

Asset Class Investment Strategies
Government Bonds

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Major Trends

Higher Yields: 10-year bond yields in the US, UK and Europe are at the highest levels since early 2019, having steadily risen over the last 12 months on inflation concerns. In the US and UK, yields are now just below their 10-year average of 2.0% and 1.4%, respectively.

Quantitative tightening to begin this year: The balance sheets of major developed market central banks are expected to contract by c. \$220B in 2022 and by \$1.4T in 2023.

Net bond issuance will be very large in 2022: Coupon bond issuance net of maturing bonds and central bank purchases will be close to US\$2T across major DM countries. This is the third-highest amount of net issuance since 2007, with only 2009 and 2010 seeing higher levels of new supply. Total new issuance was c. 34% higher in 2021, but much of this was absorbed by central banks.

Exhibit 1
10-year yields are back to 2019 levels


Source: Bloomberg

Golden Rules

- Investors should gain interest rate exposure in the most cost-effective and tax-efficient manner possible. This is typically via passive ETFs or futures.
- Investors should typically own bonds denominated in their home currency, i.e., the currency in which their future liabilities are likely to be incurred.

2022 Strategic Priorities

- Low yields mean that 10-year bonds remain an unattractive use of capital relative to alternatives such as liquid Absolute Return strategies, Inflation-Linked Bonds and other Uncorrelated Strategies.
- We will look to reduce our duration underweight in USD and GBP portfolios if the 10-year yield on Treasuries and Gilts rises above 2.5%, and in EUR portfolios if the German Bund yield rises above 1.5%. These are approximate levels and are contingent on several factors, most importantly the relative attractiveness of the alternatives at the time.

Expected 12-Month Return
Exhibit 2
Expected returns by scenario

	Recovery Falters (10%)	Stagflation (10%)	Gradual Normalisation (60%)	Reflation 2.0 (20%)	Expected Value
Fixed Income	9.6%	-12.5%	-3.7%	-8.1%	-4.1%
Notes	Assumes 10yr US Treasury yield drops to 1.0% in a negative growth shock, rises to 2.5% in the base case, 3.0% in a stronger reflationary environment and 3.5% if economy enters stagflation.				

Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not a reliable indicator of future performance.

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