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momentum
global investment management

Bond markets need to stabilise before markets can begin to recover, but with yields of around 5% across the maturity curve, there is now good value available.

Treasury hunt

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While the world's attention has been focussed on the horrific events in Israel and Gaza, the storm brewing in bond markets reached a new intensity, with the yield on the US 10-year Treasury bond last week crossing a milestone of 5%, the highest since before the Global Financial Crisis (GFC). This matters a great deal to financial markets globally, its impact shouldn't be underestimated. US Treasuries are the world's greatest safe-haven asset, and the 10-year yield is the world's discount rate. When it moves sharply, as now, it reverberates globally and immediately.

To put the move into perspective, the yield was only 0.5% three years ago, a level which seems distant today. That was at the pinnacle of the Fed's ultra-loose policy regime, with near zero interest rates and massive money printing. We all know what has happened since, and all that remains of what was being hailed as 'the new normal' of low interest rates, low inflation and slow growth is the latter - slow growth.

In the intervening period, policy rates have been pushed up from effectively zero in the US to 5.5% today, and bond yields have largely followed the same path. However, the biggest rises in yields were at shorter maturities, with 1-2 year bonds closely matching the Fed Funds rate. Yields on longer dated bonds rose, but by much less, as investors priced in expectations of a sharp slowdown in growth and lower interest rates. Only a few weeks ago, the yield on 10-year Treasuries was 3.7%, compared with well over 5% on short maturities. That led to a deeply inverted yield curve - a reversal of the normal position where yields are higher the longer the maturity, reflecting their higher duration and interest rate risks.

The big shift in longer term yields relative to shorter dated has come suddenly and sharply, with a rise of over 100bps in the 10-year yield in a couple of months, whereas shorter term yields have fallen slightly. This pace of change is highly unusual and makes the move up from the low point of the cycle one of the sharpest in history. It has been driven by the surprising resilience of the US economy, the stickiness of inflation, the Fed's narrative of tighter for longer, and growing concerns about the fiscal situation of the US and debt sustainability. Biden's spending splurge, with deficits forecast to run at over 5% of GDP through the rest of this decade, along with a dysfunctional Congress, have begun to alarm markets, faced with the prospect of huge funding requirements, running at around $1.5-2tn per annum, while the Fed continues to withdraw liquidity at the rate of $1tn a year.

As a result, markets have progressively priced out rate cuts until well into 2024, and anticipate restrictive policy for a considerable time, with the huge supply of bonds in prospect expected to keep yields much higher than those we became accustomed to during the post-GFC era. Nearly all the rise in yields has been due to rising real, inflation adjusted, yields; at 2.4% the highest in over 15 years. It results in tightened financial conditions not just in the US but globally through the dollar's role as the world's reserve currency and the substantial amount of dollar debt outside the US.

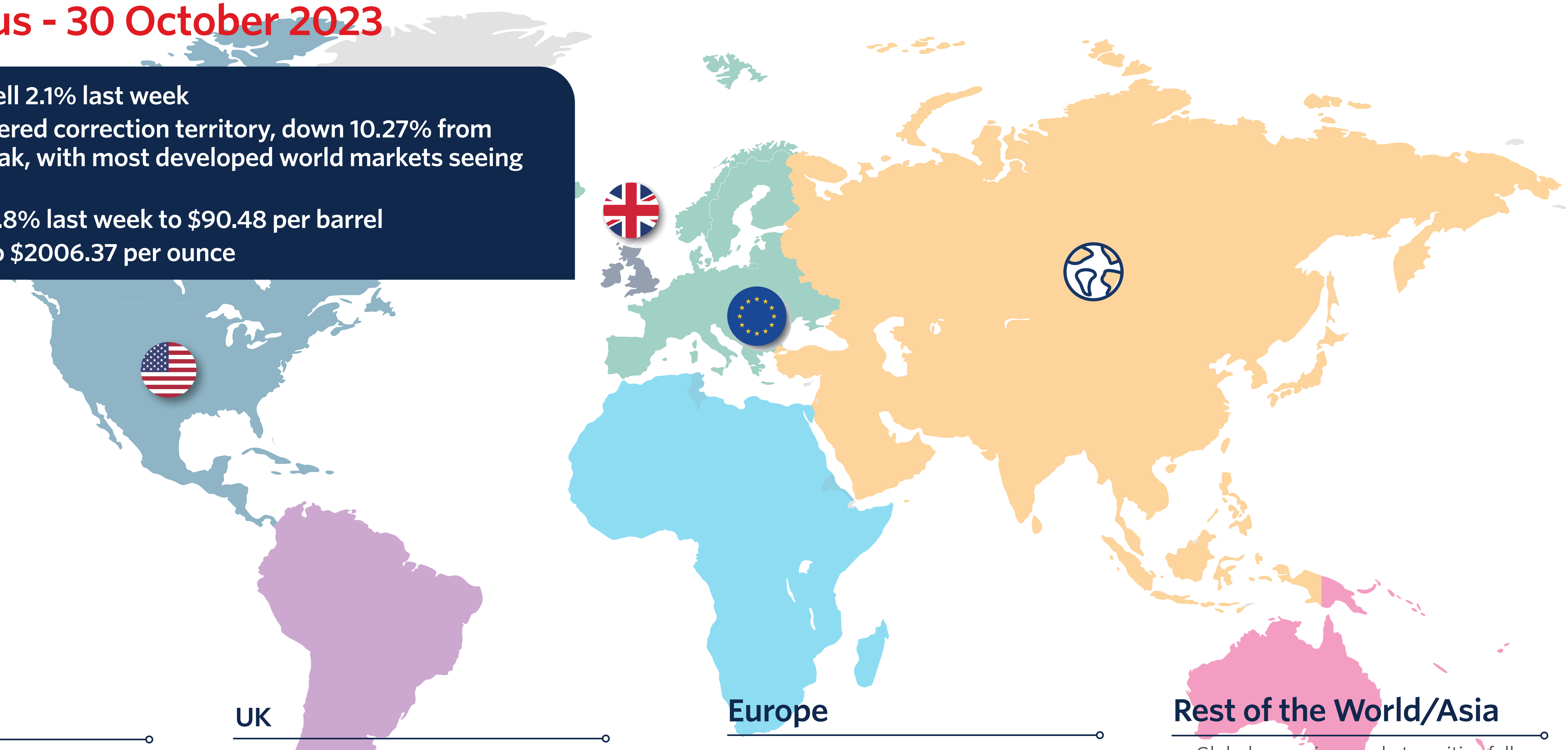
Bond markets around the world inevitably followed the path of the US, and by pushing up the discount rate, valuations of all assets were undermined, with future income flows now less valuable. Perhaps most importantly, it increases stresses in the system, exposes vulnerabilities and heightens the risk of a financial accident. Leverage has become yet more dangerous. It's a time for caution and careful security selection, and uncertainty has intensified – reflected in the extraordinary volatility in bond yields, with moves of 10-20 bps a day increasingly common. The term premium - the additional yield which is needed on longer maturities to justify the higher risks and offset the uncertainties around inflation, rates and debt - has moved significantly higher and is positive today (it was irrationally negative as recently as last month and was for most of the last five years). All of this contributes to an increasing likelihood of a sharp economic slowdown or recession in the year ahead.

For now, putting aside the (unquantifiable) risk of a serious escalation of geopolitical instability, bonds have become the principal driver of equities and other risk assets. Bond markets need to stabilise before markets can begin to recover, but with yields of around 5% across the maturity curve, there is now good value available. While cash is attractive as a parking place, it will be necessary to extend duration before too long to lock in the best real yields on offer in safe-haven bonds for over 15 years.

Source: All data Bloomberg Finance L.P., Momentum Global Investment Management.

Market Focus - 30 October 2023

- Global equities fell 2.1% last week
- The S&P 500 entered correction territory, down 10.27% from its end of July peak, with most developed world markets seeing declines
- Brent crude fell 1.8% last week to $90.48 per barrel
- Gold rose 1.3% to $2006.37 per ounce



US

- US equities fell 2.5% last week as market sentiment was dented by mixed corporate earnings reports and concerns about higher interest rates
- The yield on the benchmark 10-year US Treasury note briefly breached 5% last Monday for the first time in 16 years
- Jose W. Fernandez, Assistant Secretary of State for Economic, Energy and Business Affairs at the US State Department, has warned that China's move to curb exports of some critical minerals used in green technology shows that the West must accelerate its efforts to find its own sources
- The US economy grew at an annualised pace of 4.9% in the third quarter, led by strong consumer spending

UK

- UK equities fell 1.7% last week
- According to latest forecasts, interest rates will remain at 5.25% when the Bank of England's Monetary Policy Committee meets on Thursday 2 November
- The UK unemployment rate rose to 4.2% in the three months to August, from 4.0% between March and May
- Prime Minister Rishi Sunak will use next week's King's Speech to advance expansion of North Sea oil and gas exploration

Europe

- European equities fell 0.8% last week
- Eurozone government bond yields eased slightly after the European Central Bank kept short-term interest rates on hold at 4%, raising expectations that rates have finally peaked in the Eurozone

Rest of the World/Asia

- Global emerging market equities fell 0.6% last week
- Japanese equities were flat last week
- Chinese equities rose 2.5% last week, as an improvement in industrial profits suggested that the economy may be stabilising
- The yield of the 10-year Japanese government bond rose to a 10-year high of 0.87%, approaching the central bank's upper bound of 1.0%

Market Summary - 30 October 2023

Asset Class / Region	Currency	Week ending 27 October	Month to date	YTD 2023	12 months
		Cumulative returns			
Developed Markets Equities					
United States	USD	-2.5%	-3.9%	8.2%	9.4%
United Kingdom	GBP	-1.7%	-4.0%	1.0%	7.0%
Continental Europe	EUR	-0.8%	-4.4%	4.3%	8.3%
Japan	JPY	0.0%	-3.0%	22.0%	21.4%
Asia Pacific (ex Japan)	USD	-0.7%	-3.4%	-3.8%	10.7%
Australia	AUD	-1.1%	-3.1%	0.5%	3.9%
Global	USD	-2.1%	-4.2%	6.4%	10.1%
Emerging Markets Equities					
Emerging Europe	USD	1.9%	1.3%	16.5%	44.4%
Emerging Asia	USD	-0.8%	-3.3%	-2.3%	12.9%
Emerging Latin America	USD	2.0%	-3.3%	9.1%	6.9%
BRICs	USD	0.8%	-2.8%	-3.9%	11.3%
China	USD	2.5%	-2.9%	-10.0%	16.2%
MENA countries	USD	-2.3%	-6.6%	-5.9%	-13.2%
South Africa	USD	-0.9%	-2.1%	-11.7%	-1.8%
India	USD	-2.6%	-3.2%	5.5%	7.3%
Global emerging markets	USD	-0.6%	-3.4%	-1.7%	9.9%
Bonds					
US Treasuries	USD	0.5%	-0.9%	-2.1%	-0.9%
US Treasuries (inflation protected)	USD	0.4%	-0.4%	-1.2%	-0.6%
US Corporate (investment grade)	USD	0.8%	-1.4%	-1.0%	3.1%
US High Yield	USD	0.4%	-1.5%	4.3%	5.6%
UK Gilts	GBP	1.1%	-0.7%	-4.9%	-6.6%
UK Corporate (investment grade)	GBP	0.9%	-0.5%	0.7%	2.9%
Euro Government Bonds	EUR	0.4%	0.1%	0.1%	-3.5%
Euro Corporate (investment grade)	EUR	0.5%	0.1%	2.4%	3.1%
Euro High Yield	EUR	0.5%	-0.7%	5.4%	9.1%
Japanese Government	JPY	-0.3%	-1.2%	-1.7%	-3.1%
Australian Government	AUD	-0.3%	-1.4%	-1.0%	-1.5%
Global Government Bonds	USD	0.4%	-0.9%	-4.2%	-1.2%
Global Bonds	USD	0.5%	-1.0%	-2.6%	0.8%
Global Convertible Bonds	USD	-0.9%	-3.1%	-1.4%	2.8%
Emerging Market Bonds	USD	0.6%	-1.8%	-2.0%	5.7%

Asset Class / Region	Currency	Week ending 27 October	Month to date	YTD 2023	12 months
		Cumulative returns			
Property					
US Property Securities	USD	-2.7%	-6.5%	-9.2%	-7.4%
Australian Property Securities	AUD	-4.5%	-6.2%	-8.2%	-5.8%
Asia Property Securities	USD	0.0%	-3.8%	-13.3%	-0.8%
Global Property Securities	USD	-1.7%	-6.1%	-9.5%	-4.5%
Currencies					
Euro	USD	-0.1%	0.0%	-1.2%	6.1%
UK Pound Sterling	USD	-0.2%	-0.6%	0.3%	4.8%
Japanese Yen	USD	0.1%	-0.1%	-12.4%	-2.4%
Australian Dollar	USD	0.3%	-1.6%	-7.0%	-2.0%
South African Rand	USD	0.9%	0.4%	-9.4%	-4.6%
Swiss Franc	USD	-1.2%	1.3%	2.1%	9.7%
Chinese Yuan*	USD	0.0%	-0.3%	-5.7%	-1.2%
Commodities & Alternatives					
Commodities	USD	-0.4%	-0.2%	1.2%	1.8%
Agricultural Commodities	USD	-0.3%	1.3%	2.1%	5.2%
Oil	USD	-1.8%	-5.1%	5.3%	-6.7%
Gold	USD	1.3%	8.5%	10.0%	21.0%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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