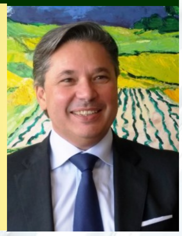
WEEKLY ANALYSIS



Mr. Alain Freymond—Partner & CIO

INTERNATIONAL BONDS

The yield curve has started to steepen. Rising yields for dollar bonds. Long-term yields also starting to rise in Europe. Trend reversal in the sterling bond market.

Key Points

- Rising yields for dollar bonds
- Long-term yields also starting to rise in Europe
- Stability of Japanese long-term rates

The yield curve has started to steepen

In the spring of 2021, yield curves had benefited greatly from increasing economic uncertainty linked to the emergence of the Delta variant. A general drop of around 30 to 50 basis points could be seen in various bond markets. Central banks' communication on inflation was one of the determining factors in the overall decline in yields. The change in central banks' perception of the outlook for inflation and economic growth is already affecting investor sentiment in bond markets. In just a few days after the announcement on 22 September of the Fed's upcoming tapering, the rise in yields has intensified. In the US, 10-year Treasury yields rebounded from 1.30% to 1.57%, though still below the March level of 1.7%.

In the UK, the acceleration took 10-year gilt yields from 0.8% to 1.15% in ten days. Overall, we believe that yield curves are starting to steepen, with varying degrees of intensity across countries. However, the correlation among interest rate markets remains significant, as illustrated by the rise in the 10-year Swiss government yield from -0.4% in August to -0.10% today.

Recall that before the health crisis, US GDP growth was +2%, and 10-year US dollar yields were also at 2% with inflation at +2.3%.

The comparison with the current situation offers a clear indication that US growth and inflation above +5% suggest a very sharp rise in long rates. We therefore believe that a steepening of the yield curve is essential given the above-mentioned normalisation of monetary policies in the coming quarters.

Rising yields for dollar bonds

As we have been saying for several months, we felt that a rise in long-term rates in 2021 was inevitable in the context of a very clear improvement in the US economic outlook. The 50-basis-point rise in 10-year Treasury rates in the second half of 2020 was merely the announcement of a trend reversal that was expected to strengthen and become more pronounced in 2021. The emergence of the Delta variant temporarily disrupted the analysis and the economic outlook.

But it was mainly the Federal Reserve's comments on the inflation issue that served as a catalyst for the decline in bond yields that materialised between spring and early summer.

These temporary growth uncertainties and inflation deemed temporary by the Fed were enough to reignite a decline in yields until August. Chairman Powell's announcement of a forthcoming tapering was partly expected, but it is now becoming clear that rates must adjust to a robust and inflationary economic reality.

We believe that dollar yield curves will soon move upwards with the exception of very short-term yields. Yield pick-up strategies are therefore being challenged by rising returns on more defensive bond assets. Internationally, US bonds now also offer a safe haven with the prospect of an attractive yield spread.