit ratings. One intuitive reason is functional: trade finance allows a company to operate day-to-day. Removing it can disrupt supply chains, accelerate operational stress and erode enterprise value, which is often against the interests of the broader creditor base. As a result, unless a business model is no longer viable, there can be strong incentives for stakeholders to keep trade finance lines functioning, supporting comparatively resilient credit outcomes.

4.3 Liquidity: self-liquidating does not mean daily dealing

Trade finance is generally not as liquid as public corporate bonds. However, its underlying exposures are short term and self-liquidating: when an invoice is paid, the specific credit obligation is extinguished. This can reduce reliance on finding a buyer in stressed secondary markets to reduce a credit exposure. Many strategies still value positions periodically (e.g. monthly) using relevant market proxies, but the short tenor can limit the magnitude and persistence of mark-to-market drawdowns relative to longer spread-duration assets.

5. Portfolio construction: combining short-dated public credit and trade finance

A coherent approach is to view short-dated public credit and trade finance as complementary tools for earning income while managing different dimensions of risk:

- **Short-dated public credit (bonds, floating rate notes, higher-rated ABS):** provides liquidity, transparency, and the ability to adjust exposures quickly. The aim is to earn carry with reduced interest-rate duration and reduced spread duration versus mainstream aggregate/credit benchmarks. It is important to note that hybrid securities and ABS may appear short-dated due to call structures, but in a rising rate environment these securities may not be called, and duration could be longer than expected.
- **Trade finance:** seeks to provide diversified carry with ultra-short tenor and potentially more defensive behaviour in periods of spread volatility, at the cost of lower liquidity and greater structural/operational complexity.
- **Dynamic allocation:** because rate and credit cycles are fluid, a flexible framework can rotate between liquid public short-dated opportunities (when spreads and “return cushion” are attractive) and more shorter duration, self-liquidating trade finance exposure (when recession risk or liquidity risk rises) all within a relative value framework.

6. Key risks and implementation considerations

A coherent approach is to view short-dated public credit and trade finance as complementary tools for earning income while managing different dimensions of risk:

- **Spread and mark-to-market risk (public credit):** even at short maturities, spreads can widen sharply in stress, and shorter maturities can underperform when markets focus on recovery values rather than refinancing.

- **Extension and structure risk (securitised/ABS exposures):** securities quoted to call or expected maturity can extend if the economic incentive to refinance diminishes, eroding expected returns.
- **Illiquidity (trade finance):** while underlying assets are short term, fund-level dealing terms and the ability to accelerate cash can be constrained; investors should align allocations with liquidity needs.
- **Operational and underwriting risk (trade finance):** outcomes depend on origination discipline, obligor diversification, documentation, servicing, and controls; manager selection is critical.
- **Macro regime shifts:** if curves re-steepen materially or spreads cheapen meaningfully, the opportunity cost of remaining short may rise—supporting a dynamic, not static, allocation approach.

7. Conclusion

Even as yield curves have normalised, current yield levels and tight credit spreads continue to favour a short-duration, income-focused approach. In USD and GBP, front-end yields remain competitive versus intermediate maturities, allowing investors to earn attractive income without taking unnecessary duration risk. At the same time, spreads are near tights, limiting the upside from further compression and reducing the appeal of extending spread duration. We therefore see greater value in lower-volatility exposures that can better withstand a move back toward average spread levels. Within that framework, short-dated public credit and trade finance are complementary. Public markets provide liquidity and flexibility, while trade finance can add a more defensive, self-liquidating source of carry with minimal spread duration. Together, they offer a diversified way to stay invested, generate income and remain adaptable as the rates and credit backdrop evolves.

Glossary (selected)

- **Interest rate duration:** sensitivity of a bond price to changes in interest rates.
- **Spread duration:** sensitivity of a credit instrument's price to changes in credit spreads.
- **OAS (option-adjusted spread):** spread over the risk-free curve after adjusting for embedded options; often used as a measure of credit and liquidity compensation.
- **Self-liquidating:** exposure amortises/repays when the underlying invoice or trade obligation is settled, reducing reliance on secondary-market sales to generate cash.

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