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Global bond monitor

This piece uses five charts from the *Guide to the Markets* to help investors identify the best opportunities, and biggest risks, across the fixed income landscape.

Fixed income has historically provided two key characteristics in a multi-asset portfolio:

1) A healthy stream of income

2) Diversification against riskier assets if the growth outlook deteriorates

For much of the past decade, the ability of bonds to offer either of these elements was steadily diminishing. A long bull market compressed yields to record low levels, forcing investors to make an unenviable choice: accept paltry returns by investing in government bonds at ever lower yields, or chase higher yields in lower quality parts of the fixed income universe and take on much more risk as a result?

While the move higher in yields over the past two years has been painful, it was also necessary to restore the asset class's ability to fulfil its key roles in a portfolio. Bonds now offer an attractive income stream to investors once again, which additionally provides a greater cushion to absorb capital losses should yields rise further from here. Also, the diversification potential of bonds has increased given greater room for yields to fall in the case of a recession that pushes inflation lower.

1 – Government bonds offer attractive income post the reset

Real global government bond yield

%, yield

Our first chart focuses on government bond markets. Bond yields fell to record low levels over the last cycle as investors reacted to a combination of low inflation, sluggish growth and central bank intervention. This fall in risk-free rates filtered through to the broader bond universe, hampering the ability of fixed income to deliver on its name. The sharp move higher in government bond yields has restored the income credentials of the asset class; allowing investors to lock in attractive income without having to take on significant credit risk.

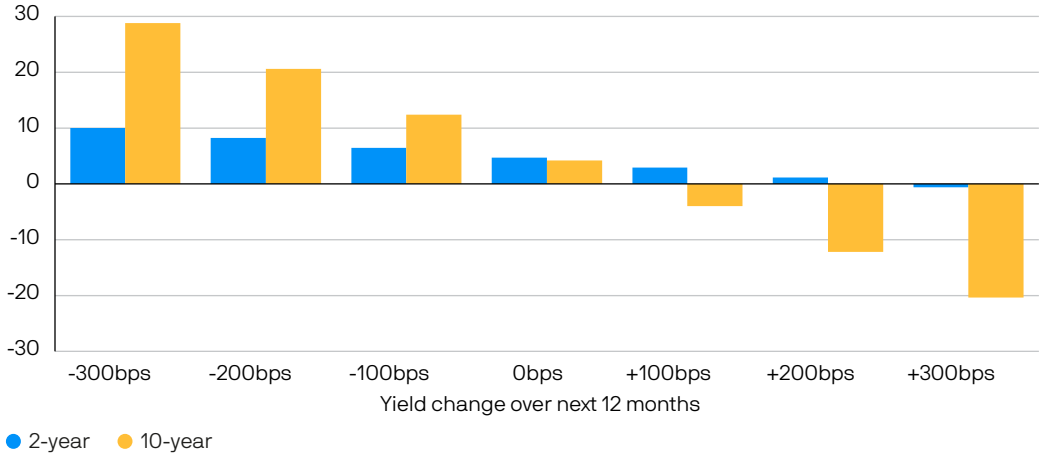
The reset in yields has also improved the diversification benefits on offer. Just a few years ago, the low starting point for yields made it difficult for bonds to act as diversifiers when stocks were hit at the onset of Covid-19, given that central banks had very little room to cut interest rates. Thanks to the move in both interest rates and bond yields over the past two years, the toolkit on offer for investors to build balanced portfolios is now more extensive.

Source: ICE BofA, LSEG Datastream, J.P. Morgan Asset Management. Index shown is the ICE BofA Global Inflation-Linked Government Bond index. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Europe*. Data as of 31 March 2024.

2 – Gauging the potential for diversification

Total return scenarios for US Treasuries

%



Our second chart considers the total return that investors would receive from US Treasuries depending on how yields move over the next 12 months. If the economic outlook deteriorates, the pressure on central banks to cut interest rates will only intensify. In this scenario, bond yields still have significant room to fall from current levels. In the event that 10-year US Treasury yields fell by 100 basis points over the next 12 months, this would deliver a return of more than 10%. This is the kind of meaningful diversification against equity losses that multi-asset investors rely on when constructing balanced portfolios, and has not been available for several years given the historically low level of yields.

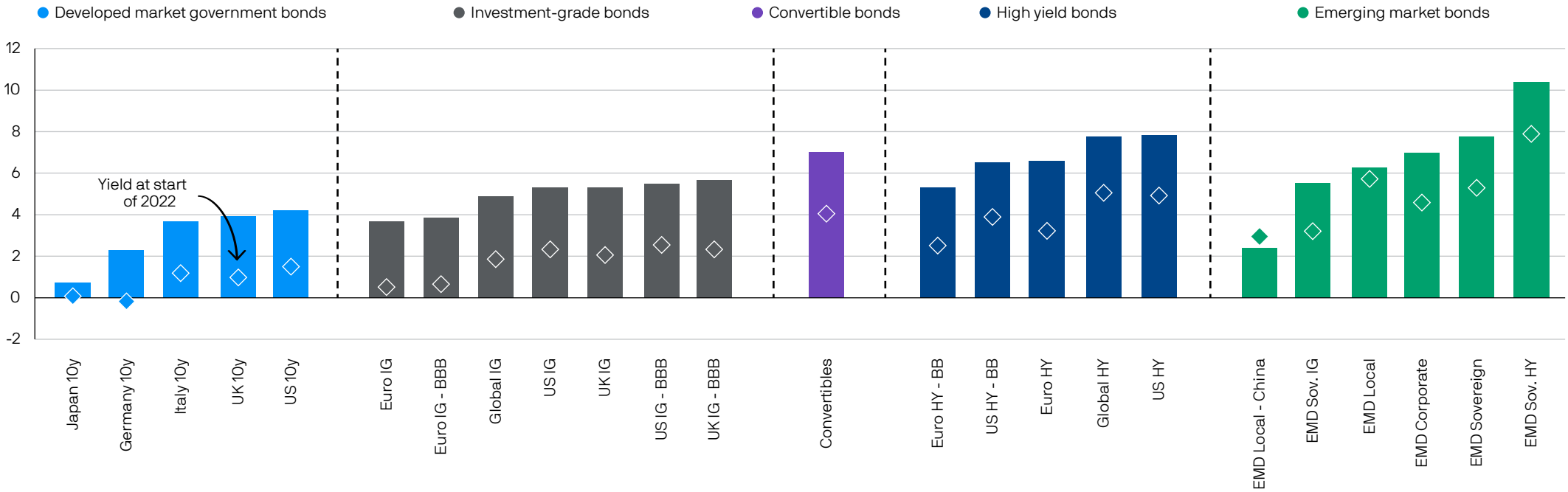
Source: Bloomberg, J.P. Morgan Asset Management. Chart indicates the calculated total return achieved by purchasing US Treasuries at the current yield and selling in 12 months' time given various changes in yield. For illustrative purposes only. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Europe*. Data as of 31 March 2024.

3 – Yields have moved higher across the fixed income spectrum

Our third chart considers the 'menu of options' across the fixed income universe. The bars show yields in April 2024, and the markers show where yields stood at the start of 2022. As the chart highlights, yields across the fixed income spectrum have increased significantly. Higher yields are available in riskier categories such as emerging market and high yield corporate bonds, but core investment grade fixed income is now delivering yields comparable to what high yield bonds were offering in 2022. This allows investors to access attractive income without necessarily taking on significant additional risk.

Fixed income yields

%

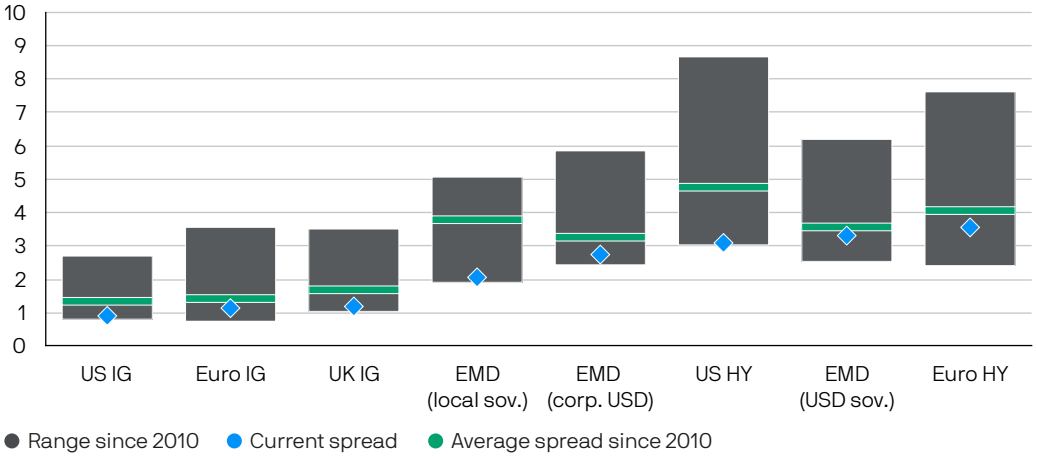


Source: Bloomberg, Bloomberg Barclays, ICE BofA, J.P. Morgan Economic Research, LSEG Datastream, J.P. Morgan Asset Management. Return correlation to MSCI All-Country World Index is calculated using monthly total returns since 2008. Indices used are as follows: Euro IG: Bloomberg Barclays Euro-Aggregate Corporate; Global IG: Bloomberg Barclays Global Aggregate Corporate; UK IG: Bloomberg Barclays Sterling Aggregate Corporate; US IG: Bloomberg Barclays US Aggregate Corporate; Convertible bonds: Bloomberg Barclays Global Convertible Rate Sensitive hedged to USD; Euro HY: ICE BofA Euro Developed Markets Non-Financial High Yield Constrained Index; Global HY: ICE BofA Global High Yield Index; US HY: ICE BofA US High Yield Constrained Index; EMD corporate: CEMBI Broad Diversified; EMD local: GBI-EM Global Diversified; EMD local – China: J.P. Morgan GBI-EM Broad Diversified China; EMD sovereign: EMBI Global Diversified; EMD sov. IG: EMBI Global Diversified IG; EMD sov. HY: EMBI Global Diversified HY. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Europe*. Data as of 31 March 2024.

4 – Be selective in lower quality parts of the market

Fixed income spreads

%, option-adjusted spread



Our fourth chart considers credit spreads, or the extra compensation that investors are paid for investing in riskier corporate bonds and emerging market debt over core government bonds. Corporate fundamentals across much of the global economy appear to be in decent shape. In recent years, we have seen a clear trend of companies reducing their leverage levels and extending the maturity profile of outstanding debt, which has helped to keep near-term refinancing needs in check. Yet even when factoring in solid fundamentals, many areas of credit already appear to be pricing in a very benign economic outlook, particularly in lower quality parts of the market such as high yield. As a result, we believe that a selective approach within credit markets remains prudent in the current environment.

Source: Bloomberg, Bloomberg Barclays, ICE BofA, J.P. Morgan Economic Research, LSEG Datastream, J.P. Morgan Asset Management. Euro IG: Bloomberg Barclays Euro Agg. Corporate; US HY: ICE BofA US High Yield Constrained; EM Debt: J.P. Morgan EMBI Global Diversified; Euro HY: ICE BofA Euro Developed Markets Non-Financial High Yield Constrained; US IG: Bloomberg Barclays US Agg. Corporate – Investment Grade; UK IG: Bloomberg Barclays Sterling Agg. Corporate; EMD local: J.P. Morgan GBI-EM Global Diversified; EMD corporate: J.P. Morgan CEMBI Broad Diversified. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Europe*. Data as of 31 March 2024.

5 – Higher starting yields give bond investors more breathing room

Global government bond yield cushion

Basis points

Looking forward, the risks to bond yields are still two-sided. A cooling global economy and the prospect of central bank rate cuts should provide support for bonds. Yet on the other hand, there is still debate about whether the battle against inflation is truly won, while concerns about the sustainability of the US government's fiscal position could come into focus as we draw closer to the election.

Crucially, our final chart shows how the higher starting yield available in global government bonds gives investors the greatest insulation from rising yields in over ten years. The yield cushion measures how far yields would have to rise before capital depreciation wipes out one year's worth of income. Global government bond yields would now have to rise by more than 40 basis points before investors lose money on a 12-month basis. For investors looking to move out of cash and back into fixed income, this larger income cushion should provide some comfort even if there are still concerns about bumps in the road.

Source: Bloomberg, LSEG Datastream, J.P. Morgan Asset Management. Yield cushion refers to how far yields can rise before capital depreciation wipes out one year's worth of income. Index used is the Bloomberg Global Aggregate - Government index. Past performance is not a reliable indicator of current and future results. *Guide to the Markets – Europe*. Data as of 31 March 2024.

Conclusion

It's been a hectic two years for bond investors but the opportunities available in fixed income now look compelling. Whether for income or diversification against recession risk, bonds deserve their place in a balanced portfolio once again, even though an element of discernment will still be required.

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