

Bonds are Back: Where to Look, What to Do in 2024

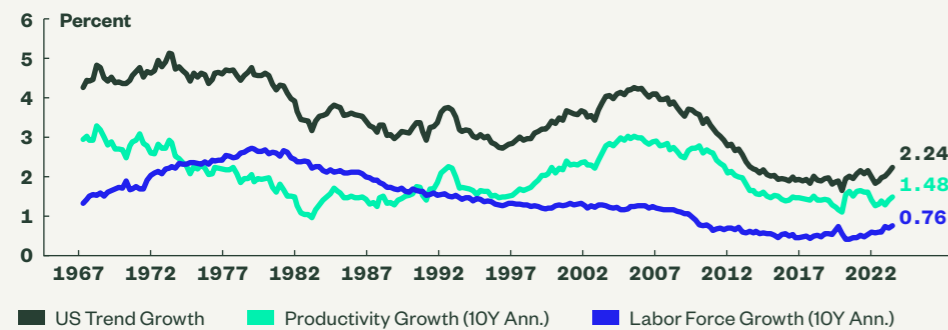
Why

A Rare Synchrony of Cyclical and Structural

On the **cyclical side**, three interrelated dynamics are in play: a slowing labour market and economy, rapidly cooling inflation and as a consequence real interest rates set at an overly restrictive level.

On the **structural side**, a more gradual, yet potent, dynamic is in motion: modest labour force expansion and waning productivity growth point to an economy whose safe operating speed or trend growth is declining.

US Structural Trends Anchor Yields



As of 30 September 2023.

Overly Restrictive Real Rates

The Federal Reserve's current projections imply real interest rates will remain overly restrictive for years to come — well above its own estimate of longer run neutral. A relenting Fed will **unlock value** in US Treasuries. An intransigent Fed may unlock even more value in them!

Projections for Real Fed Funds Rate



All sources State Street Global Advisors. Examples are for illustrative purposes only. Past performance is not a reliable indicator of future performance.

Where to Look

A Return to Sovereigns

Sovereign fixed income, and US Treasuries in particular, offers investors an attractive proposition over the medium term.

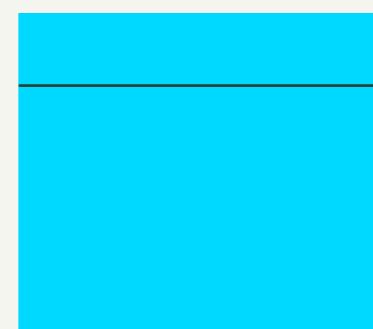
The **US Treasury** market is probably best placed to capture our favourable view on duration. The picture varies by region and country, the short end of several sovereign debt markets also presents a **compelling yield-duration** profile for those investors unwilling to embrace duration more fully.

Emerging Market Debt

Hard currency EM sovereign debt currently looks attractive. With spreads in the high yield subsegment trading well above their long-term average, markets have already priced in most credit events.

Current HY EM Spread

> 700 bps



EM local currency debt (EMD LC) has become a lot more complex, EM monetary policy has decoupled from the Fed and a strong US dollar is clouding the outlook. However, real yields have now turned positive for some of the largest issuers, and even though this is still below US Treasuries, it offers a pick-up versus the euro area.

Fixed income is probably the most attractive asset class from a risk/reward perspective this year.

Where to Be Patient

Credit

A slowing economy and advancing credit cycle will present challenges to corporate income and balance sheets. Therefore, we expect that there will be more rewarding entry levels for credit investors in the coming quarters.

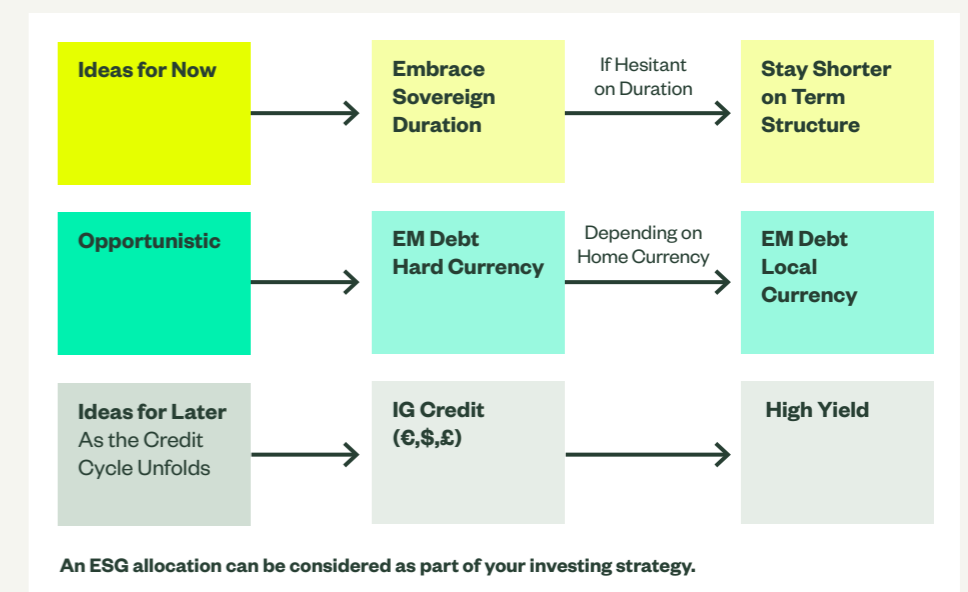
High Yield

High yield debt has been trading at relatively compressed spreads. Default rates are currently quite modest but can only rise as our predicted slowdown bites in 2024.

How to Play It

Indexing for Modern Fixed Income

- Cost-effective, reliable exposures
- Clear risk/return drivers
- Broad, liquid and nimble



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