CIO expects the Fed to cut rates by 75-100 basis points by year-end and the European Central Bank to cut rates by 25bps every meeting in the coming months. (UBS)

Why quality bonds remain attractive

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US Treasuries rallied on Monday, with yields falling 8-15 basis points across the curve after a series of steep rises over the past week. The 10-year yield fell 13 basis points to 4.36%, following a 60-basis-point increase last week when Treasuries sold off amid a broader risk-off and deleveraging move.

The rally followed comments from Federal Reserve Governor Christopher Waller, who stated that he expects the impact of President Donald Trump's tariffs on prices to be temporary. He also said that the US central bank is prepared to cut interest rates regardless of whether the tariffs are smaller or larger. This followed remarks from Boston Fed chief Susan Collins last Friday that the central bank would "absolutely be prepared" to help stabilize financial markets if necessary. Separately, Treasury Secretary Scott Bessent said that his department has tools to address dislocations in the bond market if needed.

These comments helped lift investor confidence in US Treasuries and restore the broadly negative return correlation between equities and bonds. They also underscored that while volatility is likely to persist in the near term, quality bonds remain an integral part of a resilient portfolio that can help investors navigate uncertainty ahead.

A functioning US Treasury market is critical to the global financial system, and the Fed stands ready to act if required. Financial instability came back into focus after market corrections morphed into episodes of capitulation across various asset classes, as risk positions were unwound and a dash for cash followed due to either margin calls or the desire for capital preservation. A stable financial system links, at the lowest possible cost, savers seeking to grow their money with borrowers in need of funds. If the role of intermediation between savers and borrowers breaks, it quickly spills over into the real economy of households and businesses, compromising the Fed's goals of maximum employment and stable inflation. While we believe we are not yet at the point where central bank intervention to ensure stability and market functioning is needed, the comments suggest that the importance of US Treasury market functioning and the potential economic spillover effects are too great for the Fed to wait too long to intervene, in our view.

Quality bonds offer attractive risk-reward and benefits of diversification. While we now think the risk of a more severe economic downturn is more limited following the 90-day pause in Trump's "reciprocal" tariffs and we rate US equities as Attractive, we believe high-quality fixed income continues to represent an attractive portfolio diversifier as the broadly negative correlation between stock and bond returns should continue to hold. Historical data since 1900 from the Global Investment Returns Yearbook shows that a diversified 60:40 blended portfolio of US stocks and Treasury bonds delivered an annualized real return of 5.1% (versus 6.6% for stocks and 1.6% for bonds), with lower volatility at 13.4% compared to stocks alone at 19.8%.

Bond yields are appealing as cash rates continue to fall. Despite the risk of higher inflation in the near term in the US, we expect all major central banks (except the Bank of Japan) to ease policy gradually this year. We expect the Fed to cut rates by 75-100 basis points by year-end and the European Central Bank to cut rates by 25bps every meeting in the coming months. With bond yields still at relatively high levels, we believe this creates an opportunity for investors to seek durable portfolio income and optimize cash returns. Switching cash into high-quality bonds and diversified fixed income portfolios can lock in yields, provide robust income, and help dampen portfolio volatility. Historically, the probability of bonds outperforming cash rises with longer holding periods.

So, we continue to recommend investors hold high-quality bonds in a diversified portfolio. Investors can also consider diversified fixed income strategies, senior loans, private credit, and equity income strategies to build diverse and durable portfolio income.

Original report: **Quality bonds remain attractive despite volatility, 15 April 2025.**