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Is the Great Bond Blowout Finally Happening?

Bond guru Bill Gross says 2018's rise in Treasury yields confirms a bear market

By Richard Barley
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The bond market has had an early alarm call in 2018. The 10-year U.S. Treasury yield has risen to its highest since March; bond guru Bill Gross says the move confirms a bear market. In the absence of higher inflation and a clearer shift in central-bank intentions, bonds still have support, but that could erode quickly.

The move higher—to 2.59% for the 10-year Treasury yield, from 2.43% at the end of 2017—is relatively sharp after a year that was notable for how little global bond yields moved. For some, the high of 2017, at around 2.63%, is a key level to watch for whether yields move higher still; for others, the move has already broken out of a downward channel for yields that has persisted for more than 25 years. That implies big changes.

The apparent triggers for the jump above 2.5% include a small tweak to the Bank of Japan's purchases of government bonds this week, which pushed up long-dated Japanese yields, and speculation about China's demand for Treasurys. That these factors lie far outside the U.S. only emphasize the global forces that bond markets have to cope with and the level of sensitivity to changes in direction from central banks.

The big threat lies in a resurrection of inflation. In 2017, the market was in no-man's-land: the deflation threat had passed, but U.S. inflation undershot expectations, leading the Federal Reserve to label it a "mystery."

Yet expectations have been building: a measure that looks at U.S. inflation over five years in five years' time—the so-called five-year, five-year forward—has risen to 2.13%, its highest since April, according to the Federal Reserve Bank of St. Louis. Friday's U.S. consumer-price data and subsequent releases will be vital.

Bill Gross, portfolio manager at Janus Capital Group, speaks at a conference in Beverly Hills, Calif., on May 3. PHOTO: LUCY NICHOLSON/REUTERS

The other factor to be alert for is a change in central-bank communication. So far, central bankers have been extremely gradual in signaling the end of easy-money policies. But if investors swing to believing policy might be tightened further and more rapidly than expected, that would be another blow for bonds. Moreover, bond-market duration, or sensitivity to moves in interest rates, has risen as yields have fallen, making long-dated bond prices vulnerable: a selloff could be painful.

In the absence of those shifts, one feedback loop may yet temper a sharper selloff now: if the equity market were to suffer, that might generate support for bonds, particularly given widespread concerns about stock valuations. In the very near term a market clash—think Dow 25,000 versus 2.5% 10-year Treasurys—might be one to watch.

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