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, 2015, Voya Investment Management managed $127 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: The U.S. yield curve will continue flattening, as expectations for long-term inflation and real rates decline.

Global Currencies: We are long the euro, believing that QE expansion in Europe is unlikely. Meanwhile, the Fed either will under-deliver on future tightening or subsequent hikes will be priced by the market as inappropriate, neither boding well for the dollar.

Corporates: We see opportunities in select BBB credits and favor intermediate-term bonds over longer-maturity issues.

High Yield: Current valuations look fair, but fundamentals need to improve for us to be more constructive over the intermediate to longer term.

Mortgages: We remain neutral on agencies, awaiting clarity on the path of interest rates. Non-agency, CMBS and ABS issues remain attractive.

Emerging Markets: We favor stable and better-rated sovereign and corporate credits over high-yielding or commodity-related credits.

The Fed Awakens

Macro Overview

- Not that long ago on a continent not too far away, a central banker's dovish actions disappointed the capital markets. Investors in November anticipated an expansion of asset purchases from the European Central Bank but got only a small rate cut and an extension of the current quantitative easing effort. In truth, most economic activity and inflation indicators suggest that the euro zone economy has been improving, and the necessity of further easing was questionable. But the ECB had prepared the market for it and was unable to deliver, possibly due to opposition from its more prosperous members.
- Meanwhile in the United States, the Federal Reserve has maintained a zero interest rate policy for 2,556 days in an attempt to convince investors to move out of the safest of fixed income investments and into more risky assets. Bond investors, however, do not crave adventure or excitement. The market did not like the Fed's message that the December hike was essentially a done deal, causing rates to rally and the yield curve to flatten, a classic reaction to the perception of an inappropriate hike. U.S. growth is still tethered by low productivity and low potential growth. So when the Fed says, "Fear not higher rates, fear is the path to the dark side," markets are not convinced. Markets see a meaningful set of hikes — the Fed is messaging four in 2016 — that run the risk of perpetuating low potential growth. That's why forward interest rates are falling and the dollar is not appreciating. Meanwhile, the recent downturn in the price of oil has added to the complexity around future Fed actions. Lower oil prices could add more disinflationary pressure to both core and headline inflation measures, making the Fed hike even more inappropriate.
- While Chair Yellen continues to say that a rate hike off of zero is not tightening, bond investors appear to be immune to her Jedi mind tricks.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%)	
			Nov. 2015	YTD 2015
Barclays U.S. Aggregate	100	54	-0.3	0.9
Treasury	36.2	0	-0.4	1.0
Investment Grade Corporates	24.3	155	-0.2	0.1
Fixed-Rate MBS	28.3	25	-0.1	1.5
Other				
High Yield		597	-2.2	-2.0
Global Aggregate		49	-1.7	-3.7
Emerging Markets		387	-0.3	2.7

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%)	
				Nov. 2015	YTD 2015
U.S.	2.2	EUR/USD	1.06	-4.0	-12.7
Germany	0.5	USD/JPY	123.00	-2.0	-2.7
Japan	0.3	USD/BRL	3.87	-0.3	-31.3
Brazil	15.9				

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

- We think the U.S. yield curve will continue flattening. Not only will the long-term inflation outlook decline, real rate expectations also will fall because the bond market will increasingly treat the economy's current low potential growth rate as permanent.

Global Currencies

- We don't like to be long dollar in light of higher short-term rates in the U.S. We prefer the euro given the U-turn in the ECB's messaging, and we believe further QE expansion in Europe is highly unlikely at this point. At the same time we see the Fed either under-delivering on future tightening actions or subsequent rate hikes being priced by the market as inappropriate; neither bode well for the dollar.

Investment Grade Corporates

- The investment grade corporate market has shakier off falling commodity prices of late and has been able to outpace Treasuries. Demand for high grade bonds was broad based — aside from the troubled metals and energy space — as $100 billion of new-issue supply was well received.
- Support for investment grade bonds was concentrated in the higher quality part of the market, as A rated securities led the rally. This leaves valuations in the BBB sector looking attractive, and we continue to see opportunities in select issues here. We continue to favor intermediate over longer-maturity bonds.

High Yield Corporates

- The high yield market resumed its widening trend recently, as third-quarter earnings failed to impress and volatility increased in the distressed portion of the market. The damage in recent weeks was not limited to energy and commodities, and continued to spill over into sectors such as health care and retail. Higher-quality sectors again outperformed lower-quality ones, pushing the BB-CCC spread to its highest point since mid-2009.
- The lack of top-line growth remains particularly challenging for the most highly leveraged companies. High yield has underperformed equities, investment grade corporates and bank loans — a rare combination. With the exception of a brief rally in October, there has been a steady drift wider in spreads. While valuations now appear reasonably attractive and a year-end rally is not unreasonable, we believe a broad improvement in fundamentals is needed to support a more sustained rally.

Mortgages

- Despite year-end balance sheet pressures and increased financing costs, agency mortgages have performed well versus U.S. Treasury securities. Lower interest rate volatility and steady demand from foreign investors and banks has helped mortgages. Supply remains relatively contained, and indications from the Fed suggest a "tapering of reinvestments" will largely be delayed into 2017, allaying market fears of increased supply over the next year.
- Our views of non-agency RMBS and ABS remain positive. The sectors continue to benefit from a lack of correlation with other spread sectors that have suffered from recent spikes in risk aversion. Supportive fundamentals from housing and a shrinking legacy universe have bolstered non-agency RMBS price stability. Meanwhile, signs of increasing credit availability signal further potential upside.
- We are also positive on the near-term outlook for CMBS, as a combination of wider credit spreads and moderating new-issue supply should benefit the sector. In our view, the longer-term outlook for the sector remains positive: Negative net supply and strong commercial real estate fundamentals should benefit CMBS performance well into 2016.

Emerging Markets

- The economic growth outlook continues to be the major concern facing emerging market countries as we end 2015. Macro divergence across the various regions is likely to last well into 2016, as fiscal and monetary policy support will remain limited. What's more, corporate deleveraging will be a drag on growth. In contrast, average household debt in emerging markets remains low. Also, consumption and a pickup of specific exports could surprise on the upside in economies that are showing signs of bottoming out.
- Differentiation and credit selection will be the key investment themes in 2016, since some countries will still face domestic and political headwinds. We favor stable and better-rated sovereign and corporate credits over idiosyncratic, high yielding and commodity-related credits. We remain cautions on local currencies, as Fed action will determine the tone and direction of the currency markets.

Past performance does not guarantee future results.

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