

Bond Returns vs Inflation

The yield on both U.S. treasuries and Investment Grade corporate bonds have reached the lowest levels experienced in recent years. At the same time the United States is seeing muted levels of inflation. The absence of inflation despite strong economic growth may possibly be explained by the U.S. economy’s transition to that of a service economy. The U.S. economy has benefited from technological innovation, which has increased productivity, widened profit margins and avoided the need to raise prices to increase profits.

For bond investors the Federal Reserve’s policy of increasing short-term interest rates and creating a Flat yield curve has made short-term U.S. treasury rates momentarily attractive when compared to intermediate term U.S. treasuries. We expect this opportunity to end shortly as the Federal Reserve has indicated it will lower short-term interest rates as their fear of an overheated economy has not materialized. Thus, Investors will seek another bond investment strategy to provide more secure longer term rates of return to protect against inflation.

Although the current ‘absolute returns’ of intermediate term Investment Grade corporate bonds seem to be low, when they are viewed relative to the current and forecasted inflation rate they appear attractive. The graph below indicates that Investment Grade corporate bonds with a 7-Year maturity can provide a rate of return of 3.16% which is almost 2x the inflation rate of 1.6%. The investment objective of the bond buyer is safety of principal and a rate of return that will preserve purchasing power by a providing a return greater than the inflation rate. A laddered portfolio of diversified investment grade bonds is an attractive opportunity for investors seeking to exceed inflation without taking excessive credit risk.

7-Year “BBB” Corporate Bond Yield vs CPI (Dec 09’ to Jul 19’)



Sources: Bloomberg

<i>As of 07/15/19</i>	7-Year “BBB” Corp
Yield to Maturity	3.16%
Consumer Price Index	1.6%
Return above Inflation	1.56%

To learn more about our views on this topic or our strategies, contact Matt Flood at mflood@ahbi.com / 201-484-2050 or Alex DiGregorio at adigregorio@ahbi.com / 201-484-2032