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.

Bond Market Outlook

Global Interest Rates: Rate hikes in a low-productivity environment points to a long-run flattening of the U.S. yield curve.

Global Currencies: We like to be long dollar against the euro as central bank policy divergence looms.

Corporates: Spreads remain attractive; we continue to favor financials over industrials and U.S. consumer-oriented names versus those with larger international footprints.

High Yield: Headline valuation appears reasonable, but finding value in names with good fundaments has become challenging after the recent rally.

Mortgages: Agency mortgage valuations appear rich. We remain positive on non-agency mortgages and ABS markets and have upgraded our near-term outlook for CMBS.

Emerging Markets: We favor better-rated credits among sovereigns and corporates. We are neutral on local-currency investments as we wait for the Fed.

For Your Eyes Only

- While diamonds are forever, zero interest rate policy (ZIRP) in the U.S. appears to be coming to an end. Most agree a federal funds rate hike is likely at the December 15–16 FOMC meeting, though the spectre of higher short-term interest rates has some market participants uneasy and has left futures markets short of 100% consensus on a hike. Although the Federal Reserve has a license to kill easy money policy at the time of its choosing, FOMC members are explaining the move off ZIRP as a step toward "normalization" of interest rates rather than an outright tightening; moving rates higher serves to reload the Fed's golden gun of monetary policy, the story goes, and provides it with some needed ammunition should the economy again slow. The central bank also argues that the equilibrium of real interest rates are near zero currently and will rise over time to around 1.50%; given that short-term rates allowing for inflation are near -1.0%, there is room for 100 bps worth of hikes without shifting to a contractionary policy mode.
- Market participants are not fully satisfied by either of the Fed's rationales, and are pricing in only a 70% chance of a December hike. Some observers suggest the logic of raising rates simply to facilitate potential future easing has no clear basis in economics, as it assumes a linear and symmetrical relationship between policy rates and the economy: What if the economic disruption that results from the hike necessitates an easing of greater magnitude than the hike itself? In addition, a Fed hike risks permanently sealing in the current low levels of productivity and potential growth for the economy. Third, the rise of the dollar already has tightened financial conditions; some estimate that dollar strength combined with widening corporate bond spreads equates to nearly 75 bps of fed funds rate hikes.
- In our judgment, an extremely odd jobs report is likely the only thing standing in the way of a December Fed move. Transparency and clear communication from the central bank will be important to ensure markets are not overly shaken or stirred by Fed action.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%) Oct. 2015	Returns (%) YTD 2015
Barclays U.S. Aggregate	**100**	**53**	**0.0**	**1.1**
Treasury	36.2	0	-0.4	1.4
Investment Grade Corporates	24.2	156	0.4	0.3
Fixed-Rate MBS	28.2	23	0.1	0.1
Other				
High Yield		545	2.7	0.2
Global Aggregate		49	0.2	-2.0
Emerging Markets		369	2.7	3.0

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%) Oct. 2015	Returns (%) YTD 2015
U.S.	2.1	EUR/USD	1.10	-1.6	-9.1
Germany	0.5	USD/JPY	120.62	-0.8	-0.7
Japan	0.3	USD/BRL	3.86	3.6	-23.2
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

- The yield curve should flatten in anticipation of the December Fed meeting, as the market has yet to be fully convinced that action will result and the potential economic growth rate remains tepid. While the periodic acceleration of economic data will likely drive curve steepening from time to time, the fundamental scenario of rate hikes in the face of a low-productivity environment points to long-run flattening of the yield curve.

Global Currencies

- We like to be long dollar against the euro, as central bank policy divergence is expected to commence in the near future. However, in anticipation of the December European Central Bank meeting — and given the possibility that the ECB might not deliver the extension or expansion of QE that is widely anticipated by the market — long dollar against Japanese yen will be a safer position.

Investment Grade Corporates

- Third quarter earnings repeated the theme of recent quarters, with revenue growth in line and earnings beating lowered expectations. With recent PMI data trending better, however, we have some optimism that 2016 will be improved on the revenue front. That said, a further rally in the dollar could pressure commodity prices and international-derived revenue.

- We continue to favor financials over industrials, as M&A looks poised to come back into focus given waning equity market volatility. We also prefer U.S. consumer-oriented names versus business models with larger international footprints. Despite a nice rally of late, investment-grade spreads continue to be attractive at current valuations. While the risks from a potential December hike remain, they should be mitigated somewhat by positive seasonal technicals as new-issue supply slows into the end of the year.

High Yield Corporates

- The high yield market gained 2.7% last month as a recovering equity market, modestly more upbeat U.S. economic data and a yield near 8% combined to attract cash back to the asset class while a dearth of new issuance kept supply limited. Investors seemed less than completely convinced, however, and generally limited their enthusiasm to the higher-quality part of the market, with CCC rated bonds and the troubled energy and commodities sectors continuing to underperform.

- The uptick in U.S. economic data gives us some additional confidence in our fundamental view that the domestic expansion continues. However, the market impact of the Fed finally beginning to raise rates remains a concern. Valuation of the aggregate market still appears reasonable at first blush, but the better-quality names in high yield look to be more fair to richly valued after the recent strong run and ahead of the first rate hike.

Mortgages

- Very strong demand from overseas investors and domestic banks drove agency MBS outperformance for the month. The FOMC's perceived dovish decision in September enticed many yield-based investors to enter the market; surprisingly, those same investors continued to buy even after more "hawkish" minutes were released from the FOMC's October meeting. Given the strong rally in MBS, valuations appear rich in our judgment.

- We remain positive in our view of the non-agency RMBS and ABS markets, as the bid for risk appears to be reemerging. Non-agency RMBS prices have demonstrated resolute stability, as supportive fundamentals from housing and a shrinking legacy supply provide a positive backdrop. Within ABS, safer sectors like credit cards and autos (which tend to be less correlated to other risk assets) may not provide overwhelming relative value to other sectors, though they remain poised to offer positive absolute performance as spreads retrace recent widening.

- We've upgraded our near-term outlook for CMBS on the basis of improved relative value. Following several weeks of underperformance against competing spread products, CMBS spreads should tighten from their year-to-date wides. While elevated primary supply and narrowing swap spreads remain headwinds, wider credit spreads and higher all-in yields improve the relative attractiveness of the sector. The longer-term outlook remains positive, as negative net supply and strong commercial real estate fundamentals support CMBS performance.

Emerging Markets

- Macroeconomic divergences and political uncertainties have accelerated in recent weeks, particularly in Latin America and commodity-sensitive countries. Lower growth, falling government revenues, weaker currencies and increasing inflation all are challenging policymakers in their search of the right mix of fiscal and monetary policy. A Fed hike in the near term may alleviate a significant source of uncertainty, allowing for capital inflows to return to the emerging markets. We still favor stable and better-rated credits among sovereigns and corporates. We are neutral on local-currency investments as we wait for the Fed action to give a better clarity for the U.S. dollar outlook.

Past performance does not guarantee future results.

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