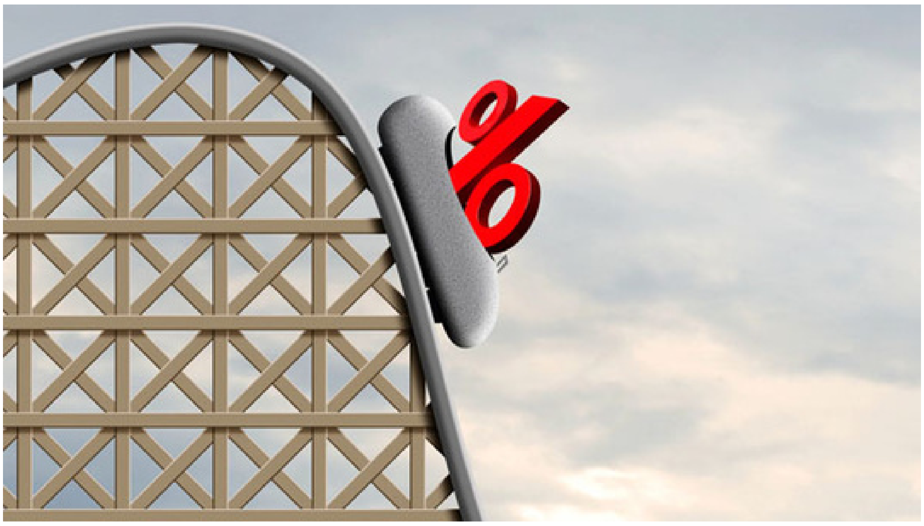
BEA Union Investment

As the rate-cutting cycle begins, seek opportunities with risk appetite

Following the September FOMC meeting, the Fed lowered rates by 50bp as anticipated, marking the start of a more accommodative monetary policy. As savings rates drop and market volatility increases, investors may want to reconsider their asset allocations and explore various strategies to better manage their funds during this period of uncertainty.



Investors with a higher risk tolerance are probably accustomed to navigating the stock market for income and growth. Easing monetary policy, falling inflation, and the prospect for economic resilience may have bolstered investor confidence towards embracing market undercurrents. However, equities have already seen significant gains so far this year, and with the looming US election, elevated geopolitical tensions, and flip-flopping expectations of the rate-cut trajectory, rising market volatility deems probable. Historical data suggests that equities typically establish a clear upward trend about six months after the Fed starts cutting rates. Investors who have second thoughts about investing in stocks at this point may consider exploring short-term bond strategies for locking in high yields and adjusting their portfolios once market visibility improves.

Highlights

- **Short-term bond prices are relatively stable, reducing concerns about price fluctuations,**
- **Long-term bonds provide steady income over the long term, along with potential for capital appreciation.**
- **Aligning investments with your risk appetite is key to navigating this evolving landscape.**

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Short-term bond rates appealing with relatively low risk; long-term bonds present capital gain potential

With stronger supply and liquidity, short-term bond prices remain relatively steady even during turbulent times. With comparatively low mark-to-market risks, investors will have fewer worries about price volatility while having greater flexibility in managing funds according to market conditions and individual needs. Short-term investment-grade bonds have higher credit ratings and robust fundamentals. The instrument's shorter maturities mean the asset class has lower default risks than debts with longer tenors. Although rates are declining, yields remain appealing since the market is still in the nascent stage of the rate-cut cycle. For instance, short-term UK and US financial bonds are still offering alluring yields in the range of 5-6%.

Over the past decade, US real interest rates typically hover between 0% and 0.5%. Assuming inflation should hold steady at 2.5-2.75%, a reasonable target range for the Fed Funds rate would be around 3-3.25%, implying room for rate cuts of another 200 basis points. Those who are willing to take on slightly higher risk in exchange for a steady source of long-term income can explore the opportunities presented by long-term bonds. With longer maturities, long-term bonds are more affected by changes in the macroeconomy, issuer credit fundamentals and rate movements. This means long-term bonds come with higher risks and volatility than short-term debts, but in return, investors are able to lock in higher yields over a longer period for bonds with lengthier maturities. In addition, given the inverse relationship between rates and bond prices, long-term bonds often experience bigger price increases when rates drop, presenting a compelling opportunity for capital gains in a rate-cut cycle.

The fundamentals and technicals of Asian bonds remain favourable. During the last cycle, Asia faced moderate inflationary pressure, resulting in more tempered rate hikes versus those in the developed countries. Although uncertainties such as the approaching US election could trigger market fluctuations, the Asian bond market generally exhibits lower volatility. When a correction occurs, many institutional investors perceive it as a window of opportunity for bargain hunting, lending support to the market. Currently, there is a plethora of options across long-term Asian investment-grade bonds offering average yields above 5%. Sectors worth noting include South Korean financials, Indonesian green metal exporters, and Chinese technology, media and telecommunications.

At the end of the day, whether to invest in short-term or long-term bonds, or equities, ultimately comes down to the individual investor's risk appetite and personal objective.

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