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Lock in yields

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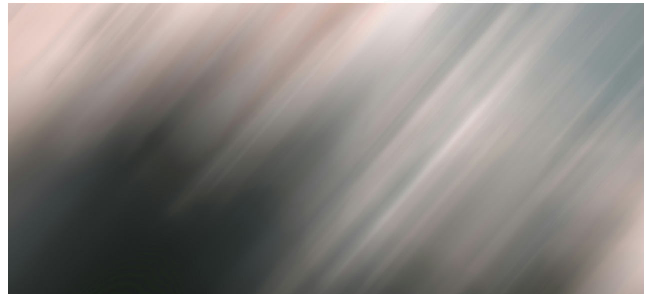
Author: Sagar Khandelwal, Strategist, UBS Switzerland AG

- **Why?** 1) Despite rising and choppier yields, we believe the case for quality bonds as a source of diversification and income is strong in short to medium maturities, as they offer attractive risk-reward. 2) We believe selective allocations to emerging market bonds, high yield, and select subordinated debt can enhance yields while still managing credit, interest rate, and growth risks. 3) A diversified income portfolio should include a mix of strategies, including equity income and yield-generating strategies.
- **Why now?** 1) Elevated levels of uncertainty strengthen the appeal of a diversified stream of income in a portfolio context. 2) Short- and medium-maturity quality bond yields in USD, EUR, and GBP remain above their pre-conflict levels, and could fall if even higher prices weigh on growth and lead central banks to cut policy rates. 3) In the current environment, equity strategies can help boost diversification and income generation.



We believe investors should consider locking in yields through quality short- and medium-maturity bonds as a way to build diversified portfolio income. Source: Marcel Strauss_Unsplash

Build core exposure to quality, short- and medium-maturity government bonds

We believe the recent increases in benchmark government bond yields in USD, EUR, and GBP provide an opportunity for investors looking to lock in elevated yields and diversify portfolios. Despite the extent of moves and some signs of higher volatility in longer-duration debt, we still think highly rated government bonds offer appealing risk-reward qualities across multiple economic scenarios. We believe markets may have moved too far in pricing hawkish monetary policy, even if some near-term rate hikes may happen, for example in the Eurozone. And in alternate scenarios to our base case, yields could fall over the medium term if a more prolonged disruption in oil supply triggers growth concerns, and investors begin to price recession risks and central bank rate cuts.

After many years of strong equity performance relative to bonds, investors may have an opportunity to rebalance toward bonds, to bring allocations back in line with long-term plans, and to help manage potential equity risks. We like looking for opportunities in quality government bonds with short to medium maturities. In Europe, yields may remain volatile as the European Central Bank is likely to tighten policy, so selectivity is important. Even in markets where yields remain low and inflation muted, we still think some allocation to government debt can make sense for adverse economic scenarios, in which government debt tends to rally and yields fall in anticipation of monetary easing. However, we would caution against yield-seeking investors extending their interest rate (duration) exposure in government bonds, as this part of the yield curve is most sensitive to worries about both fiscal sustainability and long-term inflation expectations.

Seek diversified income-paying exposure by favoring credit, equity income, and structures over duration

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For a holistic and well diversified fixed income exposure, especially for investors relying on their portfolio for income, we like select exposure to more growth-sensitive and higher-yielding bond market segments such as emerging markets (EM), high yield, or subordinated debt. Amid elevated geopolitical and sector-specific risks, investors should avoid overexposure to any single segment of the credit market.

EM bonds have benefited from resilient global GDP growth and commodity strength—enhancing their role as a key allocation and alternative to developed market fiscal challenges. Additionally, many emerging markets have maintained restrictive monetary policy to keep inflation in check. This means real rates in the EM complex are high and should benefit from capital inflows looking for diversification away from traditional markets. Despite some expected spread widening, we believe elevated yields and supportive central banks underpin a positive outlook for EM debt, which we rate Attractive, with continued outperformance versus cash expected.

Investors seeking more defensive ways to access higher-yielding bonds amid uncertainty may also look at diversified and risk-controlled tools to invest in subordinated debt, including hybrid bonds. These are a type of subordinated debt instrument issued by investment grade, non-financial companies that blend the characteristics of standard corporate bonds (paying regular interest) and stocks (no fixed maturity date and the ability to defer coupon payments).

Looking across asset classes, we also believe equity income strategies (especially in Switzerland and Southeast Asia), yield-generating structured investment strategies, and multi-asset income approaches that may also include derivative strategies can also support income objectives. However, investors should be willing and able to bear the unique risks of investing in options.

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. Note that 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.
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
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.
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.”

Appendix

Risk information
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