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Defence for your portfolio: Betashares U.S. Treasury Bond 20+ Year ETF - Currency Hedged

ASX: GGOV

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Introducing Betashares U.S. Treasury Bond 20+ Year ETF – Currency Hedged (ASX: GGOV)

When it comes to defending one's portfolio against share market declines, there are arguably few more reliable 'safe havens' than long-term bonds issued by the US Government.

US Treasury bonds are of the highest credit quality, as the risk of default by the US Government is considered very low. And due to this high credit quality, US Treasury bonds typically form a core part of the asset allocation of most of the world's major pension and sovereign funds, as well as a key part of many countries' central bank reserves.

Historically, US Treasuries have provided appealing portfolio diversification benefits, with long-term US Treasuries among the better performing assets during US recessions and periods of global economic weakness.

The Betashares U.S. Treasury Bond 20+ Year ETF – Currency Hedged (ASX: GGOV) provides exposure to high-quality, long-maturity US Treasury bonds within one convenient ASX-traded ETF.

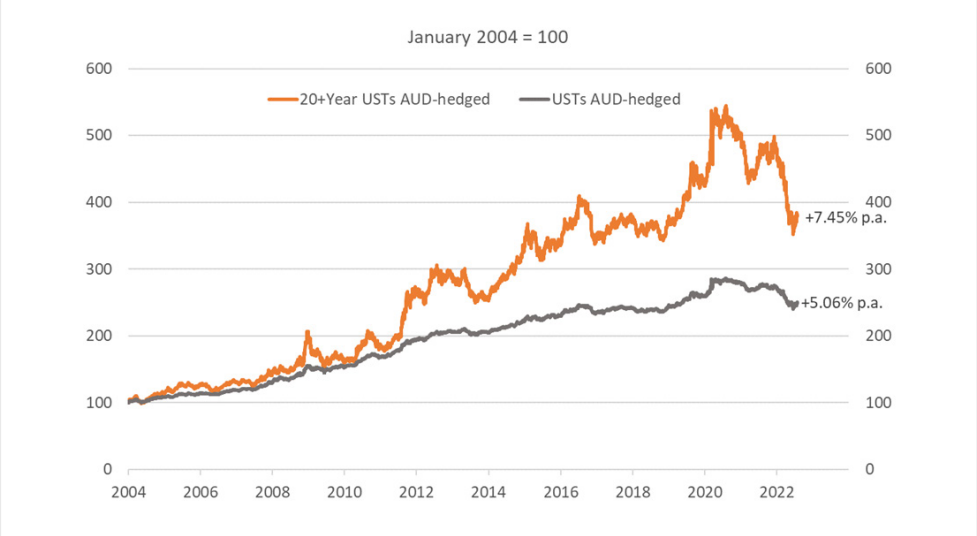
The case for long-term US Treasury bonds

US Treasuries are among the most liquid securities in global financial markets and are widely regarded as one of the world's premier 'safe haven' assets.

These bonds benefit from the full faith and credit of the US Government, having an average credit rating of AAA[1], and have tended to enjoy 'flight-to-quality' demand during periods of economic weakness and risk aversion.

Long-term US Treasuries have also typically provided higher yields and expected return prospects than shorter-term US Treasuries over the longer term. This is referred to as the 'term premium' – the excess yield an investor earns for committing to a long-term bond instead of a series of shorter term bonds or cash. Over the 30 years to 31 July 2022, the term premium has contributed an additional 2% p.a. in total returns over the broad US Treasury Index, as shown in the chart below.

Chart 1: AUD-hedged total returns of long-term U.S. Treasury bonds (20+ years) vs. broad-market US Treasury Index (all maturities > 1yr)



Source: S&P, Markit iBoxx; Bloomberg, as of 31 July 2022. Chart shows the total return performance of the S&P U.S. Treasury 20+ Year AUD Hedged Bond Index, which is GGOV's Index, and the iBoxx USD Treasuries AUD Hedged Index. Past performance is not an indicator of future performance of any index or ETF. You cannot invest in an index. Performance information does not show actual past performance of GGOV and does not take into account its management fees and costs (0.22% p.a.).

[1] As at 31 July 2022. Average credit rating from S&P, Moody's, and Fitch. Credit ratings merely reflect the opinion of a particular ratings agency, and do not provide any assurance regarding the bond issuer's ability to meet its payment obligations in relation to a bond. Credit ratings are not intended to be an investment recommendation or used as a basis for assessing investment merit and are subject to change.

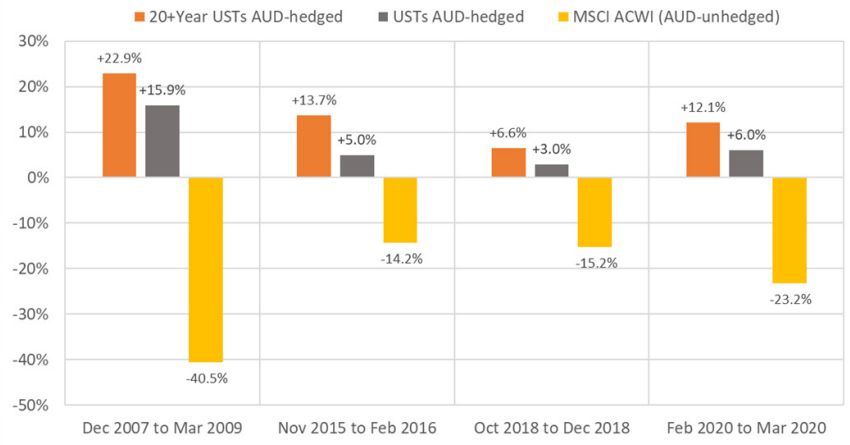
Defensive benefits

Historically, long-term US Treasuries have been among the better performing assets during US recessions, owing to their long duration profile and sensitivity to expectations of declining interest rates, and are one of the few exposures that have tended to generate positive returns in such environments.

Furthermore, the worst drawdowns in global equity markets have tended to occur during US recessions, enhancing the appeal of long-term US Treasuries as a source of diversification within multi-asset class portfolios.

The chart below shows the performance of GGOV's Index, being the S&P U.S. Treasury 20+ Year AUD Hedged Bond Index, against the iBoxx USD Treasuries AUD Hedged Index and the MSCI All Country World Index (in Australian dollars), during selected periods of global economic slowdown over the last 15 years. It demonstrates the defensive attributes of long-term US Treasuries relative to broader US Treasuries and the broader global equity market during such periods.

Chart 2: Index performance during selected periods of global economic weakness



Source: S&P, Bloomberg. Past performance is not an indicator of future performance of any index or ETF. You cannot invest directly in an index. Graph shows performance of GGOV's Index and not the actual past performance of GGOV. It does not take into account GGOV's management fees and costs (0.22% p.a.). Comparison periods have been selected based on maximum total return drawdown in the MSCI All Country World Index (in Australian dollars) during times of global economic weakness.

Conversely, the long duration profile and sensitivity to expectations in relation to interest rate movements means long-term US Treasuries have tended to underperform in times of global economic strength, though over the longer term they typically have provided higher yields and expected return prospects compared to shorter-term US Treasuries.

Why buy long-term bonds in a rising rate environment?

It is true that bond prices move inversely with bond yields and long duration bonds can have significant price volatility, but long-term yields are forward-looking with respect to the economy and policy rates.

What matters for a bond's performance isn't necessarily whether policy rates rise, but how much rates rise relative to what's already priced in, and changes in policy rate expectations over the relevant maturity horizon (which is influenced by economic growth and inflation expectations).

Treasury yields tend to price in the policy tightening cycle well before it begins. Similarly, yields tend to price in the next easing cycle in advance of the central bank cutting rates.

Because long-term Treasury yields look across a longer horizon than short-term interest rates, they will typically move lower once it becomes clear to the market that the central bank will succeed in materially slowing demand (and potentially inducing a recession and eventual rate cuts).

Long-term US Treasury bonds also tend to look through current inflation pressures to the consequences tighter policy and slowing demand will have on future growth and inflation.

Accordingly, headline US CPI is regarded as a lagging indicator of the real economy, whereas long-term Treasury yields are seen as a leading indicator of the US and global economy's future trajectory. Because monetary policy operates with a long and variable lag, it is often during a hiking cycle that may prove to be the best time to allocate to long-term government bonds.

Aside from the prospects of capital gains from weakening economic conditions, the recent policy rate increases in the US and expectations of further hikes have driven yields on long-term Treasuries to their highest levels in several years (see Chart 3). This has the potential to provide holders of long-term US Treasuries with a reliable, high-quality source of income at a yield above the market's assessment of long-term inflation expectations. As at 31 July 2022, the yield to worst on GGOV's Index stood at 3.19% p.a.

GGOV's Index characteristics (as at 31 July 2022)

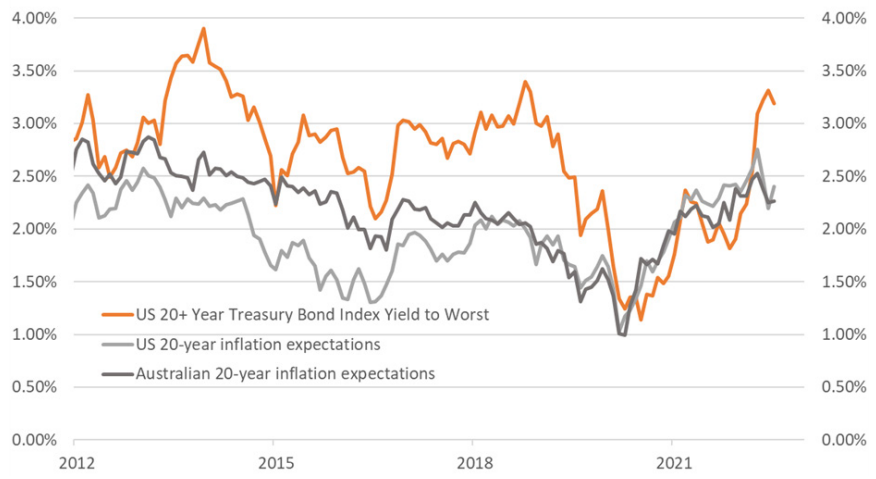
Average credit rating[1]	AAA
Average maturity[2]	26.1 years
Modified duration[3]	18.7 years
Yield to Worst[4]	3.19% p.a.

Source: S&P, Moody's, Fitch, Bloomberg.

1. Credit ratings merely reflect the opinion of a particular ratings agency, and do not provide any assurance regarding the bond issuer's ability to meet its payment obligations in relation to a bond. Credit ratings are not intended to be an investment recommendation or used as a basis for assessing investment merit and are subject to change.
2. Average length of time until the current bonds in the portfolio mature (weighted by market value).
3. An approximation of the sensitivity of the portfolio's value to a change in interest rates, e.g. modified duration of 18 years implies a 0.1% rise in the reference interest rate can be expected to reduce portfolio value by 1.8%.
4. The annualised total expected return of a portfolio if underlying bonds are held to maturity or are called, do not default, and the coupons are reinvested. Yield to worst is the lower of yield to maturity and yield to call. Assumes no change in interest rates. Subject to change over time. Does not take into account GGOV management fees and costs.

The chart below compares the yield on long-term US Treasuries with inflation expectations in both the US and Australia, as of 31 July 2022.

Chart 3: Yields and inflation expectations for US and Australia



Source: S&P, Bloomberg. Inflation expectations implied from market-derived inflation break-evens on inflation linked government bonds. Past performance is not an indicator of future performance of any index or ETF. You cannot invest directly in an index. Shows the unhedged yield of the S&P U.S. Treasury 20+ Year Bond Index, which is GGOV's Index, and market-based 20-year forward inflation expectations for the United States and Australia, as implied by long-term inflation-linked government bonds.

Summary

GGOV offers potential diversification and defensive benefits for investment portfolios, as long-term US Treasuries historically have tended to perform well in times of global economic weakness and US recessions. In addition, US Treasuries provide potential for a reliable, high-quality source of income above long-term inflation expectations.

Betashares U.S. Treasury Bond 20+ Year ETF – Currency Hedged (ASX Code: GGOV) provides access to a portfolio of high-quality, long-maturity US Treasury bonds in a single ASX trade.

There are risks associated with an investment in GGOV, including interest rate sensitivity risk, credit risk, country risk and currency hedging risk. The value of an investment and income distributions can go up and down. For more information on risks and other features of GGOV, please see the Product Disclosure Statement, available at www.betashares.com.au. A Target Market Determination is also available at www.betashares.com.au/target-market-determinations.