中信银行(国际)
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Strategic Allocation of the Bond Market Amid Rate Cuts

Video highlights:

- The Fed's rate cut decision in September has been anticipated, bond markets remain supportive of risk assets due to the relatively stable nature of bond yields compared to equities. However, due to the continued presence of various uncertainties in the market, including future U.S. inflation and economic conditions, as well as the level of U.S. debt and the Fed's interest rate path, bond investments require a flexible approach.

- According to Treasury International Capital (TIC), foreign holdings of the U.S. treasuries reached a record high of $9.16 trillion. Foreign governments and overseas institutions collectively hold over 30% of U.S. treasuries. This indicates that despite Trump's imposition of high tariffs on various countries since April, sparking trade disputes, overseas demand for U.S. treasuries has remained stable, reflecting continued market enthusiasm for U.S. Treasuries.

- Currently, the U.S. accounts for over 40% of the total amount of outstanding government debt, while more than half is from other markets. This illustrates that there are numerous opportunities across the globe. Regions such as Europe and emerging markets offer more attractive yields, reflecting investors can manage risk and seize opportunities by diversify across the global market.

- Besides, current CPI in the Asian region is relatively low. Overall, Asian central banks have considerable room to maintain accommodative monetary policies, which benefits the Asian bond market. Furthermore, most Asian investment-grade bonds are denominated in USD, and a decline in the USD can reduce the repayment pressure on issuers and lower the risk of default.

- Longer duration bonds may offer slightly higher yields, but they also carry a higher sensitivity to interest rates, resulting in greater volatility. The rolling three-year volatility can reach 6-7% and shorter-term bond reach around 2%. Shorter-term bonds are less sensitive to interest rates, but its' yields are often limited, so it is not always best to go with the shortest-term bond. By flexibly managing the duration of the bond portfolio, investors with lower risk tolerance can effectively control volatility while capturing attractive yields, achieving a balanced approach of risk management and return.

- Investors can slightly increase the duration of their bond portfolios to lock in higher interest rates in the backdrop of the Fed's rate cuts. However, U.S. inflation, rate cut path, and the potential for a government shutdown in October could bring market instability. If the shutdown lasts longer than expected, it may lead to widespread layoffs, putting significant pressure on long-duration bonds. Therefore, investors should appropriately manage their bond duration to balance risk and return.

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