12-30-2024

WSJ Print Edition

Hopes for a Bond Recovery Fade

BY SAM GOLDFARB

Wall Street investors entered each of the past two years brimming with optimism about U.S. Treasurys and other types of high-quality debt. Each time, they were disappointed.

Now, they are far more guarded. In recent weeks, money managers have been dumping Treasurys, while savers have been rushing out of longer-term bond funds.

All that selling has pushed Treasury yields to the upper end of their two-year range. Still, investors remain worried that a tough environment for bonds could get even worse if President-elect Donald Trump pursues inflationary policies such as new tariffs. Many are debating whether hiding out in shortterm T-bills could again be the smarter play.

"Cash is yielding 4-plus percent," said Ed Al-Hussainy, global interest-rate strategist at Columbia Threadneedle Investments. "That's a pretty tough bogey to beat."

Such doubts represent a big shift on Wall Street.

Just a few years ago, bonds were enjoying a decadeslong bull run and investors hardly feared higher rates. They generally assumed rates couldn't rise much above zero without triggering a recession.

When the Federal Reserve raised rates aggressively in 2022, most investors still believed it was only a passing phase. Through 2023, they consistently bet on a quicker and sharper turn to lower rates than the Fed itself was forecasting.

Now, though, more investors have come to believe that the economy can handle higher rates and that inflation will persist as a threat.

Starting in November, investors were ahead of the Fed

in betting that the central bank would reduce rates just twice next year, rather than the four times officials signaled in September. When most Fed officials also forecast two cuts in their Dec. 18 economic projections, traders immediately stepped up bets that the central bank would cut once, or not at all.

Those wagers have taken a toll on bond returns.

As of Dec. 26, an ICE BofA index of U.S. Treasurys was poised to deliver worse returns than T-bills for the fourth straight year, having returned 0.4% compared with T-bills' 5.2%. The widely tracked Bloomberg U.S. Aggregate Index, which includes investment-grade corporate bonds and mortgage-backed securities as well as Treasurys, has returned 1.1%, after barely outperforming T-bills in 2023 and falling short the previous two years.

In the past, bonds would usually follow a bad year with a good year. That hasn't happened recently, prompting "this reluctance to deal with the asset class," said Brian Nick, head of portfolio strategy at NewEdge Wealth.

Investors have pulled $5.3 billion out of BlackRock's iShares 20+ Year Treasury Bond ETF this month, according to FactSet. If that number holds to the end of December, it would be the largest monthly outflow in the fund's 22-year history.

Tumbling bond prices pushed the yield on the benchmark 10-year U.S. Treasury note up to 4.619% as of Friday, according to Tradeweb. That was up from 4.192% at the end of November and 3.860% at the end of 2023.

For personal, non-commercial use only.

Rising yields create their own headwinds for the economy because Treasury yields set a floor on an array of borrowing costs. Their recent uptick has already driven average 30-year mortgage rates back up near 7%, extending a deep slump in home buying.

Pressure on bonds also can squeeze riskier assets. Stock valuations are currently lofty by most measures, but particularly so when weighed against the risk-free return investors can get by holding a 10-year Treasury note to maturity.

Historically, that has meant that stocks have struggled to outperform bonds over the next 10 years, according to data compiled by the economist Robert Shiller.

Investors should own "at least as many bonds in your portfolio as you normally would, and maybe even more if you are sort of setting this and forgetting it for a very long period of time," said Nick of NewEdge Wealth. "Bonds are offering you more value than the broad equity market is."

Still, many others are hesitant. The 10-year yield could easily climb above 5% if Trump adds to inflation by raising tariffs and can't curb increases in the supply of Treasurys by reducing the budget deficit, said Yung-Yu Ma, chief investment officer at BMO Wealth Management.

In hindsight, it is the lowrate world of the 2010s that is starting to look as though it was "a complete bubble" for bonds, he added.

For personal, non-commercial use only.

Copyright (c)2024 Dow Jones & Company, Inc. All Rights Reserved. 12/30/2024
Powered by TECNAVIA

The following is a digital replica of content from the print newspaper and is intended for the personal use of our members. For commercial reproduction or distribution of Dow Jones printed content, contact: Dow Jones Reprints & Licensing at (800) 843-0008 or visit djreprints.com.

Copyright (c)2024 Dow Jones & Company, Inc. All Rights Reserved. 12/30/2024