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## With Treasury yields rising, other bonds could soon follow

◆ The yield on the 10-year US Treasury notes increased almost 16 basis points this week amid hopes of a coronavirus vaccine breakthrough.

◆ The benchmark note is now offering its highest return since late March.

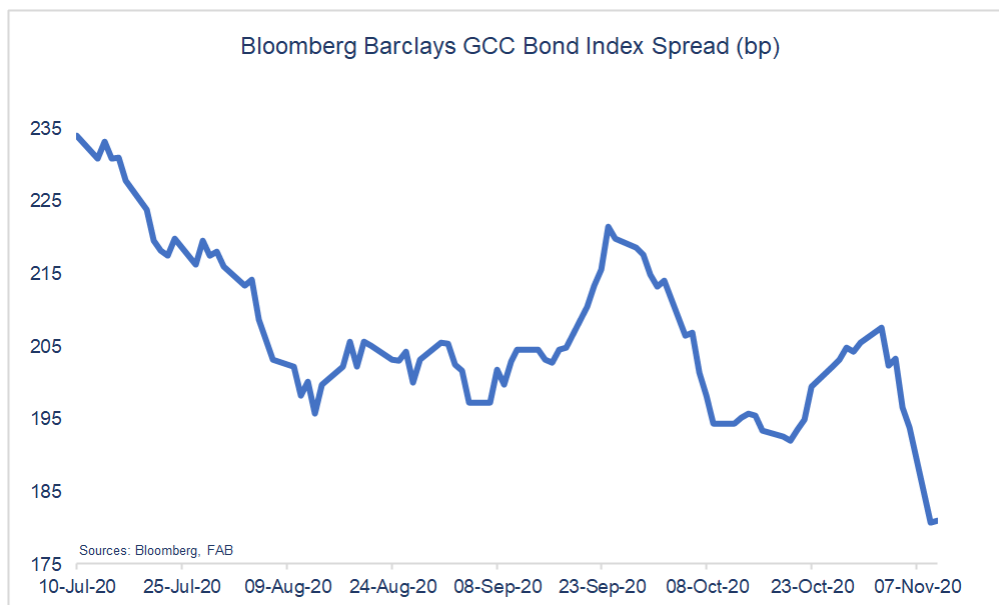
◆ GCC bonds still have not fully matched the move.

◆ A significant drop in the yield premium of bonds in the region indicates GCC spreads could widen if Treasuries fail to rally in the next days.

◆ The FAB AAC remains marginally underweight in stocks and overweight in EM and IG bonds.

Investors holding US dollar bonds tend to benchmark everything against US Treasuries, often referred to as the risk-free rate. As a result, when Treasuries drop, all the other forms of bonds tend to do so too. The move, however, is seldom in tandem. So-called spreads, the yield premium paid by riskier debt than Treasuries, usually tighten first, when Treasury yields rise, and only later catch up. This may be happening right now with bonds of the Gulf Cooperation Council.

Just in the past three days of trading, the spread on the Bloomberg Barclays GCC index, which encompasses both investment-grade and high-yield bonds in the region, has increased nearly 13 basis points. Most of the move is simply a reflection of a 15.7 basis points increase in the yield of 10-year US Treasuries, the main benchmark to watch when evaluating GCC bonds. Unfortunately, if the yield on long-dated Treasuries remains high, the price of GCC bonds is likely to fall.



Higher yield for bonds in the region, however, may represent more of an opportunity than a risk. There is reason to believe that US Treasury yields will soon hit a ceiling, with the move of the past few days offering hints of a shift in positioning.

Aside from selling Treasuries, investors have also started to price in a higher likelihood of a Federal Reserve interest rate hike by January 2022. Given the dual mandate of the Fed, which targets unemployment of about 4% and inflation around 2%, that is highly unlikely to happen, and Fed officials have repeatedly said just that.

US unemployment remains at 6.9% and there are signs that it could rise before it continues to fall and goes back to the lows of January. Core personal consumption expenditure, the inflation gauge favoured by the Fed, is still at 1.5%, and the Board of Governors recently tweaked the framework to allow inflation to run above 2% for a while before hiking rates.

### The premium on GCC bonds fell 13 basis points this week to the lowest since March

Moves in the 10-year US Treasury, however, can be self-fulfilling. Because the market is used as a hedge for many kinds of investors which have long-dated assets, whenever the yields rise, these investors tend to short the Treasury futures and make yields rise further. Barring these technical moves, the yield on the 10-year US Treasury seems likely to stay within a range of 0.5% and 1%.

In other words, it may take a few days for the impact of the repositioning to run its course. The trend for spreads in the region is down, but in the short-term they could rise. In the process, some bonds in the GCC will get cheaper. That may offer a good chance to pick up good assets at cheaper levels which may rally again once the world's benchmark settles down.

## Investment Strategy Update

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