

We meet again, Mr. Bond - Opportunity in fixed income

'We meet again, Mr. Bond', is a phrase from one of the UK's greatest franchises, James Bond, which immortalised in encounters with Bond villains the likes of Auris Goldfinger and Ernst Blofeld. Now, as much as I would love to write a note about James Bond and the truckload of speculation about the next casting for this great UK franchise, I will instead look at the nuance in the phrase.

In the world of finance, the villain currently is the bond market, with so many experienced investors having been hurt this year from buying into the bond market rally after its historic selloff, which in 2022 was one of the worst on record. This has of course failed to materalise in any sort of rally because the economy has been so unbelievably strong, leaving investors sat on the sidelines nursing losses that led to the slightly embarrassing catchphrase for bond holders in 2023, 'long and wrong!'.

Now, those of you sat in short dated bond funds or cash funds, the likes of which are in our Liquidity Plus portfolio, I doff my cap to you, as this will likely have been the best bond investment you will have made this year. Pour yourself a martini (shaken, not stirred) and read on.

We have, over the past two weeks, reached a level of pain in the US Treasury market which has been at its most acute in 2023. To illustrate, 10-year US Treasury bonds have reached a 5% yield (yields go up when bond prices come down). A 5% yield is somewhat of a watershed moment for 10-year bonds because 5% is a level that almost no investor thought it would reach (this means that the price of bonds has sold off more than almost anyone thought it would).

The last time bonds hit a 5% yield was 16 years ago in the summer of 2007, and we all know what happened to the economy shortly after in 2008... so this 5% level has some a little concerned, hence the 'We meet again, Mr. Bond' reference.

So, why have bonds performed so badly this year, and will they roar back to life as some, including TAM, hope they will?

- The market is very worried that inflation isn't going to get back to 2% without either, a) interest rates going even higher, or b) current rates staying where they are but remaining here for a lot longer than previously thought. These have been the headline worries which have kept the bond market strapped to a table with a big lazer in between its legs, à la 'Goldfinger'.
- Big economies are now trying to undo the "quantitative easing" experiment that was enacted after 2008 in which governments printed money to stimulate the economy. Cutting a long story short – that money is now due to be paid back and it's being paid back via governments selling massive quantities of bonds back into the market, which is essentially increasing the supply of bonds into a market where demand is quite weak.

So why are some investors, like TAM, remaining in bonds given all the failed starts this year? Firstly, we are buying the bonds of high-quality companies which we think are showing fantastic long-term value, some say a generational opportunity. Rolls Royce bonds are always seen as a safe investment for bond investors and these bonds are trading at roughly a 50% discount. So yes, we are worried about the market's condition, but if the market gives you the opportunity to own high-quality bonds at very attractive yields / prices and sit on these for a long time with a positive yield, we think that's a great store of value for clients.

The second piece is this 5% yield on US government bonds. Yes, that's a painful number for a US Treasury bond which is just about the safest investment one can make. However, as mentioned previously, the last time we hit 5% was 2007, before the 2008 financial crash. Yes, the 2023 economy is not back at 2008, but with the US Treasury yield back at 5%, this does put a heck of a lot of stress on all manner of economic plumbing in the US, and when the plumbing broke in 2008, the same US Treasury bond rallied 30%.

So, forgive me for sounding like a Bond villain with all this talk of 2008, we don't think we are going back there, but with US Treasuries back at historic lows and there being a roughly 50% chance of a recession in the next 12 months, we almost see it as our duty to buy that 5% yield on US Treasuries as an insurance policy in case the worst should happen. Yes, we did invest at that point and yes, we are already making our clients money from that investment.

Hopefully that paints a picture of a negative bond market, but a market not only containing fantastic long-term income opportunities for clients, but also one offing recession insurance investment (US Treasuries) at prices we haven't seen for 16 years.

Most of you will know that TAM has, and always will be, a manager who values cautious investing, and these types of investments will continually form a core element of our defensive capabilities on behalf of our clients' wealth.

So, until we meet again, Mr. Bond.

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