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The great return of the interest rate

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The plunge in the prices of 10-year US Treasury bonds is a telling example of the major shift taking place in developed-world economies. Inflation's aggressive comeback has caught central banks off guard and wrong-footed all the major institutional holders of sovereign bonds who have been funding the public purse – in some cases at a negative interest rate – for the past few years.

The above graph shows that the bond-market crash is affecting sovereign and corporate issuers across the board – not just those in the high-yield category, but also those with an investment grade, including the one issuer believed to be the most steadfast of all: the US government. With inflation back on the cards, we're seeing a return to positive interest rates, and therefore also to more normal economic and financial conditions.

We believe inflation is here to stay, and the new bond-market landscape that's emerging is creating fertile ground for active investment approaches. Active fund managers will be able to take advantage of the trend reversals in interest rates that will be triggered by swings in inflation expectations.

This new market climate, after 40 years of disinflation or even zero consumer-price growth, is putting fixed income back on the radar by restoring its potential to deliver attractive returns and making it once again a barometer of the economy. And to that end, we would note that the apparent rebound in European bond prices could be the first sign of an upcoming recession.

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