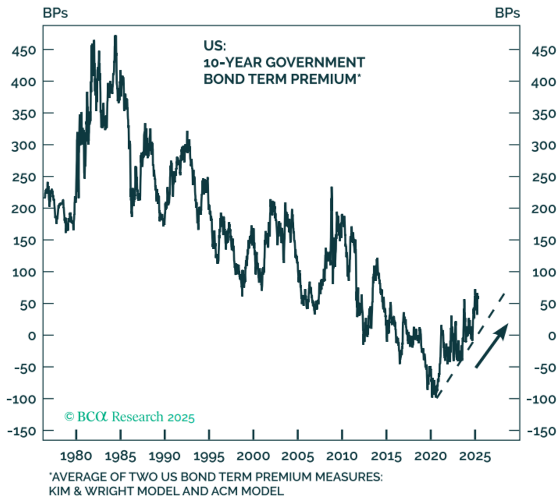
What's Topical on Your Portfolio Manager's Desk – Weekly Commentary.

Back in February 2025, your Portfolio Managers highlighted that US Bond Market (specifically, the 10-Year US Treasury Yield) might be the biggest risk to financial markets this year, amongst Donald Trump's policy movements.

This week, your PMs try to answer critical conversations pertaining to the US Bond Market volatility. We also explain the phrase "Term Premium" and elaborate on why the US Bond Market Term Premium has shot up dramatically since January 2025, as seen below.



Why IS The US Bond Market So Important?

The US bond market is seen by the global investor community as a **risk-free-rate asset,** primarily because the likelihood of the US government defaulting on its debt is considered extremely low. In practical terms, this means that financial instruments across the world are priced relative to the yield on US Treasury securities *(**specifically the*** **10-year US bond yield***)*. Whenever the **10-year US bond yield** exhibits extreme market fluctuations, as seen in 2025 thus far, then it causes uncertainty in financial markets globally (particularly equity markets). Furthermore, a rising **bond yield** signals a **fundamental tightening of financial conditions**, which could lead to an economic slowdown.

What's Causing the US Bond Market (10-year US Bond Yield) To Behave Like A Typical Equity Instrument?

Traditionally, whenever there is an unexplainable bond market movement, we as investors go back to traditional theory and link the bond market movement to government / fiscal uncertainty, given the positive relationship between the two variables. To measure political uncertainty within a bond context, there is a component called "**term premium"** embedded in sovereign bonds worldwide. *In SA, investors call it credit risk premium.* Conceptually the **term premium** is the excess return that investors require from investing in **long maturity bonds versus investing in cash.** It's also seen as **an indicator of investor confidence** in a particular government's policy direction. Thus, a **rising term premium**, similarly seen in the **US Bond Market** this year, is interpreted as a negative signal (*ceteris paribus)*.

U.S. 10 Year Treasury:

A notable example occurred in early January, when the 10-year bond yields were at 4.8%, plunged to 4% just before "Liberation Day" as growth concerns over deportation, DOGE, and tariffs resurfaced, and backed up to 4.5% during the equity market selloff on the tariff crisis in early April.

These dramatic moves observed in the **US bond market** (particularly the **term premium)** suggests that investors are selling US Treasuries, due to the lack confidence towards the current **US administration policy** implications on **US Economic Growth, US Inflation, US Fiscal Debt** and **Trade Wars.** In addition, the **Federal Reserve** will also be hamstrung by rising tariffs and their potential inflationary impact, making any rate cut difficult in the current environment.

Who Are The Sellers Of US Treasuries?

Speculation is rife that **private investors *(mutual funds)*** have been the major net sellers of **US Treasuries,** rotating into other asset classes like **Gold, Euro (Currency) Euro Bonds *(Germany Bunds),*** and to some degree **Emerging Market Bonds**. Subsequently, this **"Sell US Treasury Trade**" has led to some **US Dollar weakness** (*ceteris paribus)*. Additionally, China and Japan are substantial holders of **US treasuries,** and they too have been net sellers this year.

Why We Need A Non – Volatile US Bond Market?

As mentioned, nearly all **financial instruments** are priced off the **US Bond Market *(specifically the 10-year US Treasury Yield).*** Therefore, stabilisation in the **US Bond Market** will help **reduce equity market volatility** (*ceteris paribus)*. More importantly, **lower bond yields = lower cost of borrowing / loose financial conditions**, resulting in **good economic growth prospects.**

What Are The Implications of US Bond Market Yields On The SA Bond Market?

Three 3 variables are used to determine SA Bond yields: **(1) Rand / Inflation, (2) Credit Risk Premium** and **(3) 10-year US Treasuries**. The latter **(10-year US Treasuries)** has a significant impact on SA bond yields. However, we believe that a **strengthening USD/ZAR exchange rate** plus **stabilisation in the GNU** could overshadow moves in the **10-year US Treasury Market**. Investors could see another year of "*equity-like returns*" from **SA bonds.**

US Market Bond Implication on Portfolio Asset Allocation?

We remain cautiously optimistic about favourable equity market performance in **China, Europe, and South Africa** this year, barring a significant rise in US bond yields of over 5%. We continue to advocate for an **overweight duration call** and maintain an **underweight stance** towards **offshore assets (in particular, US Equity and US Bonds)**. We share the view that more **US Dollar weakness** will be witnessed ***if there is no recession.***