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The Fed Is Cutting Rates: It’s Bonds’ Time To Shine - J.P. Morgan

Investors often employ bonds to play the role of income generators and diversifiers against equity market volatility. After more than a decade of low base rates that kept all-in yields fairly uninspiring following the Global Financial Crisis, many investors have renewed their interest in the asset class following the pandemic-era rate hiking cycle. But now that central banks are embarking on rate cutting paths, here are three reasons to consider core bonds today:

- **All-in yields look attractive.** Yields on bonds with duration of one year or longer have bounced off of their lows over the past month, refreshing bond investors’ entry point for the better. The investment grade corporate bond Index and municipal bond index (on a tax-equivalent basis) have starting yields that beat that of 3-month Treasury Bills, which we use to proxy the yield on cash.
- **As an investment asset, bonds tend to beat cash.** Federal Reserve rate cuts are underway, and history suggests that core bonds tend to outperform cash when that’s the case. Over the past 12 cutting cycles, core bonds have generated an average return of 17% versus 7% for cash. We have been advocating for investors to right-size their liquidity positions all year, and it’s not too late – if you’re holding onto more cash than you need to cover day-to-day expenses, three to six months’ worth of emergency savings and expenditures expected over the next year or so, consider if it makes sense to extend duration on the excess.
- **If things go awry, the Fed might cut faster.** Given resilience in economic data, markets are currently pricing in a gradual path of rate cuts (i.e., just about 1% point of rate cuts over the next four meetings, or less than 25 basis points per meeting). It’s important to note, however, that the Fed’s focus has started to shift away from inflation and towards keeping the labor market healthy. Therefore, if employment data comes in weaker than expected going forward due to disruptions from recent hurricanes and labor strikes, the Fed is likely to cut faster. Decreases in yields translate to increases in prices of bonds, supporting a bond investor’s total return.

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