PRUDENTIAL
INVESTMENT MANAGERS

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# Falling global bond yields: A threat and an opportunity

In this time of extreme global market volatility arising from the threat of the Coronavirus (Covid-19) pandemic, it would be remiss not to firstly urge South Africans not to panic – not in their behavior towards others, not in their buying, and especially not in their investing. We have been through challenging times like these, and have proved that we are capable of successfully overcoming the challenges thrown at us by global events, no matter how unusual.

There is no doubt about the tragic impact that the virus is having on the lives of millions of people around the world, nor its negative effects on the global economy, as well as our own. The ultimate severity of any downturn can only be gauged as events unfold, but its impact can hopefully be mitigated by the measures governments around the world are taking now, including our own. Not only has the South African government undertaken measures to help individuals and small businesses, but the South African Reserve Bank has now cut interest rates by a full

200 basis points to help ease the negative impact on our economic growth. It is equally up to us all to do our part in stemming the extent of the crisis.

## Global bonds now risky assets

At Prudential we believe falling global interest rates and record-low government bond yields in developed markets represent a considerable threat to global financial assets and investor returns for the foreseeable future. This has become an even bigger challenge in recent weeks as global government bonds have rallied even further. Adding to this, central banks around the world, have aggressively lowered their benchmark interest rates

Now most longer-dated government bonds  across the world are offering negative real returns, meaning that investors are willing to accept guaranteed losses for lending governments money over time.  These assets used to be "insurance assets" to hold in retirement portfolios that paid you a steady, positive real return, but now could in fact be quite risky assets to hold.

What are the implications for investors' global portfolios going forward? Global balanced funds with 60% equities/40% bonds asset allocation –  traditionally a broadly accepted split– will likely be challenged to produce solid, long-term inflation-beating returns compared to their history, even with lower inflation. The reason for this is simply that the 40% allocation to bonds has a starting yield of a negative return, so if these assets are held to maturity investors would earn negative real returns on a large part of the portfolio.  Passive products, too, may be challenged in this regard. Some very active trading will be needed to pick the correct bonds and end up with positive real returns over time. This does go against the established ideas of bonds as a relative "safe haven" asset.

## Avoiding developed government bonds

We have been avoiding global developed market government bond exposure, preferring to hold US and European corporate bonds, and emerging market government bonds instead.  We believe that the latter are especially well-valued now after having underperformed their developed market sovereign counterparts in the past few years, even as their risk has broadly improved. This has come on the back of falling inflation, better governance, improved debt management and steady economic growth in many of these emerging markets.

For more information, please feel free to call our Client Services Team on 0860 105 77 or email us at **query@prudential.co.za**.