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# Global Bond Monitor

**This piece uses five charts from the *Guide to the Markets* to explain why, despite investors having scaled back their initial hopes for rapid rate cuts, we see compelling opportunities across the fixed income landscape.**

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

1) A steady 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. It also meant fixed income investors increasingly felt they needed falling interest rates and additional capital gains to see healthy returns in core bonds. This has caused some to question whether the persistence of a higher interest rate environment will be detrimental to the asset class.

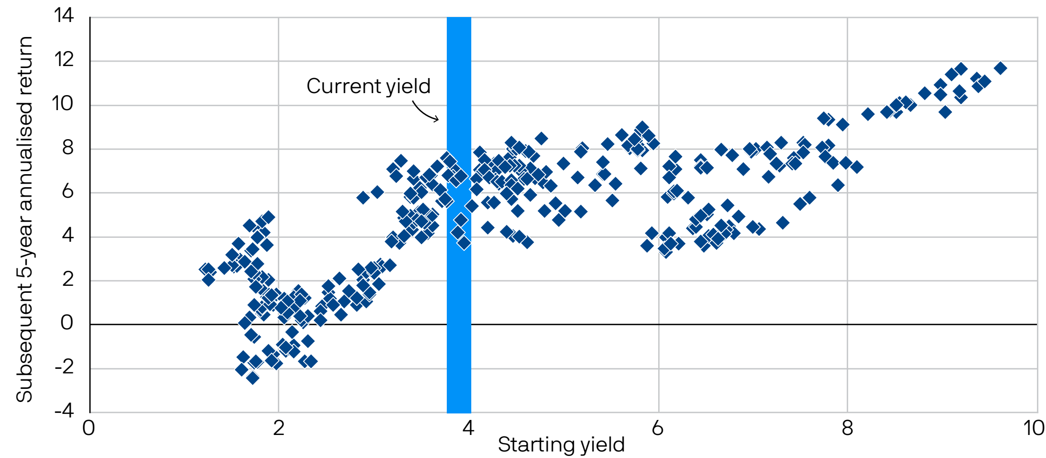
The declines witnessed in fixed income markets in 2022 were unprecedented. The global aggregate bond index fell by 16%, the worst annual decline since the index began in 1990 and more than three times as bad as the second worst year on record. 2023 also saw significant volatility, as the market swung sharply between over optimism and over pessimism on the economic outlook. While markets are likely to remain volatile for some time, we believe that the fixed income reset is now broadly complete and that the role of bonds in a balanced portfolio has been restored. Bonds once again offer an attractive income stream to investors. Absent a shock to growth yields are unlikely to fall significantly, so this income is likely to form the bulk of investor returns, and portfolios should be positioned to capture it. Comfortingly, the higher starting point also means bonds have a greater cushion to absorb further upwards pressure on yields before investors lose money over a twelve-month period.

J.P.Morgan ASSET MANAGEMENT

## 1 – High starting yields have historically led to positive returns

**Global fixed income starting yields and subsequent returns**

%, yield, and annualised total returns



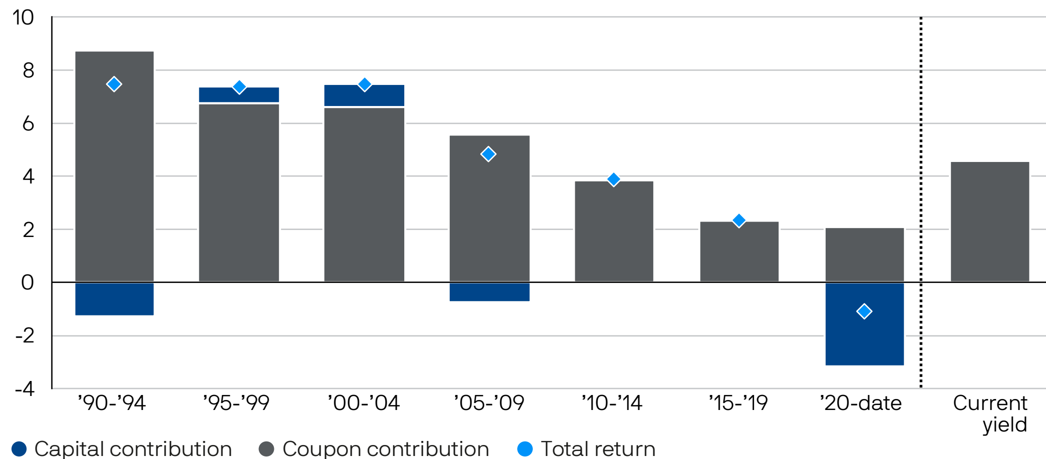

Our first chart looks at the impact of starting yields on subsequent returns. Investors are aware of the impact of equity valuations on subsequent medium-term returns, and the same dynamic is true in fixed income. Historically higher starting yields have led to higher subsequent returns. From current starting yields investors have typically enjoyed annualised returns of around 6% over the subsequent five years. This holds true even during periods of rising yields as the higher starting coupon means that fixed income is less reliant on capital appreciation. For investors today the yield on global aggregate bonds would need to rise from 4% today to 7% over the next five years for investments to lose money over the same period.

Source: Bloomberg, J.P. Morgan Asset Management. Index used is the Bloomberg Global Aggregate index. Past performance is not a reliable indicator of current and future results. *Guide to the Markets - Europe*. Data as of 30 June 2024.

## 2 – Fixed income is for income

**Average contribution to US Treasury annual returns**

% total return and % point contribution

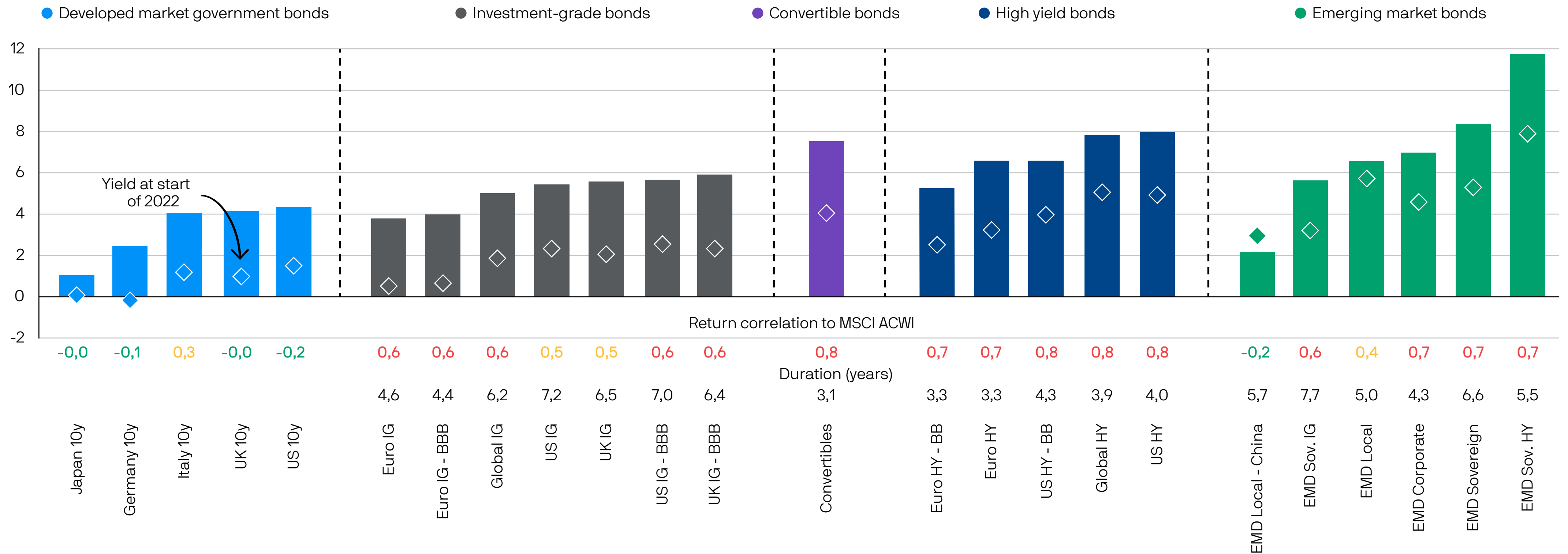



Our second chart considers the source of fixed income returns. Prior to the Global Financial Crisis strong coupon payments formed a sizeable part of the returns investors enjoyed from their bonds. Conversely, the low yields available at the end of the last cycle meant that investors increasingly looked to additional capital appreciation to deliver healthy returns in core fixed income. Applying the lessons of the low yield environment has raised concerns amongst some investors. They are worried that the asset class could suffer if the central bank easing cycle proves to be only shallow. We think such concerns are overplayed. With healthy coupon payments reestablished, a "higher-for-longer" interest rate environment should change the source of fixed income returns, rather than necessarily hurt them. Falling yields would deliver attractive short-term capital gains, but these would be achieved at the cost of cannibalising future coupon payments.

Source: Bloomberg, LSEG Datastream, J.P. Morgan Asset Management. Index used is the Bloomberg US Treasury index. Chart shows annualised returns and contributions in each period. Returns from 2020 to date include year-to-date annualised returnsFor illustrative purposes only. Past performance is not a reliable indicator of current and future results. *Guide to the Markets - Europe*. Data as of 30 June 2024.

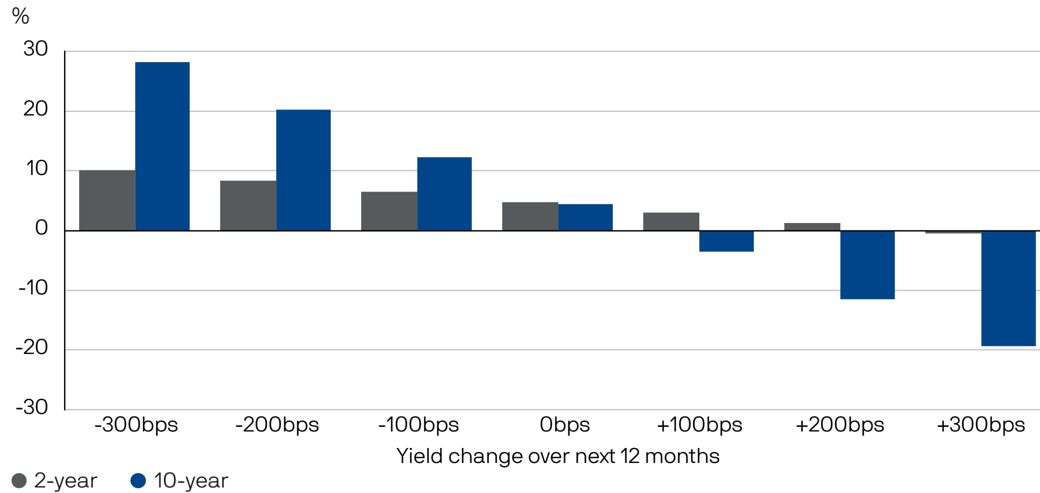
## 3 – Yields have moved higher across the fixed income spectrum

Our third chart considers the 'menu of options' across the fixed income universe. The bars show yields in June 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. With credit now offering attractive all-in yields fixed income investors should consider a broader selection of the fixed income menu in their portfolios. Credit spreads are tight relative to history. But so long as corporate earnings remain strong then default rates and spreads should remain contained. While this is the case investors can have greater confidence in stepping out from government bonds into credit and picking up the additional yield on offer.




Source: Bloomberg, 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 Euro-Aggregate Corporate; Global IG: Bloomberg Global Aggregate Corporate; UK IG: Bloomberg Sterling Aggregate Corporate; US IG: Bloomberg US Aggregate Corporate; Convertible bonds: Bloomberg 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 30 June 2024.

## 4 – Diversification potential has improved




Our fourth 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 over the coming months, 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 very low level of yields.

Source: LSEG Datastream, 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 30 June 2024.

## 5 – Higher starting yields give bonds more breathing room in case of upside surprises

While the next move for interest rates is still likely downward, medium-term risks are two sided and concerns about the sustainability of the US fiscal position could come into focus as we draw closer to the election. For investors, burnt by 2022 and 2023, the risk these pose to yields could reduce confidence in returning to the asset class.

Our final chart shows how the higher starting yields available in global bonds gives them greater insulation from rising yields than has been available for 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 bond yields would now have to rise by 60 basis points before investors lose money on a twelve-month basis. Investors can have more confidence in returning to fixed income even if they have concerns about shorter term volatility.

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. Past performance is not a reliable indicator of current and future results. *Guide to the Markets - Europe*. Data as of 30 June 2024.

## Conclusion

It has been a bumpy two years for bond investors but the opportunities available in fixed income now look compelling. With the reset higher in yields complete, the “higher-for-longer” environment does not pose a risk to fixed income returns but rather points to sustainable income in the medium term. Absent a shock to growth yields and spreads are likely to remain contained and investors should position their portfolios to capture the attractive yields on offer. In the current environment the key lesson for investors is that once again fixed income is for income.

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