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Bond Market in Flux

Secure investment class not as attractive, market pros say

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The last few years have seen an unusually high amount of activity in the bond market, as many investors fled the Wall Street stocks that shed much of their value through 2008 and early 2009.

Treasury bonds have been particularly active for many investors because of their stability and history of steady rates of return. Corporate and foreign government bonds also saw higher levels of activity, for similar reasons.

The stock market has posted significant gains, along with some hefty losses, since March of 2009, when many analysts suggest that economic recovery began, which has helped shift some investors out of the bond market. The increasingly likelihood that the Federal Reserve will continue its practices of quantitative easing (through the purchase of government bonds), will also likely make the bond market less attractive to investors, several Milwaukee-area bond market professionals suggest.

“We do not find much value in the bond market,” said Dave Carroll, senior portfolio manager in the private client group at Milwaukee-based Cleary Gull Inc. “When you look at the (bond) market historically, the real rate of return is about 1.5 percent over inflation. That’s pretty fair, unless you really think we’re headed into deflation. And we think the Fed will do whatever it can to prevent that.”

Jason Weiner, senior fixed income fund manager with M&I Investment Management, agreed.

“The markets are slowly healing themselves and the bond market is reflective of that,” he said. “I need to be defensive and keep an eye on inflation and if the needle moves toward deflation, that’s the bond market’s worst enemy.”

The Fed’s policies have created volatility in the bond market, said Paul Winghart, fixed income portfolio strategist in RBC Wealth Management’s Minneapolis office.

“At this point, the heavy hand approach toward monetary policy is keeping interest rates (low) on the shorter end of the yield curve,” he said. “It’s created a lot of volatility in general. We’re seeing quite a bit of volatility in the fixed income markets, big swings in rates.”

The move by the Fed to continue quantitative easing is pushing many bond market professionals into other asset classes to gain satisfactory investment yields for clients, Weiner said.

Cleary Gull’s private client group has recently extended the duration of some of its bonds to maximize yield because of falling rates on five-year notes. It’s also purchased high-quality corporate bonds to pick up additional basis points, Carroll said.

The group is also considering moving client assets away from the bond market.

“We’re exploring if we will reallocate out of the bond market,” he said. “We’ve talked internally about moving into some higher quality equities with a nice dividend on them.”

While the stock market slumped, the U.S. Treasury bond market saw steady rates of return between four and five percent for many investors for most of 2007 and 2008 (with the exception of a dip in mid-2008). Those rates of return are not likely next year, Weiner said.

“We’ll have to take two, two-and-a-half percent, which is pushing (many investors) into other avenues,” Weiner said. “But it’s hard to define this as a bubble. There’s still a lot of money flowing into the sector.”

Carroll agreed, and said that recent speculation about a potential bubble in the bond market is without merit. However, Cleary Gull has moved some client assets into other bond markets to gain some higher rates of return.

“We have moved up to 10 percent of our bond portfolios offshore with a global bond fund,” Carroll said. “We wanted to get a little non-dollar exposure because we think the dollar will be in a secular decline over the next year.”

Winghart believes many investors who have a portion of assets in the bond market will see the value in maintaining a presence there in the long term.

“I think the value in fixed income (assets) has made an impression on clients,” he said. “I think (many investors) will be more apt to having a portion of their assets exposed to it.”