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

Why fixed income remains our preferred asset class

17 June 2024, 2:25 pm CEST, written by UBS Editorial Team

Yields are high. Inflation is falling. Central bank rate cuts are starting. And economic growth is robust, keeping default rates low. We therefore see this as a good time to build active and diversified fixed income exposure.

Tactically, within fixed income, we prefer quality bonds, which offer potential capital gains if yields fall (as we expect) and can help diversify portfolios against equity market risks. Quality bonds should, in our view, be a core part of fixed income portfolios, alongside satellite exposure to riskier credits.

Volatility in US Treasury yields has picked up.

- Encouraging economic data helped push the 10-year US Treasury yield lower by 34 basis points earlier this month.
- The move reversed after the May US labor report showed the number of job additions significantly exceeded the consensus estimate.
- The 10-year US Treasury yield came back down again after weaker-than-expected inflation data for May, to 4.22% as of 14 June.

But we expect yields to fall as the Fed starts to cut rates.

- Recent US data add to our confidence that the trend toward slower inflation is back on track. They also point to a cooling labor market and a slowing economy.
- We expect the 10-year US Treasury yield to fall to 3.85% by December as the Fed starts to cut rates later this year.
- Earlier this month, the European Cental Bank and the Bank of Canada both cut rates by 25 basis points, following similar moves by the Swiss National Bank and Sweden's Riksbank.

Fixed income remains our preferred asset class.

- Bonds offer the potential for higher total returns than cash as yield declines result in capital gains.
- Tactically, we continue to favor high-quality segments, which would rally sharply if global economic growth slows abruptly.
- Complementing a core holding in quality bonds with a satellite in riskier credits can potentially improve overall portfolio yields.

Did you know?

- High-quality bonds are among the safest investments, in our view, based on the creditworthiness of their issuers. That makes them an effective way to preserve capital, reduce volatility, and stabilize portfolios. US Treasuries can also be bought and sold easily, even in times of crisis.
- 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.
- Interest rate expectations would have to rise significantly from here for investors to earn a negative return on high-quality 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. 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.

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Original report - **Is it time to lock in bond yields?, 17 June 2024.**

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