CIO notes that high-quality bonds are among the safest investments in an investor's portfolio, as they can preserve capital, reduce equity volatility, and stabilize portfolios. (UBS)

CIO continues to rate fixed income as most preferred in our global portfolios

10 July 2024, 2:25 pm CEST, written by UBS Editorial Team

Fixed income markets have been volatile this year, with investors constantly reassessing their expectations on the Federal Reserve's path toward rate cuts amid mixed economic data.

CIO continues to rate fixed income as most preferred in our global portfolios, and recommend investors put excess cash to work in the asset class amid the global rate-cutting cycle.

The Fed appears on track to begin easing in the coming months. While Fed Chair Jerome Powell declined to give a timetable for rate cuts during his testimony before the Senate Banking Committee on Tuesday, he left the central bank's options open by stressing the two-sided risks for monetary policy. He said recent inflation data have shown modest further progress, adding that unexpected weakness in the labor market could prompt a cut. With the US "no longer an overheated economy," Powell's comments suggested the case for cuts is becoming stronger. We continue to expect the first Fed cut in September.

This means the attractive starting yield from quality fixed income is unlikely to last for much longer. With the Fed likely to join the global rate-cutting cycle soon, we believe bond yields will fall. The 10-year US Treasury yield is currently trading in the upper range of the past five years, providing a favorable chance for investors to lock in rates that could offer ample buffer against ongoing volatility and attractive portfolio returns as yields fall. We see scope for significant capital appreciation as markets start to price deeper rate cuts into the next year, or in the event of a growth shock.

Bonds have historically outperformed cash over the long term while offering benefits of diversification. Cash looks set to deliver progressively lower returns as central banks continue on the easing path. Historically, the probability of bonds outperforming cash rises with longer holding periods—from 65% over 12 months to 82%, 85%, and 90% over five, 10, and 20 years, respectively. In addition, we note that high-quality bonds are among the safest investments in an investor's portfolio, as they can preserve capital, reduce equity volatility, and stabilize portfolios.

So we recommend investors position for rate cuts by buying quality bonds, implementing bond ladders, and holding diversified fixed income positions with satellite exposure to riskier credits to improve overall portfolio yields. This also applies to sustainable investments into green, social, and sustainable bonds, as well as those issued by multilateral development banks.

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Original report - **Favoring bonds amid a lower-rate environment, 10 July 2024.**