



Weekly round up

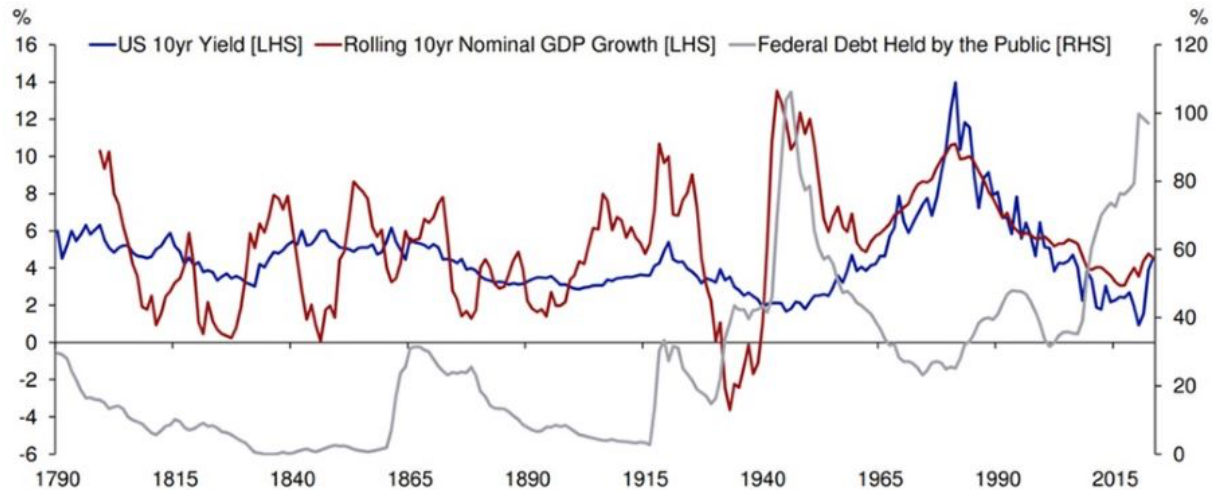
As September drew to a close, it occurred to us that history might conclude that 2023 only reinforced September's reputation as a pretty miserable month for total return investors.

Ever the optimist, we note that the S&P 500 closed down -9.34% in 2022 and is likely to lose only half that figure in September. Meanwhile, European high yield has a chance to break out of the seasonal negative energy and into slightly positive total returns, breaking a four-year consecutive negative streak that was capped by last year's sharp -3.99%¹ decline. Among the month's other outliers was oil, which generated a total return of almost +10% over the month. The catalyst for the rise in oil prices last week was US crude oil inventories, which fell by 4.1% on the week; lower inventory levels have only occurred twice in the last ten years. U.S. and German 30-year yields rose by 30 basis points (bps), 25 bps more than their respective 2-year yields. The US 30-year recorded a monthly loss in excess of -13%.

In the US, the rise in yields has been attributed to the central bank's "higher for longer" stance, the rollercoaster economic outlook, rising federal deficits, the loss of conviction that the inflation target can be met, quantitative tightening, economic policy in Japan and China, and the negative carry cost of inverted curve positioning. However, this doesn't answer the question on everyone's mind: are government yields finally cheap?

Taking the U.S. 10-year yield as a benchmark, the simplest approach might be to look at the long-term average yield. Based on data dating back to 1790, the average yield is 4.5%. If the 10-year yield is higher than nominal growth, it may be advantageous to invest in 10-year bonds rather than in the economy, driving the yield down until equilibrium is reached. This relationship has worked well since the late 1960s (see chart of the week). Average nominal growth over the last ten years has been 4.6%. However, if we look to the future and use the Federal Open Market Committee's economic projections for 2024 and the long term, the 10-year yield should be 4.0% and heading towards 3.8% in the long term. Nevertheless, this approach assumes no risk premium for government stability and fiscal responsibility, which is being questioned by investors as debt-to-GDP (gross domestic product) approaches 100%, uncertainty surrounding the 2024 elections increases, and the US government came very close to a potential shutdown on October 1. Unfortunately, accounting for this variability is not straightforward, but we suggest adding a further 50 basis points to the yield, leaving the fair value of the US 10-year at 4.5%.

Chart of the week: US 10-year yields



Source: GFD, Deutsche Bank

Source: Global Financial Data (GFD), Deutsche Bank, as of 26th September 2023.

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