
(UBS)

Why bonds offer appealing portfolio characteristics

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The combination of diversification, income, and potential price appreciation offered by quality bonds means fixed income remains attractive despite potential yield volatility.

The 10-year US Treasury yield has declined for three consecutive weeks, trading below 5% at the time of writing. The drop in yields came despite a climb in oil prices amid ongoing conflicts in the Middle East.

The bond market may still come under pressure in the near term. The geopolitical situation remains fluid, with US President Donald Trump saying it's "decision time" on whether he makes a deal with Tehran or resumes attacks. Also, inflation has reaccelerated, hyperscalers are raising more money for their AI investment, and fiscal concerns have not abated.

But attempting to forecast the precise peak in yields is both difficult and, from a long-term perspective, potentially less important than investors assume. We continue to rate fixed income as Attractive owing to the diversification benefits, income, and potential price appreciation.

Bonds offer appealing portfolio characteristics. The recent decline in yields suggests that Treasuries are being perceived as a "safe haven asset" again, with investors seeking relative safety amid a broad risk-off environment. While not our base case, higher oil prices have put economic growth risks back into focus, and quality bonds should benefit if growth weakens. With macro uncertainty likely to remain elevated, we believe quality bonds offer diversification and stability in a portfolio.

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Current yields offer sufficient income to compensate for the risk of further yield volatility. Starting yields have historically been a good indication of subsequent total returns, and we think current still-elevated yields provide sufficient portfolio income to compensate for the risks of further monetary tightening, persistent inflation, and fiscal uncertainty. For capital losses to offset one year of income, two-, five-, and 10-year Treasury yields would need to rise by around 246, 109, and 63 basis points, respectively, from current levels. We view such a move as unlikely.

An adjustment in Fed pricing leaves scope for price gains. While the Federal Reserve is expected to keep interest rates steady when policymakers meet this week, markets are pricing in more tightening over the next 12 months than we currently expect. This means that Treasury yields may decline further as investors scale back their expectations, leaving scope for capital gains in bonds.

So, we continue to see opportunities in fixed income. With yields at current levels, investors are being paid to hold duration while gaining a valuable hedge against downside growth scenarios. We favor selective exposure to medium- and longer-duration high-quality bonds and stay cautious on the longest maturities.

Original report: **The case for bonds beyond peak yields, 26 October 2026.**

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