Switching cash into high-quality bonds and diversified fixed income portfolios can lock in yields and provide robust income. (UBS)

Current bond yields are appealing for investors seeking durable portfolio income

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US Treasuries gained on Thursday as the latest data showed signs of slowing economic activity, reversing Wednesday's selling across the curve. US producer prices unexpectedly fell in April, and retail sales growth decelerated notably.

The 2-year yield fell 9bps to just below 4%, the 10-year yield eased by 10bps to 4.4%, and the 30-year yield declined to 4.9%. However, yields remain relatively high and close to the level right before US President Donald Trump announced the 90-day pause in “reciprocal" tariffs last month.

Risk sentiment has improved this week following the deescalation of the US-China trade war. With easing recession fears, markets have pared back their expectations for interest rate cuts despite softer-than-expected inflation data. Fed funds futures now point to just 56 basis points of policy easing by year-end, down from 100 basis points around two weeks ago.

Investors are also focused on the potential for proposed tax cuts to lead to bigger budget deficits requiring increases in the supply of Treasury debt. On Wednesday, Republicans in Congress approved tax cuts in a budget package that could push the US deeper in deficit, although there is some way to go before the bill can be signed into law.

But we continue to expect Treasury yields to fall further for the remainder of the year and believe high-quality fixed income remains an important part of portfolio diversification for investors.

Federal Reserve easing is likely to resume later this year. Fed Chair Jerome Powell earlier this month said there was no need to "hurry" in cutting rates given the solid state of the US economy, but he also stressed the elevated economic uncertainty due to tariff policies. Vice Chair Philip Jefferson echoed these comments on Wednesday, saying that tariffs and related uncertainty could slow growth and boost inflation. He highlighted that the Fed's monetary policy is "well positioned to respond in a timely way to potential economic developments." While we believe the US could avoid a full-blown recession this year, slowing growth and a weakening labor market should allow the US central bank to resume cutting interest rates in the coming months. Our base case is for 100 basis points of further easing starting in September.

Quality bonds have historically offered portfolio stability, especially in times of uncertainty. While we have likely moved past peak pessimism in Trump's trade policy, ongoing uncertainty could still trigger further bouts of market volatility. High-quality fixed income represents an attractive portfolio diversifier, in our view. 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%.

Current bond yields are appealing for investors seeking durable portfolio income. The long-term underperformance of cash is a structural phenomenon, and cash rates could fall quickly in the event of further weakness in economic data. With bond yields at relatively high levels, we believe this creates an opportunity for investors to optimize cash returns. Switching cash into high-quality bonds and diversified fixed income portfolios can lock in yields and provide robust income. Historically, the probability of bonds outperforming cash rises with longer holding periods.

So, we continue to rate highly rated government and investment grade bonds as Attractive, and expect them to deliver mid-single-digit returns over the next 12 months. We also see value in diversified fixed income approaches, senior loans, and private credit in a portfolio context.

Original report - **High bond yields create opportunity in portfolios, 16 May 2025.**

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