CIO believes current yields offer an opportunity to lock in income, with returns coming from both yield and capital appreciation, as the Fed resumes easing later this year. (UBS)

Current yields offer an opportunity to lock in income

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As markets get back into full swing after holidays in the US and UK, sentiment in the bond market started the week on a more positive note. Last week was dominated by worries over the trajectory of government borrowing in the US and beyond. This took a toll on quality bonds, especially at the long end of the curve.

Notably, investors have been concerned with the potential for President Trump’s sweeping US tax and spending bill, which won approval from the House of Representatives last week, to add trillions to government debt over the coming decade. That helped push the 30-year US Treasury yield as high as 5.15%, a level last seen in October 2023.

Weak investor demand for a 20-year Japanese bond auction, along with negative comments from the prime minister on the state of the nation’s public finances, also sent yields higher. And in Europe, the focus has been on fiscal strains as nations boost defense spending at a time when sluggish growth is depressing tax revenues.

News in Japan helped dampen anxiety this week, with Reuters reporting that the Ministry of Finance plans to trim ultra-long issuance in response to recent turbulence—contributing to a roughly 16-basis-point decline in the 30-year yield. This chimes with our view that policymakers will respond to excessive swings in fixed income markets if needed. The Trump administration has already shown a willingness to shift policy in response to rapidly rising yields, including pausing the “reciprocal” tariffs that unsettled markets in April. The Fed has also indicated its readiness to act if fixed income markets become dysfunctional.

While we advise investors to brace for further volatility in fixed income markets, especially as Trump's fiscal package progresses through Congress, the recent rise in yields has presented an opportunity for investors. More broadly, we see several ways for investors to add durable income to portfolios.

High grade and investment grade bonds offer appealing risk-reward, in our view. We believe yields on quality bonds in most major markets are attractive, and we anticipate the continuing global rate-cutting cycle will contribute to investor inflows. We also continue to see government bonds as a credible alternative to cash for investors looking to lock in currently elevated yields. Investment grade bonds are also appealing from a risk management perspective, especially as economic growth slows. We see an opportunity for investors to switch cash into high-quality bonds to lock in yields, dampen overall portfolio volatility, and provide additional robust income.

Complementing quality bonds with select short- and medium-duration riskier credit investments can enhance diversification and returns. US high yield bonds now offer a yield of close to 7.9%, as of 23 May, with almost 6% on euro high yield, levels we expect to attract capital inflows. Adding select emerging market bonds, senior, loans, and private credit can provide an additional boost to income while offering access to different drivers of return.

Income investors should not neglect equity strategies. Such approaches include high dividend, dividend growth, or yield-generating structured investments. Structures such as put writing and covered call writing can enhance income potential by harvesting volatility premia, can diversify portfolio income sources, and may be treated as capital gains in some jurisdictions. We estimate that mixing high dividend, dividend growth, and option strategies could deliver a total yield of around 5-7% per year. Options do carry unique risks that investors must be aware of before engaging in them.

So, we believe current yields offer an opportunity to lock in income, with returns coming from both yield and capital appreciation, as the Fed resumes easing later this year. We expect coupons for senior loans and private credit to fall alongside rates, potentially rewarding early investment.

Original report - **Mood improves in fixed income markets, 27 May 2025.**

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