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 March 31, 2015, Voya Investment Management managed $129 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: The market is pricing in one to two rate hikes by the end of the year.

Global Currencies: Dollar/euro likely range bound for now. We like euro/yen trade.

Corporates: Large new-issue calendar has put supply pressures on spreads, which are starting to look attractive.

High Yield: Fundamentals generally remain good, though pockets of weakness can be seen in industrials and energy.

Mortgages: Extension risk is keeping agency MBS in check, though Fed sponsorship helps. CMBS fundamentals remain supportive, but spreads are being pressured by new issuance and slipping underwriting standards.

Emerging Markets: Risk aversion and volatility in U.S. and European rates suggest caution is warranted here.

See You in September

- As Tom Petty said, "The waiting is the hardest part." Another policy meeting has passed with no action from the Federal Reserve Open Market Committee, which continues to stress that its decision to hike the federal funds rate will be "data dependent." We think the Fed wants to hike this year, and September certainly is still in play. However, if the central bank does take action at the end of the summer it's not likely to be driven by runaway inflation or evidence that the slack in the economy has been unambiguously eliminated. Instead, a Fed move in September likely would be prompted by the central bank's concerns about financial market stability.
- So that gives us about three months to party like it's 1999 — which was the last and only time in which the Fed raised short-term interest rates while core PCE (its favorite measure of inflation) was near the current level of 1.25%. It's widely accepted that this 1999 hike had little to do with inflation pressures or an overheating economy; rather, the Fed stepped in to unwind the easing it had introduced in response to the dislocations caused by the Long Term Capital Management crisis. In this instance, however, the Fed's good intentions were waylaid by the 2000 bursting of the dot-com bubble.
- Whatever justification the central bank uses for the eventual liftoff of its upcoming rate-hike cycle, the normalization of policy will in all likelihood be a slow, measured and well-telegraphed process. Of course, that doesn't mean markets will react as expected. For example, the first rate hike could inspire a re-pricing of the terminal federal funds rate beyond current forward rates, resulting in an initial steepening of the yield curve; eventually, though, the yield curve will experience the usual bear flattening should the Fed follow its historical pattern of overshooting market expectations.
- Of course, until Yellen and company actually take action, we're all just Fed watchers trying to interpret the clues the central banks scatters about. For the best look on how all this may play out, we'll need to look for inspiration that pre-dates Tom Petty. As The Happenings famously sang in 1966, "See you in September."

Spreads, Returns and Yields

			Returns (%)	
Index	Percentage of Index	Spread (bps)	May 2015	YTD 2015
Barclays U.S. Aggregate	**100**	**44**	**-0.4**	**1.2**
Treasury	36.1	0	-0.5	1.1
Investment Grade Corporates	23.9	128	-0.7	1.6
Fixed-Rate MBS	27.9	17	0.0	1.1
Other				
High Yield		439	1.2	3.8
Global Aggregate		41	1.1	-0.9
Emerging Markets		339	1.8	4.2

				Returns (%)	
Country	Yield on Ten-Year Bonds (%)	Currency		May 2015	YTD 2015
U.S.	2.12	EUR/USD	1.08	-2.1	-6.7
Germany	0.49	USD/JPY	119	-3.8	-2.9
Japan	0.39	USD/BRL	3.18	-5.2	-14.5
Brazil	12.22				

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

- The market is now pricing in one to two federal funds rate hikes by the end of the year. If wages and employment costs creep up over the next couple of months, we are likely to see bearish flatteners in the U.S. yield curve. In fact, once the Fed starts to move, it won't surprise us to see the yield on five-year Treasuries jump above 2.0% from the current 1.7%.

Global Currencies

- We expect the dollar/euro exchange rate will be range bound between 1.08 and 1.16, as it's hard to justify a bid for the dollar beyond 1.08 until there's more clarity about the remaining slack in the labor market. We like euro against yen, as we believe the most likely resolution of the Greek situation — namely, an 11th-hour compromise — will not damage the euro too much. Meanwhile, we are negative on yen despite its recent decline. With inflation lagging far behind the Bank of Japan's target of 2%, Japan has a difficult challenge ahead; it would not surprise us to see the BOJ introduce a negative policy rate this year.

Investment Grade Corporates

- With more than $150 billion in new issuance, the primary calendar for investment grade corporates set a record for May, and the strength has continued into June; large M&A transactions and opportunistic issuance to fund share buybacks have been the main drivers. While deals were well supported, investors struggled to absorb all of the new supply, resulting in pricing pressure and sending spreads back near year-to-date wide levels.
- This backup in investment grade spreads has left valuations more balanced, with room to tighten. A move higher in Treasury rates should be supportive of corporate spreads, as higher all-in yields bring insurance and pension buyers back into the market; however, corporates could feel a negative short-term impact if interest rates increase at a faster than expected pace.

High Yield Corporates

- High yield spreads tightened 6 basis points in May. Energy again outperformed the rest of the market, returning 0.5% compared to the 0.3% delivered by the rest of the sectors. Energy weakened in the back half of the month, however, as oil prices stalled near $60.
- Corporate fundamentals generally remain in good shape, though weakness in general industrial revenues and declining energy earnings are beginning to negatively impact credit statistics. Assuming the recent softness in domestic economic data proves transitory, the economic fundamentals remain supportive for credit.
- With spreads excluding energy approaching 400 basis points, valuation appears fair. Given the steepness of the credit curve and the differential between energy and non-energy issues, outperformance is likely to remain dependent on improvement in energy and/or lower-quality names. Absent any new developments, spreads are likely to experience modest widening pressure ahead of the September FOMC meeting.

Mortgages

- Agency mortgage performance ended May roughly flat to Treasuries. While prepayment fears further abated as interest rates rose, the impact of volatility and the budding fear of extension risk has kept mortgages from outperforming. Fed sponsorship is unchanged, but liquidity concerns and elevated volatility could pose headwinds to mortgages going forward.
- The favorable fundamental backdrop in housing and labor continues to fuel risk appetites across the residential mortgage-backed and asset-backed landscape. While mortgage credit availability has been slow to materialize, prospects for acceleration in mortgage lending represents an opportunity; signs of this already can be seen in recent housing-related data, fueling our strongly positive outlook for non-agency RMBS. In terms of ABS, credit availability is good and risk seekers have been rewarded year to date.
- Our view on commercial mortgages is less emphatic. While well-contained cap rates and rising valuations suggest fundamentals remain supportive of risk appetite in the space, a robust new-issue market has multiple implications that temper our enthusiasm. First, the well-stocked pipeline introduces a technical factor that compares unfavorably to conditions in the non-agency RMBS market, where new issuance has been inconsequential. Secondly, it suggests that risk discipline by CMBS lenders continues to slide. While the recent rise in rates should encourage yield-oriented buyers to participate in the sizeable upcoming issuance, these risks warrant caution.

Emerging Markets

- We affirm our cautious outlook for emerging markets debt, as price action is being impacted by volatility in U.S. and European rates. Technical factors have weakened somewhat, as the asset class saw some outflows from hard-currency credit markets, though this was somewhat abated by low sovereign issuance. Looking ahead, the main performance drivers will be the current yield and income, with risk aversion and U.S. rates volatility pushing prices in the coming weeks.

Past performance does not guarantee future results.

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