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The advantage of semi-government bonds

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There are opportunities for fixed-rate bond investors, especially in semi-government bonds, as the likelihood of yields decreasing appears stronger than the chance of them increasing. Importantly, the higher carry in longer-end semi-government bonds (i.e. those with higher coupons) provides a greater cushion against higher yields (if that were to play out, not our base case view).

The main advantage of semi-government bonds is their higher yield than government bonds.

Furthermore, semi-government bonds are a great way to access duration without taking credit risk over a material period.

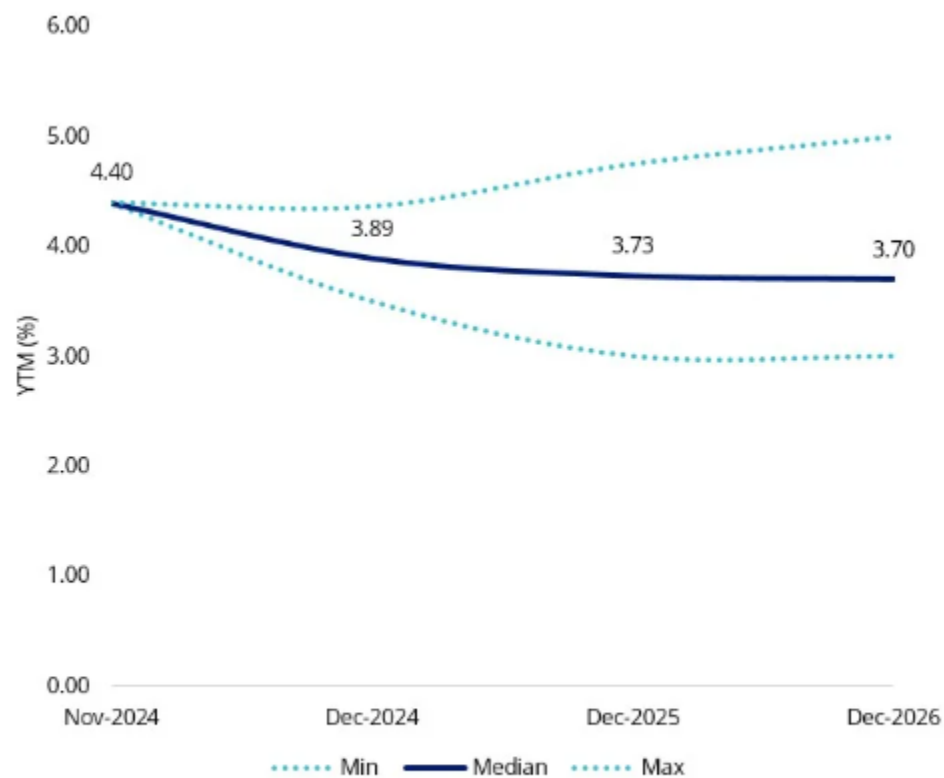
A positive going into 2025 is that broker consensus is for Australian 10-year bond yields to edge lower over the next 24 months as the RBA moves closer to an easing cycle. Investing in long-dated semi-government bonds could be advantageous if this does play out.

In our view, investing in the 15-20 year part of the interest rate curve is best as you:

- 1. Are appropriately compensated for the term premia (i.e. more than the 10-year part of the curve); and**
- 2. Can harness better duration performance relative to the 10-year part of the interest rate curve (by nature of having more interest rate sensitivity).**

Essentially, if there are more rate cuts than the market expects, then all-else-equal, 15-20-year interest rate-sensitive securities should do better than 10-year interest rate-sensitive securities.

See chart below, which shows the Australian 10-year bond yields median, min and max broker forecast for the next 24 months.



Source: Bloomberg, As at 20 November 2024.

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