

Bond Bites

UBS Asset Management | Fixed Income views
February 2020



Jonathan Gregory
Head of Fixed Income UK

The strange disappearance of the bond vigilante

In 1936 British economist John Maynard Keynes described a remedy for a world chronically oversupplied with savings and with persistently low returns on investment. He worried that the ability of the monetary authorities to cut interest rates to the required low level would be sternly resisted by a powerful rentier class: the owners of capital who demanded the highest possible returns. Arguing for a dramatic cut in interest rates to allow the economy to function effectively he supposed this must lead to the 'euthanasia of the rentier'. ¹

Keynes never witnessed the kind of collapse in interest rates he imagined would be needed in extremis; but nearly 100 years later, we all did. Central banks, in the aftermath of the financial crisis, crushed policy rates to zero or lower and carpet-bombed the world with cash ². But the modern day rentier (read bond-holder) has side-stepped extinction, and indeed prospered, as central banks purchased trillions of dollars' worth of bonds, yields collapsed and prices shot higher. The question for bond-holders today is not so much how to count the dead, but whether to stick or twist?

There *have* been casualties nonetheless. Bond vigilantes, those investors who protest monetary policies considered inflationary by aggressive selling were, if not immolated, then at least sent into deep hibernation. At one level this is surprising; so powerful have been the weapons unleashed by central banks that this extinction event occurred alongside global debt levels reaching an all-time high of US\$184trillion or the equivalent of 225% of GDP ³. Richer developed market economies are generally the more indebted ones and historically this was the profitable terrain over which the vigilantes waged war on spendthrift governments.

Those days may come again but, so far, many governments and central banks have persuaded market participants that they have the willingness and ability to maintain yields at very low levels, killing the asset market volatility that some investors thrive on. The nuclear winter for bond vigilantes does not presage the demise of active bond managers though, and there are still opportunities for those who can adopt a flexible approach across countries and sectors. So, while it is true we expect very low returns from developed market bond yields, in our global bond strategies we still emphasize relative value opportunities across countries.

For example, it is clearly getting harder to find value in traditional 'core' global-bond markets such as Europe, the US and Japan. But these countries' share of global GDP is shrinking and a truer perspective on global bond markets today must embrace countries like China, Brazil and Mexico. In many cases these countries are experiencing weak growth and low inflation pressures which can lead to further outperformance for their bond markets versus core countries.

My colleague Kevin Zhao, Head of Global Sovereign Bonds, and manager of our strategy that was voted Best Global Bond Fund by Refinitiv Lipper in 2019, often talks about these themes. You can read his latest thoughts [here](#). And you can see more about our flexible bond strategies [here](#).

The monetary authorities in core countries today are determined to keep yields low, indeed their mandates demand it. This will certainly suppress income earned on bonds for the foreseeable future, but this need not be terminal for bond-holders. We believe that investors may still count on bond portfolios to deliver attractive total returns over time if they can adapt their approach to a more flexible and global outlook.

1 As a pillar of the British establishment we may safely assume Keynes hoped for this figuratively, not literally.

2 Strictly speaking, not physical cash but newly created bank reserves held with the central bank.

3 See IMFBlog post 'New Data on Global debt' Jan 2019; <https://blogs.imf.org/2019/01/02/new-data-on-global-debt/>

For marketing and information purposes by UBS. For professional clients / qualified / institutional investors only.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund.

Americas

The views expressed are a general guide to the views of UBS Asset Management as of October 2019. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA

The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document. Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient. The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG. This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK

Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction. Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed. You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia

This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

China

The securities may not be offered or sold directly or indirectly in the People's Republic of China (the "PRC"). Neither this document or information contained or incorporated by reference herein relating to the securities, which have not been and will not be submitted to or approved/verified by or registered with the China Securities Regulatory Commission ("CSRC") or other relevant governmental authorities in the PRC pursuant to relevant laws and regulations, may be supplied to the public in the PRC or used in connection with any offer for the subscription or sale of the Securities in the PRC. The securities may only be offered or sold to the PRC investors that are authorized to engage in the purchase of Securities of the type being offered or sold. PRC investors are responsible for obtaining all relevant government regulatory approvals/licenses, verification and/or registrations themselves, including, but not limited to, any which may be required from the CSRC, the State Administration of Foreign Exchange and/or the China Banking Regulatory Commission, and complying with all relevant PRC regulations, including, but not limited to, all relevant foreign exchange regulations and/or foreign investment regulations.

Hong Kong

This document and its contents have not been reviewed by any regulatory authority in Hong Kong. No person may issue any invitation, advertisement or other document relating to the Interests whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Interests which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) and the Securities and Futures (Professional Investor) Rules made thereunder.

Japan

This document is for informational purposes only and is not intended as an offer or a solicitation to buy or sell any specific financial products, or to provide any investment advisory/management services.

Korea

The securities may not be offered, sold and delivered directly or indirectly, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to the applicable laws and regulations of Korea, including the Capital Market and Financial Investment Business Act and the Foreign Exchange Transaction Law of Korea, the presidential decrees and regulations thereunder and any other applicable laws, regulations or rules of Korea. UBS Asset Management has not been registered with the Financial Services Commission of Korea for a public offering in Korea nor has it been registered with the Financial Services Commission for distribution to non-qualified investors in Korea.

Taiwan

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in the Republic of China (R.O.C.). This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in the Republic of China (R.O.C.). No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of the Republic of China (R.O.C.).

Source for all data and charts (if not indicated otherwise): UBS Asset Management

The key symbol and UBS are among the registered and unregistered trademarks of UBS.

© UBS 2020. All rights reserved.

AMMA-3633 02/20

www.ubs.com/am

For professional / qualified / institutional clients and investors only.

