CIO continues to favor quality bonds in their global portfolios and recommend investors lock in currently attractive bond yields. (UBS)

Quality bonds remain attractive amid rising yields

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US Treasury yields hit their highest levels since November on 8 April, as traders further scaled back expectations on how much the Federal Reserve will cut rates this year. The 10-year yield climbed to as high as 4.46% intraday on Monday before settling at 4.42%. This marks a 48-basis-point rise since the start of the year.

The rise in yields came amid evidence of continued strength in the US economy, including a rebound in manufacturing activity and strong job creation. Wednesday's release of the US consumer price index for March will be another key data point for investors to calibrate their expectations on the extent and timing of Federal Reserve rate cuts in 2024.

But while yields are likely to remain volatile in the near term as markets shift views on the Fed's path, we continue to see an attractive risk-reward outlook for quality bonds, including government and investment grade corporate bonds, for three reasons:

Yields offer an appealing source of portfolio income. High developed market policy rates have led to appealing all-in yields in the asset class. This can give investors an attractive source of regular portfolio income, with ample cushion to provide a buffer and smooth returns if volatility persists. We maintain that now may be a good entry point to lock in yields, especially in light of simmering geopolitical tensions and a packed electoral calendar.

Yields are expected to fall this year. While the latest US labor report showed a stronger-than-expected increase in job creation, the March report included data indicating signs of a slowdown in annual average hourly earnings growth. We also expect March CPI to show a smaller monthly increase than in January and February. Overall, our base case remains that the Fed should be in a position to cut rates around mid-year for a total of 75bps of rate reductions in 2024. As such, we forecast the 10-year US Treasury yield to fall to 3.5% by December. This creates the potential for capital gains in bonds,

with the largest potential gains occurring in an adverse scenario where decelerating US growth and rising unemployment would spur the Fed to make deeper interest rate cuts.

Quality bonds offer potential diversification benefits. High-quality bonds are among the safest investments based on the creditworthiness of their issuers and therefore the likelihood that investors receive back their full invested capital at maturity. That makes them an effective way of preserving wealth, reducing portfolio volatility, and bringing balance to financial plans, in our view. A portfolio with a 60/40 split between stocks and bonds has historically been less volatile than one composed solely of stocks, and it has never delivered a negative return over a 10-year horizon.

So, we continue to favor quality bonds in our global portfolios and recommend investors lock in currently attractive bond yields. We prefer those with maturities in the 1–10-year bracket and see value in sustainable bonds. We also like an active exposure to the asset class as a means of balancing income opportunities across the various parts of the fixed income universe—including some of the more growth-sensitive parts of the bond market but doing so in a diversified way.

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