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. bond market is likely to be pulled by slowing domestic growth on one side and stabilizing oil on the other. Modest conviction on the latter leads us to favor longer-term TIPS.

Global Currencies: The rally in the euro and yen against the dollar is likely to continue.

Corporates: While we see good long-term value in spreads, a catalyst for near-term tightening remains elusive.

High Yield: Valuations appear reasonably attractive, but sustained tightening requires an improved fundamental outlook.

Mortgages: While our near-term view of agency RMBS is neutral, fears of the eventual end of Fed reinvestment persist. We remain positive on non-agency RMBS and ABS.

Emerging Markets: We favor better-quality, liquid and blue-chip issuers in hard-currency credits, and remain extremely selective in local-currency issues.

Here Come the Monkeys

- According to the Chinese lunar calendar, 2016 is the Year of the Monkey, a time said to be full of ambition, adventure and irritability. That third characteristic has been broadly evident as this new year dawned in February, with turbulence in the capital markets proving quite the irritant for investors around the globe.
- The slowing U.S. economy, evidence of which has emerged rather suddenly over the past few months, is one of the developments troubling markets. While the domestic deceleration can be explained in part by the delayed impact of the dollar's rally against many developed market currencies, the greenback's strength is not manifesting itself in the usual way; net exports — a typical casualty of a surging dollar — have been stable in recent readings. The current transmission mechanism boasts a new twist, as the strong currency is depressing corporate profits, which in turn is affecting consumption demand here at home, as evinced by declining personal spending data.
- Recent declines in asset prices, meanwhile, already have begun to weigh on aggregate wealth, providing a secondary headwind to the domestic and global economies. That said, oil prices have exhibited some signs of resilience near $30/barrel in recent trading sessions; if crude can hold this level or perhaps move even modestly higher, the Federal Reserve's inflation targets may be in reach sooner than expected.
- Such is the duality of today's bond market: As they battle to influence the prospects for target-level inflation, the yin of slowing economic activity opposes the yang of stable (to possibly rebounding) oil prices. At this point, we expect the yang to prevail in 2016 and therefore remain constructive on domestically focused spread sectors like U.S. investment grade corporates, asset-backed securities and non-agency residential mortgages.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%) Jan. 2016	Returns (%) 2015
Barclays U.S. Aggregate	**100**	**63**	**1.4**	**0.5**
Treasury	36.7	0	2.1	0.8
Investment Grade Corporates	24.1	193	0.4	-0.7
Fixed-Rate MBS	28.5	21	1.3	1.5
Other				
High Yield		736	-1.6	-4.5
Global Aggregate		56	0.9	-3.2
Emerging Markets		448	0.0	1.3

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%) Jan. 2016	Returns (%) 2015
U.S.	1.9	EUR/USD	1.08	-0.3	-10.2
Germany	0.3	USD/JPY	119.00	-0.8	-0.4
Japan	0.1	USD/BRL	3.18	-0.9	-32.9
Brazil	16.2				

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 that the U.S. bond market will be pulled in two directions. On one side it will face rallying pressure from slowing U.S. growth, some of which has already been priced into the market. At the same time, oil prices cannot fall forever; a simple flattening in the price of crude will help push long-term inflation expectations higher. We expect inflation to prevail and thus like long-term TIPS.

Global Currencies

- The rally in the euro and yen against the dollar is likely to continue for a while. The repatriation of capital back into Japan by local investors will not likely cease, while the prospect remains that policy rates will go even more negative. In addition, we expect the Fed will back away from its 2016 rate-hike plans within the next few weeks. Consequently, we prefer being short the dollar relative to euro or yen at these levels.

Investment Grade Corporates

- Corporate spreads widened significantly to start 2016 and are now approaching 200 basis points, a level not seen since the European financial crisis in 2011. Spreads are pricing in something close to a mild recession; given this is not our base case — we expect continued modest expansion — we think there is good long-term value at current spreads. However, a catalyst for near-term spread tightening remains elusive. The longer-term path to tighter spreads probably requires improving economic data to bolster investor confidence.
- Heavy new-issue supply is expected to continue, with the M&A pipeline scheduled to dominate issuance in the first quarter before moderating. We continue to see a fairly robust deal market as companies look to create growth through combinations and cost-cutting, though recent deals have been structured to include more equity to maintain investment grade ratings.

High Yield Corporates

- The high yield market started 2016 where it left off 2015. Despite reports of high cash levels and limited issuance within high yield, investors were not in a risk-taking mood. Prices followed equity markets lower for the first half of January, before staging a bit of a rally to cut losses by month end.
- With corporate earnings generally weak and economic data threatening to roll over, there has been little investor enthusiasm for the high yield asset class. While valuations appear reasonably attractive at current levels, a sustained move tighter likely requires an improvement in the fundamental outlook.

Mortgages

- With 30-year fixed-rate mortgages currently at 3.75–4.00%, approximately 50% of outstanding agency MBS pools have a refinance incentive of 50 basis points or more. That said, most borrowers have experienced these rate levels before in the current cycle, thus decreasing the marginal refi response.
- The market continues to focus on Fed reinvestment; the latest weak GDP print in conjunction with overall global weakness suggests that the Fed will continue to reinvest the proceeds of maturing securities throughout 2016. Meanwhile, speculation about an additional rate cut to single-family loans grew following the Federal Housing Administration's announcement that it was cutting mortgage insurance premiums for multifamily loans. In our view, however, this is not likely to occur until later this year, if at all.
- Our view of non-agency RMBS and ABS remains positive. Non-agency RMBS prices have demonstrated resolute stability, as supportive fundamentals from housing and a shrinking legacy universe provide an advantageous backdrop. Within ABS, safer sectors like credit cards and autos are benefitting from the risk-off backdrop, as reallocations into this high-quality asset class have been apparent.
- We have downgraded our near-term outlook for CMBS to negative, as challenging market technicals and diminished relative value limit the sector's attractiveness. Given a swelling new-issue pipeline and tepid primary demand, performance for the sector is expected to be challenged over the near term. However, our longer-term outlook remains positive, as negative net supply and strong commercial real estate fundamentals should support CMBS performance more broadly later in 2016.

Emerging Markets

- After a volatile and weak start to the new year on the back of increasing uncertainties in China and in the commodity space, emerging markets have rebounded. Oversold commodity-sensitive credits and currencies, in particular, have reacted positively to an oil and metals rally and central bank easing.
- Investors are currently distinguishing between attractive credits that cheapened during the market selloff while reassessing the long-term impact of fundamentals and the credit metrics of commodity-related and high yield credits. We favor better-quality, liquid and blue-chip issuers in our credit selection. We recently reduced our structural underweights in local-currency issues but remain highly selective as volatility may quickly erode the attractiveness of local yields.

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