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 should drift lower as a lack of global inflation will support bond prices.

Global Currencies: The yen looks poised to appreciate versus the U.S. dollar thanks to weaker Japanese inflation and growth expectations and the lack of additional BOJ action.

Corporates: Despite the rout in commodity-sensitive sectors, fundamentals for the overall market remain supportive.

High Yield: Continued U.S. growth remains supportive for high yield spreads, though the potential for further weakness in China and other emerging markets poses risks.

Mortgages: ABS and non-agency RMBS provide safe havens from the negative macro forces hurting other risk markets.

Emerging Markets: Hard-currency spreads have widened, providing for select opportunities. Local-currency issues have been hit harder; better Fed clarity will be needed before these bonds become attractive.

Wake Me up When September Ends

- *Summer has come and passed. Can zero interest rates really last? Seven years has gone so fast. Wake me up when September ends.* Green Day fan or no, an investor could be forgiven for wanting to sleep through the volatility that has emerged over the past couple of months in anticipation of the FOMC's pivotal September 16–17 policy meeting. While it was once widely expected that this gathering would result in the central bank's long-anticipated move away from zero interest rate policy, more recent financial market gyrations on fears about weak global growth and moribund inflation inspired doubts that a third quarter hike was truly in the offing. This intuition proved prescient, as the Fed remained on hold in September, citing concerns about recent "global economic and financial developments."
- Of course, some of the August market tumult was an early signal of what may lie ahead once the Fed actually pulls the trigger. For example, flows from emerging market central banks, especially China, have reversed. We think these central banks will continue to sell developed market sovereign debt (namely, U.S. Treasuries) in an effort to support their currencies, offsetting some — but nowhere near all — of the ongoing quantitative easing efforts by developed market authorities like the Bank of Japan and European Central Bank. The BOJ is in a particularly difficult situation, having increased its monetary base by close to $2 trillion with little success in boosting inflation to its 2% target. Even with inflation likely to turn negative in the coming months, the BOJ won't expand QE until it remains below zero for an uncomfortable period of time.
- Fixed income markets likely will take the Fed's dovish September announcement somewhat positively, although the reaction will be modest. We think the Fed has a short window of time in which to hike, and that window is closing. With two FOMC meetings left in 2015, futures markets are pricing in a 40% chance of a rate hike before year end. The big challenge for the Fed is that so few market participants think a hike is appropriate given the extremely weak outlook for global inflation. Moreover, we think it will be very difficult for the central bank to manage the "few hikes and done" message.

Spreads, Returns and Yields

			Returns (%)	
Index	Percentage of Index	Spread (bps)	August 2015	YTD 2015
Barclays U.S. Aggregate	**100**	**57**	**-0.1**	**0.4**
Treasury	36.2	0	0.0	0.9
Investment Grade Corporates	23.9	163	-0.6	-0.8
Fixed-Rate MBS	28.0	27	0.1	1.0
Other				
High Yield		544	-1.7	0.2
Global Aggregate		51	0.1	-2.7
Emerging Markets		392	-1.3	1.6

				Returns (%)	
Country	Yield on Ten-Year Bonds (%)	Currency		August 2015	YTD 2015
U.S.	2.2	EUR/USD	1.12	2.1	-7.4
Germany	0.8	USD/JPY	121	2.2	-1.2
Japan	0.4	USD/BRL	3.62	-5.5	-26.6
Brazil	14.3				

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. interest rates will likely drift lower from current levels. While the interaction between the selling by emerging market central banks and the buying by developed market central banks has kept rates elevated thus far, we think low to negligible global inflation will dominate bond market pricing during the months to come, putting downward pressure on yields. Ongoing ZIRP combined with the Fed lowering its inflation expectations and rate outlook will also support bond prices and keep yields low. Given this, we like to be long the ten-year point of the U.S. Treasury curve.

Global Currencies

- With the Bank of Japan unlikely to provide additional stimulus in the next few months, the Japanese yen should appreciate against the dollar given expectations for weaker inflation and slower economic growth. Notably, the yen's real effective exchange rate — which accounts for inflation — is at historical lows.

Investment Grade Corporates

- The rout in commodity-sensitive sectors like metals and energy led the move wider in corporate credit spreads over the past month; year-over-year revenue growth for these sectors was down 14% and 22%, respectively. However, outside the commodity-related names, sales growth was 3.9% while EBITDA expanded 4.0%, the best performance since third quarter 2012, suggesting fundamentals for the overall investment grade corporate market remain supportive.

High Yield Corporates

- The high yield market posted a third consecutive month of negative returns in August, driven by a combination of negative news from China, uncertainty about the timing of the first Fed rate hike and increased equity volatility. Weakness spread from the usual suspects (energy, commodities and CCC rated issues) to the broader market, though commodity-related sectors suffered most as the market continued to differentiate between the "haves" and the "have-nots" among high yield names.
- The prospect of continued U.S. growth remains supportive for high yield spreads, though the potential for further weakness in China and other emerging markets presents additional risk. High yield corporate fundamentals have begun to weaken, with the lack of top-line growth particularly challenging for the most highly leveraged companies. Though headline default rates are starting to increase, the risk of a near-term spike in defaults remains low outside the energy and metals sectors.

Mortgages

- Agency mortgages delivered positive relative performance in August. Macro uncertainties increased the market's perception of a delay in Fed tightening and therefore an extended reinvestment period, which is supportive of agency mortgage-backed securities. Agency mortgages also seemed to benefit from a flight-to-quality and/or flight-to-liquidity as markets grew agitated.
- Asset-backed securities and non-agency residential mortgage-backed securities have remained safe havens from the negative macro forces hurting other risk markets. Favorable housing market indicators and stable labor markets combined with negative news from China and the commodity complex have fueled continued risk appetite in these sectors.
- The near-term outlook for commercial mortgage-backed securities continues to be cautious, as elevated new-issue supply tempers our otherwise positive fundamental view of the sector.

Emerging Markets

- The emerging world is still digesting the long-term impact of the Chinese decision to liberalize its currency, capital outflows and the resulting technical impacts to valuations. The downgrade of Brazilian debt to non-investment grade by Standard & Poor's confirmed that emerging markets are still confronted with significant idiosyncratic risk and uncertainty.
- Nevertheless, while the emerging markets as a whole seem somewhat dislocated, we favor adding select hard-currency investments; hard-currency credit risk premiums have widened to levels not observed for months. Weakness in local-currency issues, while more severe, will likely benefit the external accounts of emerging market countries over time. Lastly, were the Fed to provide more clarity on the magnitude and duration of its rate-hike cycle, select opportunities within local-currency markets should materialize.

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