



Time to Buy Bonds?

Following the sharp increase in global inflation, most central banks, led by US Federal Reserve (Fed) have increased interest rates to contain the surging inflation partly due to excess liquidity from the pandemic cash hand-out as well as higher commodity prices. As a result, bond yields have also surged in line with higher bank rates. This is a marked difference from the near zero interest rates in developed economies prior to the pandemic. The US short-term (ST) interest rate went up higher than long-term (LT) bond yields, in what is called an inverted yield curve. That gives investors an opportunity to invest in bonds with higher yields before interest rates start to decline, most likely by next year.

The global bond market had gone through a multi-decade bull run following the decline of interest rates that even hit zero or near-zero yields in many countries such as Japan, Europe and US. But the reversal of rates came in after global inflation set in due to various reasons such as supply disruption during the pandemic period, high shipping costs, Russia-Ukraine war, etc.

To tackle the surging inflation, Fed raised its near-zero interest rates aggressively from Mar-22 to a high of 5% by Jul-23. That caused a sharp reversal of the bond market. As rates jumped, prices of bonds collapsed, ending the 40-year bond bull market in US (see Exhibit 1). The bond market in US has fallen to a new low never seen for many years.

Is it time to place some money in high-yielding bonds? Which one to buy? ST bonds? Or LT bonds?

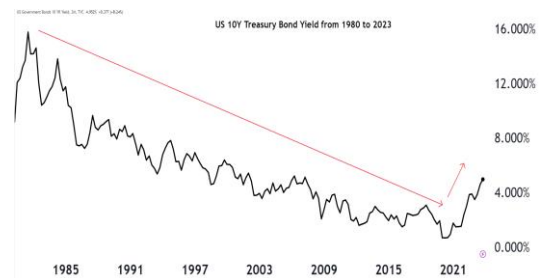
Longer-term bonds have higher duration risk. Duration is a measure of the period to maturity of a bond. Simply put, a bond of seven-year duration will decline 7% in price when the interest rate increases by 1% and vice versa.

As such, now is a better timing to lock in LT duration bonds which will be very profitable when interest rates start to come down. This could happen if Fed starts to normalise interest rates next year when inflation is no more a threat.

The situation in Malaysia is different from that in US as our pre-pandemic interest rates were not as low as in developed economies conversely our interest rates now do not go up as much as those in US. The lower bond volatility in Malaysia does not provide an obvious opportunity compared with those in developed markets such as US, Australia and UK.

There are certain local unit trust bonds with modest bond duration. More attractive longer-duration instruments can be found in the US SPTL ETF (see Exhibit 2) with portfolio duration of 16 years and US TLT ETF (see Exhibit 3) with portfolio duration of 16.5 years. Both are invested in zero-credit-risk US treasuries.

Exhibit 1: US 40-yr bull run ended



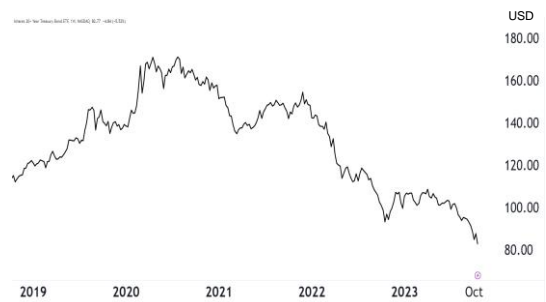
Source: TradingView, PCM Oct'23

Exhibit 2: SPDR Portfolio LT Treasury ETF



Source: TradingView, PCM Oct'23

Exhibit 3: iShares 20+ Year Treasury Bond ETF



Source: TradingView, PCM Oct'23

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