



## FUNDAMENTAL FLASH

# Much Ado About Bond Yields

22 MARCH 2021

Prepared by Affin Hwang Asset Management

### **State of Emergency**

*US bond yields have pierced new highs this year stoking inflationary fears against a strengthened economic recovery outlook post-COVID-19. Risk assets particularly expensive growth stocks saw some weakness in the wake of rising bond yields due to a higher discount rate on valuations. Can too much of a good thing really be that bad for markets?*

*David Ng, Deputy MD and CIO of Affin Hwang Asset Management together with Esther Teo, Senior Director of Fixed Income share their views.*

### **Equity**

#### **1. How have global and Asian markets fared amidst the surge in bond yields which has increased to new highs in 2021?**

As at 17th March, global markets as measured by the MSCI World index is up 5.1% which is a shade lower or 0.1% from its peak on 15th February. Asian markets as measured by the MSCI Asia ex-Japan index is up 4.9% year-to-date (YTD), and is 7.7% below its peak on 17th February.

### **Flashpoints**

- A surge in bond yields have stoked inflationary concerns leading to a rotation from growth to value.
- However, the rise in bond yields is also a validation of an economic recovery and growth returning.
- Though, it will be a concern if bond yields rise too quickly to levels that prohibit economic activities.
- US Treasury 10 year yield could potentially rise to 2.0% with risks of overshooting on the back of strong growth due to vaccination and pent-up demand.
- But, with structural factors such as debt burden and digitalisation, the Fed is likely to stay dovish inflation targets are achieved.

#GrowWithUs

The YTD performance of the Asian markets is similar to that of global markets. The bigger pullback in Asian markets was mainly due to the technology sector which was what led the market higher in the first place.

## 2. Should investors be worried about rising bond yields?

No investors shouldn't worry about rising bond yields, unless it rises to levels which prohibit economic activities, which is a risk we are actively monitoring. Global markets were up 5.1% in the last two and a half months, even as bond yields rose from 0.9% to 1.6%.

Bond yields are still at historical low levels with the exception of 2020 which was an anomalous year due to the COVID-19 pandemic. Bond yields are reacting to expectations of rising inflation which is reflective of a recovery in global economic outlook.



## 3. What's the reading on the equity market now in terms of outlook?

Historically stocks have reacted positively to an improving economic outlook. The world GDP is expected to be 2.5% higher in 2021 compared to a pre-pandemic year like 2019 according to Fitch. With dissipating risks of strict lockdown measures due to the global vaccination rollout as well as loose fiscal and monetary policy support, there is room for equities to perform. Corporate earnings results are also pointing at the right direction with a majority of companies beating expectations.

Markets may be adjusting now, but it does not derail the long-term recovery track with growth returning. Periods such as this provide opportunity for long-term investors to enter at attractive entry levels as well as weed out short-term traders wary of volatility.

## 4. How are we positioning our equity portfolios now?

We are employing a barbell strategy by positioning in reopening names on one end and secular growth companies that will grow structurally post-COVID-19 on the other.

Investors are rotating from growth to reopening/value names given the rise in bond yields. We have likewise made some changes trimming some growth names and adding reopening-plays. It is important that the reopening names we hold are strong companies with multi-year prospects as opposed to beneficiaries of short-term cyclical bumps.

## Fixed Income

### 1. At what levels do we expect bond yields and inflation to settle? Any chance of the US Federal Reserve tightening?

With expectations of a strong economy recovery as a result of a favourable vaccination rollout progress and significant pent up demand, the US Treasury 10 year yield could potentially rise towards 2.0% with risks of overshooting. The recent rise in yield also reflects higher inflationary expectations.

For example, the 10 year breakeven which is a measure of inflationary expectations has risen by 175bps to 2.3%. In response, the 10 year nominal yield has increased by 120bps and is now back to pre-COVID-19 level at 1.7%.



We expect the US 10 year Treasury yield to peak at 2.0%-2.5% in this cycle before stabilising within the 1.0%-2.0% range. This is because there is still a significant amount of labour slack and permanent dislocation in the global economy caused by the pandemic. For example, 22 million workers have lost their jobs in March and April 2020. As of Feb 2021, only 13 million of these jobs have been recovered. Some of these jobs that were lost during the pandemic are unlikely to be recovered with digitalisation taking place.

With structural factors such as debt burden and digitalisation, long term growth and inflation will remain low. With that, the Fed is likely to keep rates at (close-to) zero lower-bound-for-longer until employment and inflation targets are achieved. We expect interest rate hikes in the US will not convene until after 2023.

### 2. How are we positioning our fixed income portfolios now in light of rising bond yields?

We are taking a defensive stance given the current rising yield environment. We have increased cash levels to high single-digit to low double-digit depending on respective funds. A high cash level enables us to deploy capital into papers that have become more attractive (i.e. better yields). We have also reduced duration via sale of long-dated bonds and use of interest rates futures which has helped lower the portfolio sensitivity to movement in interest rates.

### 3. Any sector opportunities that we are titling the portfolio towards?

We continue to like selective solid high yield names, primarily Chinese properties and bank capitals that are still providing a decent buffer against the rise in yields. We are also taking the recent rise in yields as an opportunity to add some of the quality investment grade names such as China state owned and selective private owned enterprises. We are also gradually adding exposures to RMB denominated bonds as well as IDR denominated bonds to enhance portfolio yield.

#GrowWithUs



## **Disclaimer**

*This article has been prepared by Affin Hwang Asset Management Berhad (hereinafter referred to as "Affin Hwang AM") specific for its use, a specific target audience, and for discussion purposes only. All information contained within this presentation belongs to Affin Hwang AM and may not be copied, distributed or otherwise disseminated in whole or in part without written consent of Affin Hwang AM. The information contained in this presentation may include, but is not limited to opinions, analysis, forecasts, projections and expectations (collectively referred to as "Opinions"). Such information has been obtained from various sources including those in the public domain, are merely expressions of belief. Although this presentation has been prepared on the basis of information and/or Opinions that are believed to be correct at the time the presentation was prepared, Affin Hwang AM makes no expressed or implied warranty as to the accuracy and completeness of any such information and/or Opinions. As with any forms of financial products, the financial product mentioned herein (if any) carries with it various risks. Although attempts have been made to disclose all possible risks involved, the financial product may still be subject to inherent risk that may arise beyond our reasonable contemplation. The financial product may be wholly unsuited for you, if you are adverse to the risk arising out of and/or in connection with the financial product. Affin Hwang AM is not acting as an advisor or agent to any person to whom this presentation is directed. Such persons must make their own independent assessments of the contents of this presentation, should not treat such content as advice relating to legal, accounting, taxation or investment matters and should consult their own advisers. Affin Hwang AM and its affiliates may act as a principal and agent in any transaction contemplated by this presentation, or any other transaction connected with any such transaction, and may as a result earn brokerage, commission or other income. Nothing in this presentation is intended to be, or should be construed as an offer to buy or sell, or invitation to subscribe for, any securities. Neither Affin Hwang AM nor any of its directors, employees or representatives are to have any liability (including liability to any person by reason of negligence or negligent misstatement) from any statement, opinion, information or matter (expressed or implied) arising out of, contained in or derived from or any omission from this presentation, except liability under statute that cannot be excluded.*