



# Is a yield earthquake coming?

Quite possibly – and it could shake markets this year



**Mark Dowding**  
Chief Investment Officer  
BlueBay Fixed Income Team

**Published**  
January 2022

During 2021, investors were surprised at how long-dated government bond yields proved firmly anchored at very low levels – even as economies recovered from the shock of the 2020 pandemic recession. This occurrence was even more notable against a backdrop of strong inflation, which central bankers now fear is less transitory than originally expected.

With ultra-low long-dated yields supporting elevated price/earnings multiples, the question central to all investors is whether this low-yield regime can persist.

On one hand, some may argue that the natural level of interest rates has been on a declining trend for several years, citing a long-term thesis of secular stagnation. Yet, with little evidence of a slowdown in technological progress (look at how quickly new vaccines are currently being developed), it seems odd that this thinking should hold sway in bond markets.

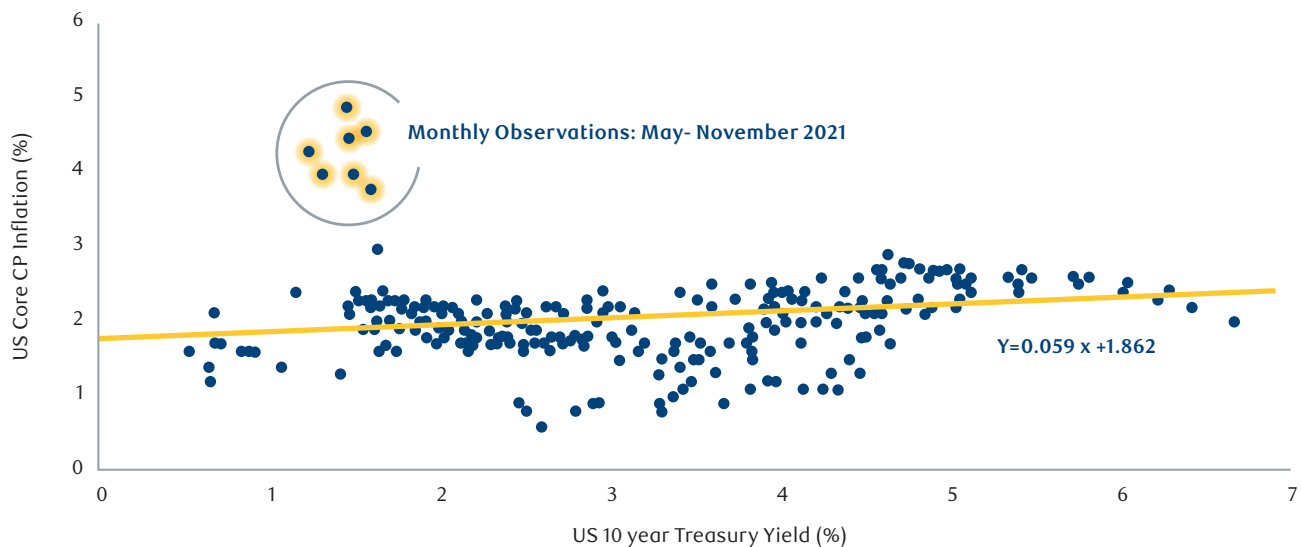
This thesis also contradicts elevated growth expectations regarding future corporate earnings.

On the other hand, secular stagnation is characterised by a shortfall in demand relative to supply. Currently, the reverse of this is true, with supply incapable of keeping pace with demand. Moreover, a paradigm shift towards more expansive fiscal policy and demand management may infer that secular stagnation is unlikely to take hold – especially if policymakers observe they can spend money freely without facing any consequences.

Instead, it could be that government bond yields have been temporarily anchored by an abundance of liquidity over the past couple of years and that as the monetary cycle turns, so investors should be more fearful of higher yields.

From this perspective, it is possible to observe the tectonic plates on which yields are supported, starting to shift. Indeed, it may not be an exaggeration to wonder if an earthquake in yields could fundamentally reshape the financial landscape in the months to come.

## US bond yields & inflation between 2000 & 2021



Source: Bloomberg, January 2022

Just as seismologists study history to predict future earthquakes, historical data suggests that yields are materially out of alignment and are overdue adjustment.

The chart highlights the anomaly between prevailing inflation and bond yields. Meanwhile, higher CPI is leading to a de-anchoring of inflation expectations, causing secondary impacts.

With labour markets tight, wages are moving higher. Unions, whose members have seen real wage cuts, are gearing up for industrial action, pushing for double-digit pay claims in 2022. Although goods price inflation should decline after Easter, as base effects and supply disruptions ease, higher wages and service price inflation should mean that inflation remains considerably above central bank targets.

Inflation is now attracting more attention from policymakers, and central banks may be increasingly pressured to withdraw monetary accommodation in the coming months.

Yet, with interest rates very negative in real terms, policy may need to be tightening materially before it reaches a neutral point, let alone becomes restrictive. This was seen

between 2003-07, when the US Federal Reserve hiked rates at every meeting, yet was blamed for overly easy monetary policy contributing to the global financial crisis. Hence, higher central bank rates may be something of a persistent headwind for yields for quarters to come.

And expansive fiscal policy could compound this. Higher deficits equal higher bond issuance and with austerity out of favour, fiscal policies can also reshape the yield landscape.

So, is an earthquake in yields coming? Possibly, yes.

If it does happen, then there is a good chance it will occur in 2022. In that case, long-duration assets may be vulnerable to a material correction. Shorter-dated assets look like a safer home for capital against this landscape. There remain opportunities in the credit markets if you are able to avoid the landmines. In equity markets, a rotation towards the asset class, and specifically sectors such as European bank stocks, could make it a compelling place to be.

This document may be produced and issued by the following entities: in the European Economic Area (EEA), by BlueBay Funds Management Company S.A. (the ManCo), which is regulated by the Commission de Surveillance du Secteur Financier (CSSF). In Germany and Italy, the ManCo is operating under a branch passport pursuant to the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) and the Alternative Investment Fund Managers Directive (2011/61/EU). In the United Kingdom (UK) by BlueBay Asset Management LLP (BBAM LLP), which is authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and is a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts of the registered office of the Swiss representative shall have jurisdiction pertaining to claims in connection with the distribution of shares in Switzerland. The Prospectus, the Key Investor Information Documents (KIIDs), where applicable, the Articles of Incorporation and any other applicable documents required, such as the Annual or Semi-Annual Reports, may be obtained free of charge from the Representative in Switzerland. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Australia, BlueBay is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, BBAM LLP is not registered under securities laws and is relying on the international dealer exemption under applicable provincial securities legislation, which permits BBAM LLP to carry out certain specified dealer activities for those Canadian residents that qualify as “a Canadian permitted client”, as such term is defined under applicable securities legislation. The BlueBay group entities noted above are collectively referred to as “BlueBay” within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of BlueBay by the respective licensing or registering authorities. Unless otherwise stated, all data has been sourced by BlueBay. To the best of BlueBay’s knowledge and belief this document is true and accurate at the date hereof. BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. Opinions and estimates constitute our judgment and are subject to change without notice. BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only. This document is intended only for “professional clients” and “eligible counterparties” (as defined by the Markets in Financial Instruments Directive (“MiFID”)) or in the US by “accredited investors” (as defined in the Securities Act of 1933) or “qualified purchasers” (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer. No part of this document may be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose in any manner without the prior written permission of BlueBay. Copyright 2022 © BlueBay, is a wholly-owned subsidiary of RBC and BBAM LLP may be considered to be related and/or connected to RBC and its other affiliates. ® Registered trademark of RBC. RBC GAM is a trademark of RBC. BlueBay Funds Management Company S.A., registered office 4, Boulevard Royal L-2449 Luxembourg, company registered in Luxembourg number B88445. BlueBay Asset Management LLP, registered office 77 Grosvenor Street, London W1K 3JR, partnership registered in England and Wales number OC370085. The term partner refers to a member of the LLP or a BlueBay employee with equivalent standing. Details of members of the BlueBay Group and further important terms which this message is subject to can be obtained at [www.bluebay.com](http://www.bluebay.com). All rights reserved.

January 2022



**Global Asset  
Management**