

# Bond Bites

UBS Asset Management | **Fixed Income views**  
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## 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'.<sup>1</sup>

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<sup>2</sup>. 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<sup>3</sup>. 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/>

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