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Why global bonds deserve a fresh look

Investment strategy insights

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- Global bond yields have moved higher, hurting capital returns. The outlook for major central banks is more hawkish, suggesting further volatility ahead for yields.
- That said, global bonds can still offer appealing income and portfolio diversification for patient investors.
- Rebalancing excess cash into quality bonds and select high yield and emerging market credit may help improve portfolio resilience.


Source: UBS

Global bond markets have repriced to a world where US growth and inflation pressures look firmer than previously expected, the conflict in the Middle East appears more protracted than hoped, and oil supply disruptions look set to endure.

Strong US employment, steady economic growth, and firmer US price pressures (especially in the services sector) have all reduced expectations for US policy easing and increased expectations of further Fed tightening. The Federal Reserve delivered a hawkish hike in September, with a unanimous decision to raise rates 25bps, while projections point to a median two-hike path and rates on hold in 2027, with upward economic projections for PCE and core PCE inflation. We expect the Fed to raise rates again in December.

In the Eurozone, the European Central Bank (ECB) recently raised rates, and its updated staff projections suggest that inflation pressures will prove more persistent than previously thought. Headline inflation is forecast at 3.0% in 2026, 2.5% in 2027, and 2.1% in 2028. Compared with the June projections, the forecasts for 2027 and 2028 were revised up by 0.2 and 0.1 percentage points, respectively. Core government bond yields have recently traded at some of their highest levels since the global financial crisis. We now expect the ECB to raise rates again in December.

For investors already allocated to bonds, rising yields and falling bond values can seem unsettling. But from a longer-term perspective—and for investors sitting on excess cash—we believe now may be a good time to review fixed income allocations and consider rebalancing.

Higher starting yields can offer a larger cushion

For much of the past decade, bonds offered slim income opportunities in many markets. Starting yields were extremely low, leaving little yield "cushion" to offset periods of market volatility. Today, the situation is very different.

While bond prices remain sensitive to movements in interest rates, investors are now entering the market with substantially higher yields. That income stream is once again doing much of the heavy lifting. Across investment grade, high yield, and emerging market bonds, coupon income is helping cushion the impact of rising yields and reducing the likelihood of losses over a 12-month investment horizon.

Despite a significant reassessment of monetary policy expectations, rising government bond yields, and concerns about inflation, many credit sectors have continued to generate positive total returns because income has more than offset bond price declines. The relationship between yields and returns has become considerably more favorable for long-term investors, in our view.

Higher yields also mean investors have a larger yield cushion. Breakeven calculations indicate that many fixed income sectors can absorb a meaningful rise in yields before total returns fall below zero. For example, spreads on euro investment grade and high yield debt would have to rise roughly 90 and 180 basis points for total returns to fall to zero, while the comparable figure for EM corporate bonds (JPM CEMBI Index) is roughly 150 basis points.

Although forecasts for bond price appreciation have moderated as rate expectations have risen, expected 12-month total returns across several major bond sectors remain positive and potentially more appealing than holding excess cash.

Why and how to diversify across bonds

In a world of persistent inflation risks, geopolitical uncertainty, and shifting monetary policy expectations, diversification remains essential. Rather than concentrating exposure in a single bond segment, investors can build more resilient portfolios by combining high-quality government bonds, investment grade corporate credit, selected high yield exposure, and emerging market debt.

We view fixed income as Attractive, and we see select opportunities across regions and market segments. The recent sharp rise in yields has created tactical opportunities to add some duration in high quality bonds. Medium- to long-duration, high-quality bonds have scope for price gains and can provide valuable diversification in an economic downturn.

In the Eurozone, the combination of upward-sloping yield curves (where investors are rewarded for taking more interest rate risk) and attractive all-in yields may present some tactical opportunities to extend duration in high-quality European government bonds.

We especially like the most financially sound Northern European issuers. We also see selective opportunities in countries where fiscal and political uncertainty continue to support attractive risk premiums relative to fundamentals.

In credit, stronger investment-grade issuers offer attractive carry across medium tenors, while exposure to higher-risk credit should remain relatively short-dated. We remain more cautious on the longest-dated bonds, given fiscal sustainability concerns and the growing extent of AI-related debt issuance. Investors should calibrate both credit risk and duration to their objectives and investment horizons—for example more income-focused investors may prefer shorter maturities to reduce duration risk.

The investment case for emerging market credit

Emerging market credit remains one of the most compelling opportunities within global fixed income, in our view. We believe the asset class offers attractive income, diversification benefits, and increasingly resilient fundamentals. Many sovereign borrowers have strengthened external balances, while corporate issuers generally maintain conservative leverage and solid earnings momentum.

Supportive technical conditions have also underpinned performance. While spreads are near historically tight levels, return potential continues to be supported by relatively high all-in yields.

Appendix

Non-traditional asset classes are alternative investments that include hedge funds, private equity, private credit, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. **An investment in an alternative investment fund is speculative and involves significant risks.**

Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- **Hedge Fund Risk:** There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- **Managed Futures:** There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- **Real Estate:** There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- **Private Equity:** There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- **Private Credit:** There are risks specifically associated with investing in private credit. This could include losses stemming from defaults on loans, which in significant adverse circumstances could result in a substantial loss of investment.
- **Foreign Exchange/Currency Risk:** Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid and commonly known indices, House View scenarios, and analyst convictions over the next 12 months.
Absolute view
Attractive: We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral: We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive: We consider this asset class to be unattractive. Consider alternative opportunities.
Note: For equities, we have a five-tier rating system with two additional preferences. When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
Relative preferences
For the multi asset view, we also include relative preferences to help investors compare between items.
Preferred: We view this item more favorably than others within its asset class.*
Neutral: We see this item similarly to others within its asset class.*
Least preferred: We view this item less favorably than others within its asset class.*
*In the case of cross-asset, compared to other asset classes.
Note: The tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.

Appendix

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