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.

Greece Is the Word

- With apologies to Olivia Newton John and John Travolta, the Greek public's "no" vote on the reforms necessary for additional rescue funds gave the market chills that soon were multiplying. "Better shape up" was the response from the country's troika of creditors. With banks closed and the economy on the verge of collapse, Greek lawmakers had no choice but to do just that, approving new austerity measures that proved the euro zone is the one that it wants.
- So with that, the low point of the latest "Grexit" tantrum appears to be behind us. While the past week has seen significant progress toward near-term stability in the euro zone, more positives are on the horizon; deliberations over the coming weeks should lead to improvements in the sustainability of Greek debt and the restructuring of its banking system. Although longer-term uncertainty about the region's lack of fiscal and monetary policy integration persists, the market's attention should gradually shift toward the currency bloc's economy and the impact of the European Central Bank's quantitative easing efforts. Some of the region's economic strength observed earlier in the year already has begun to fade.
- Though Greece has dominated headlines in recent weeks, the situation there is but one of three components of the global macro environment that will continue to influence markets. Domestically, the Federal Reserve is preparing to take its next steps toward policy normalization. We expect a fed funds rate hike this year — likely in September — but the initial increase should be small and the trajectory of the cycle relatively flat given tame wage-price inflation, low productivity and weak consumer demand. Meanwhile, there are concerns about the extent to which the recent meltdown in Chinese equities will hinder economic expansion locally and/or possibly spill over into other markets. While indexes had sold off 30%-plus in a few short weeks before stabilizing, the impact should be relatively contained. The last leg of the run up happened over a very short window of time — basically a few months leading up to mid-June — and thus had yet be incorporated into growth expectations within or outside China.

Spreads, Returns and Yields

			Returns (%)	
Index	Percentage of Index	Spread (bps)	June 2015	YTD 2015
Barclays U.S. Aggregate	**100**	**51**	**-0.1**	**6.0**
Treasury	36.1	0	-0.9	0.0
Investment Grade Corporates	23.9	143	-1.8	-0.9
Fixed-Rate MBS	27.9	27	-0.8	0.3
Other				
High Yield		468	-1.5	2.5
Global Aggregate		49	-0.4	-3.1
Emerging Markets		340	-1.4	2.8

				Returns (%)	
Country	Yield on Ten-Year Bonds (%)	Currency		June 2015	YTD 2015
U.S.	2.35	EUR/USD	1.12	1.5	-7.9
Germany	0.76	USD/JPY	123	1.4	-2.2
Japan	0.47	USD/BRL	3.10	2.4	-14.4
Brazil	12.62				

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 macro influences referenced on page one will keep bearish flattening pressure on the U.S. yield curve. The Fed rate hike runs the risk of perpetuating a low-productivity economy, which tends to have a flattening effect on the yield curve, while a European shift in focus from Greece to the region's economy and ECB activity is bullish for the long ends of both the Bund and Treasury curves. This will pressure the belly of the U.S. yield curve as the yield curve flattens.

Global Currencies

- We expect the euro to be well bid given progress on Greece, though it likely won't break an upper bound of 1.14 versus the dollar. As focus shifts back to the region's sluggish economy and the ECB's commitment to stimulative policy, euro/dollar will drift back down.
- We continue to be bearish on the yen. The odds of Japan hitting its 2% target rate for core inflation is very low despite some positive news from the summer wage negotiations. Easing policy in Japan will need to be reinforced sometime later this year.

Investment Grade Corporates

- Another month of heavier-than-expected new issuance kept pressure on credit spreads in June. Now nearing mid-2013 "taper tantrum" levels, spreads appear to present good value despite global macro headwinds. We'll look to second quarter earnings for more insight into the state of corporate fundamentals. Aggregate leverage continues to tick up from stress in the metals, mining and energy sectors, as well as debt-funded M&A activity in the industrial sector.
- While investment grade spreads appear attractive, they may remain cheap in the near term as any strength from better-than-expected earnings or relief from Greece and China headlines likely will be met with additional supply.

High Yield Corporates

- The strategy of "sell in May" worked yet again in the high yield market, as June performance was poor thanks to U.S. interest rate fears, Chinese equity volatility and the brinksmanship in Greece. Single B rated bonds outperformed the market, delivering the right balance of not too much rate risk (like BBs) and not too much credit risk (like CCCs). The energy sector weakened, as investors began to accept the reality that oil prices are likely to be capped for the foreseeable future.
- Improved U.S. economic data leave the fundamental backdrop for credit supportive. Meanwhile, corporate fundamentals have begun to weaken, but the pace of deterioration remains modest outside of energy and commodities. A broad spike in defaults remains unlikely in the near term.

Mortgages

- Rate volatility in June drove the basis wider. Fundamentally, mortgage cash flows remain attractive. Near-term performance remains vulnerable to technical demand, with traditional investors remaining on the sidelines awaiting a more attractive entry point or conviction of lower rate volatility. We maintain a neutral stance on agency mortgages.
- Favorable housing and labor fundamentals continue to drive risk appetite within residential mortgage-backed securities. Recent housing data show signs of improving mortgage-credit availability, which supports our positive view as we begin the third quarter. While increases in interest rates pose a threat to home affordability, improvements in employment and wages should help mitigate some portion of the increase in mortgage costs. The reemergence of global macro concerns favors the relative safe haven and low correlation offered by more traditional asset-backed security sectors like credit cards and autos.
- Our view on commercial mortgage-backed securities remains relatively cautious. While commercial real estate fundamentals remain supportive, persistent new-issue supply is a headwind. Additionally, rising concerns about the further loosening of underwriting standards is providing an additional challenge to CMBS.

Bond Market Outlook

Global Interest Rates: Macro influences are keeping bearish flattening pressures on the U.S. yield curve, while a re-focus on the ECB is supporting long Bunds.

Global Currencies: While the euro should find support given progress on Greece, moribund Japanese inflation is bearish for the yen.

Corporates: Continued technical pressures have driven spreads to attractive levels, but a catalyst will be needed to inspire near-term tightening.

High Yield: Improving U.S. data leave the fundamental backdrop supportive, while deterioration in corporate fundamentals is mostly modest.

Mortgages: Agency MBS look fairly valued. Supply and underwriting concerns are pressuring CMBS.

Emerging Markets: Despite ample global liquidity and higher yields, we remain cautious on emerging market debt.

Private Credit: The low-yield environment continues to drive strong issuance in the market, as companies look to take advantage of historically low borrowing costs.

Mortgage Derivatives: A benign prepayment environment, modest new supply and strong demand are all constructive for mortgage derivatives.

Commercial Mortgage Loans: Opportunities in the multi-family space remain for life companies, as GSEs have little left to allocate.

Emerging Markets

- Despite ample global liquidity and higher yields, we remain cautious on emerging market debt. Nevertheless, continued strength in the U.S. dollar makes emerging market hard-currency debt a positive carry play, and we remain negative for debt denominated in local currencies. Risks to the asset class continue to mount, including pockets of idiosyncratic country risk and the long-term impact of a slowing Chinese economy on commodities.
- In this environment, we remain extremely selective in our risk positioning. As current yield and income will be the main performance driver, we aim to maximize carry while reducing portfolio interest rate risk.

Private Credit

- Demand for private credit assets remains robust. The low-yield environment continues to drive strong issuance, as companies look to capitalize on historically low borrowing costs. U.S. private credit is currently trading at a fair spread to public investment grade credit, while providing investors with the usual structural advantages characteristic of the asset class.

Mortgage Derivatives

- After tightening considerably over the previous few months, mortgage derivative spreads were little changed in June. Given steady realized prepayment speeds, carry in the sector was subdued. Until realized speeds catch up with the market's more benign prepayment expectations, carry's contribution to total return will remain limited.
- We are constructive on mortgage derivatives. While spreads are tighter than they were earlier this year, they have yet to fully retrace to December levels, and ample opportunity remains at both the sector and security levels. The prepayment environment is quite benign, and seasonal prepayment drivers will diminish as we approach the fall. New supply is modest, while demand for the asset class remains strong in light of fears in other financial markets.

Commercial Mortgage Loans

- Yields of commercial loans have remained stable throughout bouts of volatility in the Treasury market. Supply is robust, but spreads remain fairly well contained.
- Opportunities remain for life insurance companies in the multi-family space — i.e., increased loan volume and wider-than-typical spreads — as the government-sponsored entities have nearly used up their annual allocations to the assets. We also continue to see plenty of opportunity in higher-risk real estate deals like bridge or mezzanine loans, as CMBS volatility is driving borrowers to the loan market instead.

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