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 June 30, 2015, Voya Investment Management managed $125 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: U.S. rates will be driven by two macro forces: the Fed and China's slowdown putting pressure on already-weak commodity prices.

Global Currencies: The trade-weighted U.S. dollar will continue to appreciate until oil prices stop falling.

Corporates: Investment grade corporate bond spreads are attractive, though a catalyst will be needed to improve overall market sentiment and drive spreads tighter.

High Yield: While U.S. economic growth remains supportive, the potential for further weakness in China or other emerging markets poses a risk.

Mortgages: Mortgage performance remains volatile as the market has become increasingly focused on the timing of the first fed funds hike.

Emerging Markets: We favor better-rated hard-currency debt over local markets while looking for opportunities in oversold credits and currencies.

Rates: The Final Frontier

- In the original *Star Trek*, Captain Kirk relied heavily on his human/Vulcan science officer Mr. Spock for guidance. Captain Picard, who helmed the series for one of its several reboots, found a confidant in an android by the name of Data. Similar to the crews of the starship Enterprise in all its iterations, the Federal Reserve boldly went where no other Federal Open Market Committee had gone before, embracing zero interest rate policy in 2008. But it's time to return home, and the Fed has long-stated that it would pursue a more Picard-esque — i.e., "data-dependent" — approach to the timing and trajectory of its rate liftoff.
- Captain's log, stardate August 2015, and we still think the Fed is likely to hike this year given continued improvements in the job market. That said, economic growth has been far from stellar in the six years since we first emerged from recession; there is very little sign of wage pressures or general inflation, and consumers remain cautious, as evidenced by timid retail sales and increasing retail inventory accumulation. Consequently, logic dictates that any Fed action would be driven by its desire to begin normalizing money markets more than anything else. Meanwhile, despite all evidence pointing toward a slow, deliberate trajectory of hikes, the reaction of capital markets remains uncertain; this is especially true among those sectors that have surged during six years of ZIRP, like emerging market debt.
- Speaking of emerging markets, the weakness in the Chinese economy is the other major force at play on the macro environment. While we don't think a hard landing is likely in China, Beijing's urgency to cling to any sort of growth impulse — as reflected by the recent depreciation of the yuan — is troubling and may suggest the country's slowdown is worse than official data indicate. Any further signs of weakening in the Chinese economy or in the economy here at home and/or the continued deterioration of commodity prices may give some ammunition to Fed doves, further confusing markets trying to digest the coming rate-hike cycle.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%)	
			July 2015	YTD 2015
Barclays U.S. Aggregate	**100**	**55**	**0.7**	**0.6**
Treasury	36.2	0	0.8	0.9
Investment Grade Corporates	24.0	154	0.7	-0.3
Fixed-Rate MBS	27.8	28	0.6	0.9
Other				
High Yield		513	-0.6	1.9
Global Aggregate		49	0.2	-2.9
Emerging Markets		362	0.1	2.9

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%)	
				July 2015	YTD 2015
U.S.	2.18	EUR/USD	1.10	-1.5	-9.2
Germany	0.64	USD/JPY	124	-1.1	-3.3
Japan	0.42	USD/BRL	3.42	-9.3	-22.3
Brazil	12.97				

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

- U.S. rates will be driven by two macro forces: the Fed and China's slowdown pressuring already-weak commodity prices. The fed funds futures market is currently pricing in a one-third chance of a September rate hike and near-complete certainty of Fed action before the end of 2015. As the hike nears, real interest rates in the front end of the Treasury curve have some room to sell off, though inflation break-evens will continue to drive nominal rates lower until oil prices stop falling. The net effect will be further flattening of the yield curve.
- When the Fed actually starts hiking — and if the pace ends up closer to the Fed's dot plot as opposed to the more moderate climb priced in the forwards — the yield curve may flatten more significantly. This second round of flattening would be the result of the market pricing in a low-productivity and low-potential-growth economy locked in by the Fed hikes. Our belief is that the Fed ultimately will act even more slowly than markets currently expect.

Global Currencies

- The trade-weighted dollar will appreciate at a steady pace until oil prices establish a new equilibrium. Non-China Asian currencies are likely to fall as markets price in fears of a currency war triggered by China's recent devaluation of the yuan.

Investment Grade Corporates

- The investment grade corporate market is facing headwinds from weaker commodity prices, lower foreign-sourced earnings due to dollar strength, rising event risk from M&A and stock-buyback activity, heavy new-issue supply and potentially less accommodative monetary policy within the U.S.
- Corporate spreads are approaching levels that are more consistent with recession than with ongoing economic expansion. We expect the U.S. economy to continue its steady growth as well as some global improvement the rest of this year, suggesting that much of the negative risks to corporates already have been priced into the market. While we view corporate spreads as attractive, tightening will likely require some sort of sentiment-improving catalyst.

High Yield Corporates

- Once again, the story in July was all about commodities, with the energy and metals & mining sectors selling off sharply as commodities crashed. However, the rest of the high yield market posted modest positive returns, with a high degree of dispersion across winners and losers.
- Continued domestic growth remains supportive, though the potential for further weakness in China and other emerging markets presents additional risk. Corporate fundamentals have begun to weaken, with a lack of top-line growth proving particularly challenging for the most highly leveraged companies. Headline default rates are starting to increase; however, this has been focused in the energy and metals & mining sectors, and a broader increase in defaults is a low-probability event in the near term. The selloff leaves high yield spreads at attractive levels given our belief that the credit cycle has a way to go.

Mortgages

- Mortgage performance remains volatile, as the market has become increasingly focused on the timing of the first fed funds rate hike. Mortgage cash flows continue to provide excellent carry versus duration-neutral Treasuries, and prepayments remain subdued. Technicals remain a risk, with non-Fed demand uncertain and seasonal supply peaking.
- Housing and labor continue to shape our positive fundamental outlook for non-agency RMBS. Although mortgage credit availability has been slow to expand, prospects for acceleration are emerging. As the increase in home prices and potential for higher interest rates poses a threat to affordability, employment/wage gains will be needed to mitigate the increase in mortgage costs. We favor traditional ABS sectors like credit cards and autos, as they can provide a relative safe haven from various macro concerns.
- For CMBS, our near-term outlook is more cautious given technical headwinds from elevated new-issue supply. Our fundamental view remains favorable. If loan underwriters begin to pull back supply ahead of the September Fed meeting, the outlook for the sector should improve, as commercial real estate fundamentals remain firmly supportive.

Emerging Markets

- China's liberalization of its currency markets sent a shock wave across the emerging world. Though the risk of a widespread currency war is minimal, China's devaluation hurt commodity-sensitive currencies and credits globally. While political noise in Brazil and Turkey has presented further challenges, we are not expecting any major credit events.
- The potential post-Labor Day launch of the Fed tightening cycle and the wording related to it will set the tone for emerging markets for the remainder of the year. Therefore, despite the emergence of opportunities in oversold credits and currencies, we favor better-rated hard-currency debt over local markets going into autumn.

Past performance does not guarantee future results.

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