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Moves to Make as the Bond Market Sinks.

As stocks rose after Trump's election victory, bonds tumbled. But the worst may soon be over.

While the stock market held an election celebration last week, the bond market threw a Trump tantrum. Yields rose sharply, especially those on long-term Treasuries. The 30-year bond climbed 0.3 percentage point to 2.94%, resulting in a 6.3% decline in price. (Bond prices move inversely to yields.) The 10-year Treasury yield climbed almost as much, to 2.15%, the first time since January it has topped the 2% mark.

It wasn't just Treasuries. Municipal bonds, corporate bonds, and preferred securities all fell. Bloomberg estimates $1 trillion in the value of bonds evaporated last week after the election. Stocks bought for yield, like utilities and real estate investment trusts, suffered too.

The main reason for the rate surge is the expectation that inflation will rise. Thanks to the Republican sweep, investors are betting Donald J. Trump will be able to implement tax cuts, increase infrastructure spending, and ease regulations, stimulating economic growth. Trade restrictions, a key pillar of the Trump platform, would also spur inflation, even while impeding growth.

Rate strategists believe yields could rise further when markets reopen Monday after the Veterans Day holiday Friday. But there are reasons to expect the spike to end fairly soon. Yields may rise another 0.2 to 0.3 percentage point this year, says Raman Srivastava, deputy chief investment officer at Standish Mellon. But he doesn't expect anything like the spike in yields in 2013 that took the 10-year Treasury to 3%.

For starters, the Federal Reserve remains likely to raise short-term rates in mid-December, which should act to dampen inflation expectations. Even if all goes as planned for Trump, the economic growth the market is forecasting will take time to materialize. For example, it will take at least until the end of next year before growth from infrastructure spending could emerge, says Srivastava. Longer term, demographic and global macroeconomic trends are going to restrain inflation. "Structurally, I don't see a shift," he says.

And the president-elect may face more hurdles implementing his policies than many expect. "Investors shouldn't take this past week too much to heart," says Dan Heckman, fixed-income strategist at U.S. Bank Wealth Management. "There has been a lot of anticipation of certain things happening, but the reality is that we don't know if they are going to come to fruition or not."

A FEW TRUMP MISSTEPS, and the stock market could get less optimistic. "I expect volatility in the markets over the next few months going into the first 100 days," says Michael Arone, chief investment strategist at State Street Global Advisors.

Owning bonds as a buffer against that volatility makes sense, but investors need to "pivot" for a rising-rate environment, he says. Stay in government bonds, but shorten maturities and add some Treasury Inflation-Protected Securities, Arone suggests. He is overweighting corporate credit—both high-yield and investment-grade—and adding some floating-rate securities, like senior loans.

Consider a barbell approach, balancing longer-term, higher-yielding bonds with short-term debt that can be reinvested at higher yields as rates rise, suggests Heckman. Srivastava encourages diversifying—including globally—as some bond markets may have overshot to the downside.

Munis may already be an opportunity, argues John Miller, head of Nuveen’s municipal-bond group. Yields jumped 0.25 percentage point last week. “If one can get over the shock of how fast that move was, I would say this does look like a good opportunity to put money to work for the long run,” he says.

To be sure, it’s still early to buy more bonds; no one wants to catch a falling knife. But selling off high-quality issues in your portfolio now doesn’t seem like the right move either.

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By AMEY STONE

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