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Fixed Income ETF flows remain resilient despite bond market turbulence

London, 12 November 2024

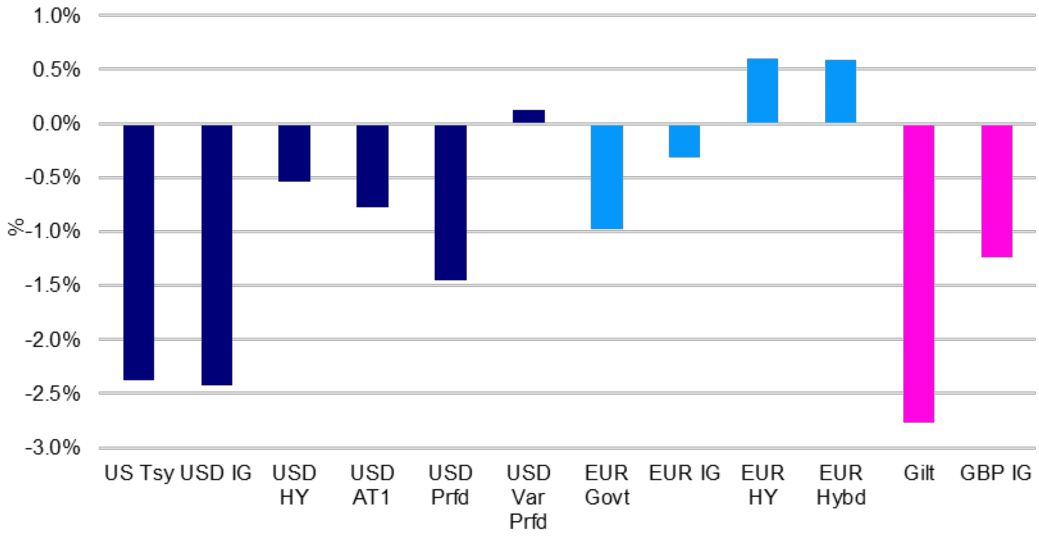
- Bond markets performed poorly in October as yields rose, partly driven by stronger US labour market data
- Flows into fixed income ETFs remain strong, with a further $6.5bn in October, bringing the total so far in 2024 to over $58bn
- Rising yields and steeper yield curves could see investors start to deploy the current record levels of cash into bond markets

Paul Syms, Head of EMEA ETF Fixed Income and Commodity Product Management at Invesco, comments:

"Bond markets broadly performed poorly in October as the market reevaluated the outlook for rates, having rallied strongly into the first cut from the Federal Reserve. Although yields had started to drift higher from the lows in mid-September, a strong US employment report at the beginning of October drove a stronger sell off in the US Treasury market. At 254k, the change in non-farm payrolls was much stronger than expected, accompanied by strong earnings data and a decrease in the unemployment rate to 4.1%.

"With the Fed having indicated their focus has been moving away from combating inflation to supporting the labour market, the strength of the data caused markets to reduce expectations for further rate cuts. Across the pond, the Gilt market also performed poorly, but the rise in yields here received additional impetus from the Budget. Despite the announcement of £40bn in tax rises, along with an increase in government spending, concerns regarding the UK's longer-term growth prospects. Additionally, the rise in near-term spending could slow the pace of rate cuts from the Bank of England."

Asset class returns – October 2024



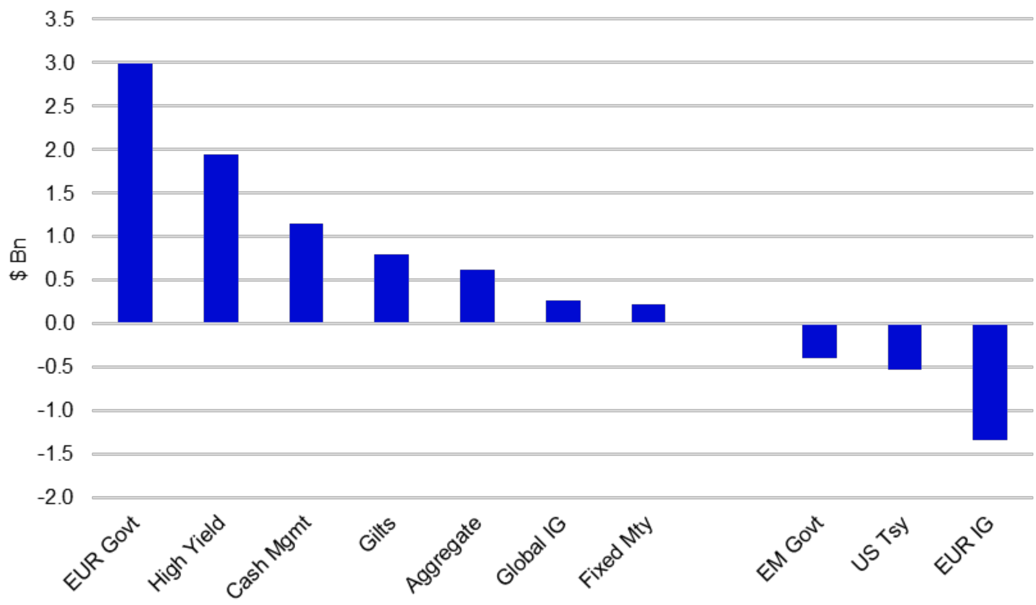
Source: Bloomberg, Invesco as at 31 Oct 2024

Fixed Income ETF Flows

“However, flows into fixed income ETFs remained robust with NNA of $6.5bn taking the year-to-date total above $58bn. EUR government bond ETFs were the strongest category with net inflows of $3.0bn, followed by High Yield with $1.9bn. Cash Management ETFs continued to be in demand with NNA of $1.2Bn over the month taking the year-to-date total to $12.3bn.

“Gilt and Aggregate bond ETFs complete the top five categories for October with inflows of $0.8bn and $0.6bn respectively. EUR-denominated investment grade credit experienced a reversal of fortunes, leading to outflows of $2.2bn, after having been the strongest category for inflows in September. US Treasuries experienced a second month of net selling with outflows of $0.5bn.”

Top Fixed Income ETF Categories in October 2024



Source: Bloomberg, Invesco, as at 31 Oct 2024

Outlook

"While central banks remain in easing mode, bond markets may have rallied too far and too fast which, along with incoming data and events, has caused yields to back up sharply. The benchmark 10-year US Treasury yield ended October at 4.28%, 70 basis points higher than the lows seen in mid-September. While that bearish sentiment has influenced other bond markets, Gilts also reacted to the idiosyncratic event of the first Labour government budget in 14 years and its potential impact on the outlook for UK rates. This highlights the impact that changes in fiscal policy can have on anticipated bond supply, monetary policy and therefore yields.

Positioning

"Cash management ETFs have been the strongest fixed income category for inflows so far this year while US money market fund assets are sitting at record levels (topping $6.5Tn according to ICI Money Market Fund Assets as at 30 Oct 2024). Inverted government yield curves and relatively flat credit curves have meant that, to date, there has been no need for investors to increase interest rate risk given the attractive level of yields available on cash and short-dated bonds.

"However, as yields and therefore expected returns on cash decline, now that central banks are cutting rates, investors are likely to start to increase duration by extending along the curve to lock in yields currently available in bond markets. How quickly this happens is likely to depend not just on incoming economic data but also on market perceptions about the impact of political events, particularly the result of the US election."

Will the recent rise the 10-year US Treasury yield be sufficient to attract investor demand?

Source: Bloomberg, as at 31 Oct 2024

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For further information, please contact:

Invesco
Jane Drew
jane.drew@invesco.com
Telephone +44 20 3370 1104

Lansons
Anthony Cornwell / Tom Straker
anthonyc@lansons.com / toms@lansons.com
Telephone +44 207 294 3606 / +44 20 7566 9705

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All data and charts sourced from Invesco, Bloomberg, as at 31 October 2024. All figures in USD

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