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Opportunities from the bond selloff

The selloff in bonds is creating tactical and medium-term opportunities for investors. September's surge in bond yields has created a compelling risk-reward for investors with 6-12-month horizon to add US 10-year bonds. In equities, sectors riding the AI-led earnings boom.

Bonds

The US 10-year government bond yield, a global benchmark for borrowing costs, surged more than 50bps in September and is up almost 110bps this year. The sharp rise is primarily driven by expectations of a resilient US economy supporting higher Fed rates, and partly by rising fuel price-driven near-term inflation, surging capital needs from the AI industry and fiscal concerns. The current yields, after the recent surge, offer investors with 6-12-month horizon an attractive risk-reward: bond arithmetic indicates investors will lose less than 1% even if the 10-year yield rises to 6% and stand to gain over 10% if the yield falls to 4.5%.

Equities

Large-cap equities, especially in the US, have weathered the surge in bond yields reasonably well over the past quarter. This is backed by expectations of sustained strong earnings, led by the AI-driven technology sector. However, small-cap and mid-cap sectors have started to underperform over the past month amid concerns about rising energy and borrowing costs. Preference for sectors benefitting from the AI investment boom. The semiconductors and memory segments of the tech sector. Structural AI demand should prolong the memory upcycle while long-term agreements improve revenue visibility.

FX

The USD's latest bounce on the back of rising US bond yields has again created a tactical opportunity to add to higher yielding non-USD bonds. AUD corporate bonds is offering positive yield premium over comparable US corporate bonds. The medium-term constructive view on the AUD/USD should provide additional upside for USD-based investors over the next 6-12 months. The latest dip in gold is a good opportunity to add exposure, given expectations of sustained demand from Emerging Market central banks. USD 4,000/oz continues to be a strong technical support for gold.

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