Fixed Income Perspectives

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Voya Investment Management's fixed income strategies cover a broad range of maturities, sectors and instruments, giving investors wide latitude to create a new portfolio structure or complement an existing one. We offer investment strategies across the yield curve and credit spectrum, as well as in specialized disciplines that focus on individual market sectors. We build portfolios one bond at a time, with a critical review of each security by experienced fixed income managers. As of September 30, 2014, Voya Investment Management managed $125 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: Valuations are generally rich, but we see no near-term catalyst for a global rate selloff given the flood of liquidity coming from central banks.

Global Currencies: We remain overweight the U.S. dollar and underweight the euro and Japanese yen. We also favor the British pound and Swiss franc versus the euro.

Corporates: We remain mildly constructive on the credit markets in 2015, as valuations have improved, balance sheets remain healthy, and the domestic economy remains strong.

High Yield: The asset class is attractive and poised to outperform most other fixed income asset classes once oil prices stabilize.

Mortgages: Increased volatility and low interest rates are negative for agency MBS, though we are more constructive on non-agency MBS and CMBS.

Emerging Markets: While lower commodity prices help stem inflation and easy monetary policies could support emerging markets assets, the sector is likely to remain under pressure.

Macro Overview

- Resolutions that promise sweeping change can be inspiring in concept but daunting to implement. But after the new year's shaky start — characterized by a spike in equity and interest rate volatility, continued weakness in oil and commodity prices, and a strengthening dollar — the European Central Bank finally moved beyond rhetoric, revealing a concrete game plan to defeat the euro zone's own version of "deflategate" in 2015 and beyond.
- With negative deposit rates in Germany, anti-austerity politics gaining momentum in Greece and near-zero euro zone inflation, it had become clear that Mario Draghi's July 2012 pledge to do "whatever it takes" to keep the currency bloc intact would require more than just an assortment of ineffective half-measures. Enter the ECB's historic pledge to purchase €60 billion of assets per month through September 2016. And while the inclusion of sovereign debt in the program drew headlines, the most important detail may be the plan's seemingly open-ended nature; Draghi's focus on pushing inflation up to the central bank's target suggests that purchases could extend beyond the stated end date should sufficient progress here be lacking. The ECB's open-ended resolution may be intended to backstop the currency union and stabilize financial markets; if the U.S. QE experience is any indication, this will also buy policymakers time to address the fiscal, social and political issues underpinning the euro zone's very real growth and inflation woes.
- China's growth is slowing, meanwhile, and the U.S., though relatively strong, is by no means immune to the spillover effects of global growth and commodity weakness, increased global monetary accommodation and domestic issues like moribund wage growth. As such, we do not expect any sweeping changes to Fed policy anytime soon.
- While the front-end of the U.S. yield curve is susceptible to the Fed, we see no near-term catalyst for a selloff in global rates. We remain overweight a variety of spread sectors, including U.S. investment grade corporates and U.S. high yield, as recent spread widening leaves valuations compelling despite low yields. Though volatility has picked up, a new default cycle is unlikely in the near term, particularly among U.S.-focused credits.

Spreads, Returns and Yields

			Returns (%)	
Index	Percentage of Index	Spread (bps)	Dec. 2014	2014
Barclays U.S. Aggregate	100.0	46	0.7	5.9
Treasury	36.1	0	0.1	5.1
Investment Grade Corporates	23.3	131	0.1	7.5
Fixed-Rate MBS	28.1	28	0.2	6.1
Other				
High Yield		483	-1.4	2.5
Global Aggregate		45	-0.7	0.6
Emerging Markets		388	-2.5	4.8

			Returns (%)	
Country	Yield on Ten-Year Bonds (%)	Currency	Dec. 2014	2014
U.S.	1.7	EUR/USD 1.12	-3.0	-11.4
Germany	0.4	USD/JPY 132.00	-1.2	-12.5
Japan	0.3	USD/BRL 2.57	-2.7	-0.1
Brazil	11.8			

Source: Barclays, JPMorgan, Standard & Poor's

Note: All spreads are to Treasuries and option adjusted except for Emerging Markets, which is nominal. All returns are total returns including dividends expressed as percentages. All returns in U.S. dollars.

Sector Overviews

Global Rates

- Rates have rallied substantially across the euro zone, and the euro weakened against the dollar. Falling developed market yields have given way to a strong performance in the Treasury market. The Treasury curve has continued to flatten, with yield on the 30-year rallying to all-time lows while the ten-year is nearly 100 bps lower than a year ago.
- We are underweight interest rate risk in the U.S., concentrated in the front end of the curve, though we have closed underweights in interest rate risk denominated in other currencies. Valuations are generally rich, but we see no near-term catalyst for a global rate selloff given the liquidity that will result from the ECB's new asset-purchase program.

Global Currencies

- We continue to favor the U.S. dollar versus the euro and Japanese yen. Versus the euro, we also favor the British pound and Swiss franc. The yen may have already experienced most of its weakening, with the BOJ's bond-buying announcement well in the past. The ECB's new bond-buying program has already had a weakening effect on the euro, which should persist. That said, the size and speed of further euro devaluation is mitigated by lower U.S. interest rates and the EUR/USD selloff of the last few months.

Investment Grade Corporates

- Corporate performance has continued to be weak, though there are tentative signs of stabilization and we remain mildly constructive on the credit markets in 2015. Oil prices appear to be trying to find a bottom, whlie corporate spreads search for stability; long-dated bonds and energy bonds both have shown signs of life since mid-January. While corporate balance sheets remain healthy and domestically sourced earnings should be strong, international earnings could be negatively impacted by weakness in global growth and strength in the U.S. dollar.
- The ECB action, while supportive of spreads, does create a potential negative in that ECB bond buying also will contribute to lower Treasury yields. Any move lower in oil also would pressure corporate fundamentals; while lower oil prices are a general economic positive, corporate bond markets have a disproportionate exposure to the energy industry.

High Yield Corporates

- The high yield market has struggled to gain traction thus far in 2015, and there remains a significant divergence between the performance of energy and non-energy issues. Within energy, we have seen an increased bifurcation between well-positioned "haves" and "have-nots" as opposed to the indiscriminate selling we saw when the oil price decline began to accelerate in late 2014. Other commodity-related sectors (coal, iron ore, etc.) continue to follow a similar path to oil-related issuers.
- Our fundamental view of high yield credit quality is largely unchanged. Spreads are justifiably wider, as risks have increased, but the U.S. economic recovery appears solid enough to prevent a turn in the credit cycle. With ex-energy spreads above the long-term average and defaults likely to remain well below the historical average, it seems that high yield investors are being more than adequately compensated for credit risk. At current levels, high yield bonds also likely have the ability to absorb at least a portion of an eventual rise in interest rates. As such, high yield should outperform most other fixed income asset classes over the coming year, though stabilization in oil prices is needed.

Mortgages

- Agency MBS has struggled in early 2015, driven by a confluence of factors. A dip in primary mortgage rates has re-introduced refinancing fears, while the Fed no longer adding MBS to its balance sheet has reduced this source of demand. And although the ECB's announcement appears bullish for spread assets, the purchases could pressure U.S. rates, a negative for the agency MBS market.
- We are more constructive on securitized credit markets — including non-agency MBS and CMBS — given solid fundamentals, strong technicals, attractive relative value and insulation from volatility. Non-agencies have been well bid since the beginning of the year; supply has picked up sharply the past two weeks, and competition for assets has remained fierce. The CMBS market started the year quietly before activity picked up sharply mid-January. Spreads and volatility in CMBS have been quite manageable relative to the corporate debt markets.

Emerging Markets

- Emerging markets are contending with slow economic growth, a re-rating of systematically important countries like Russia and Brazil, idiosyncratic geopolitical events and falling commodity prices. While reduced commodity prices could stem inflation pressures and continued easy monetary policy in the developed world could support EM assets, negative sentiment toward the sector persists. Both the corporate and the sovereign indexes have stumbled out of the gate in 2015, and we remain cautious on emerging markets overall.

Past performance does not guarantee future results.

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