CIO thinks that cash rates are likely to fall and that current bond yields can be locked in, providing a more durable source of portfolio income. (UBS)

Consider taking advantage of current attractive yields

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Yields are attractive. Inflation is falling. Central bank rate cuts are starting. And economic growth is robust, keeping default rates low.

CIO recommends investors build an active and diversified fixed income exposure. Complementing a core holding in quality bonds with a satellite in higher-yielding parts of the fixed income market can improve overall portfolio yields.

Recent data point to a moderation in US economic activity.

- The June labor report added to evidence that the demand for workers is moderating, with the unemployment rate edging up to the highest level since November 2021.
- Both the core consumer price index and core personal consumption expenditure for May showed further deceleration in inflation. Other data have also been consistent with an economy heading for a soft landing.
- The 10-year US Treasury yield stood at 4.27% as of 5 July, down from over 4.7% in April.

This weakening in data should be sufficient to justify a first Fed rate cut in September.

- Fed officials acknowledged “diminishing” price pressures in their June policy meeting.
- We expect the 10-year US Treasury yield to fall to 3.85% by December.
- We think markets will start to price a lower level of long-term interest rates once the Fed begins to reduce rates.

Fixed income remains our preferred asset class.

- High-quality corporate and government bonds have attractive yields and the potential for capital appreciation if markets start to price deeper rate cuts.
- This also applies to sustainable investments into green, social, and sustainable bonds, as well as those issued by multilateral development banks.
- Complementing a core holding in quality bonds with a satellite in riskier credits can potentially improve overall portfolio yields.

Did you know?

- In their latest projections, Fed officials put their estimate of the longer-run fed funds rate at 2.8%, much lower than the current market pricing.
- Historically, bonds delivered higher returns than cash over the long term, and their probability of outperforming cash rises with longer holding periods—from 65% over 12 months to 82%, 85%, and 90% over five, 10, and 20 years, respectively.
- We prefer medium-duration bonds with a maturity up to 10 years, as we think concerns about the high US debt burden and loose fiscal policy may pose a risk for longer-duration bonds.

Investment view

While we think cash rates are likely to fall, current bond yields can be locked in, providing a more durable source of portfolio income over time. We like quality bonds for their attractive risk-return proposition, and we think complementing the core holding with a satellite in riskier credits can potentially improve overall portfolio yields.

Main contributors: Daisy Tseng, Vincent Heaney

Original report - **Is it time to lock in bond yields?, 8 July 2024.**

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