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 December 31, 2015, Voya Investment Management managed $125 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: We like to be long the U.S. bond market, as we expect the yield curve to flatten following the recent re-pricing of the front end.

Global Currencies: The dollar's initial decline should slow once the full impact of ECB and BOJ easing policies is felt.

Corporates: Spreads should be volatile this year in response to growth concerns and uncertainty regarding commodities. Given the extent of the current rally, our near-term outlook is neutral.

High Yield: Performance likely will be dominated by moves in the commodity space, as the energy sector has incorporated a number of "fallen angels."

Mortgages: Risks appear balanced for agency mortgages, though legacy non-agency RMBS will continue to be favored.

Emerging Markets: Demand should remain supportive as long as central banks and China do not offer negative surprises.

The Big Dance

- As the 2015–16 college basketball season approaches its climax on the court, developed market central banks have engaged in a bit of March Madness of their own, turning to new pages of their monetary policy playbooks as they struggle to bolster economic growth, inflation and labor productivity.
- Challenged by the increasing ineffectiveness of traditional monetary policy approaches, the G3 central banks are doing their best to be innovative. The Bank of Japan went negative with its key policy rate while at the same time maintaining positive rates on certain bank reserve assets. Designed to stimulate the economy without hurting the banking system, this strategy hasn't worked; in fact, the yen has appreciated further since its announcement. Having witnessed the outcome of Japan's experiment, the European Central Bank took a different tack: in addition to cutting key interest rates, the ECB added corporate bonds to the roster of securities eligible for its now-expanded monthly asset-purchase program. While this attempt to improve credit growth by reducing spreads was well intentioned, these factors are not chain-linked in correlation and the impact to date has been minimal.
- The Federal Reserve, far and away the number-one seed in this tourney of central banks, continues to struggle philosophically with the potential impacts of rate hikes: locking in a low-productivity economy on one hand, preventing financial instability on the other. Its latest meeting suggested a bias toward avoiding the former, as the Fed both delayed another rate hike and lowered its projection for the trajectory of future hikes.
- Basically, we've reached the final four of competing forces dominating the macro environment; in addition to the aforementioned central bank easing and tightening, a weakening U.S. economy and Chinese currency uncertainty fill out the bracket of factors keeping markets on edge. Given the strong likelihood that the U.S. is not plunging into recession any time soon and China is able to manage its currency and capital flows without creating further shocks, however, risky assets should survive and advance. In this environment we favor U.S.-centric risk assets such as non-agency mortgages.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%)	
			Feb. 2016	YTD 2016
Barclays U.S. Aggregate	**100**	**64**	**0.7**	**2.1**
Treasury	36.8	0	0.9	3.0
Investment Grade Corporates	24.2	197	0.8	1.2
Fixed-Rate MBS	28.3	21	0.4	1.7
Other				
High Yield		726	0.6	-1.0
Global Aggregate		57	2.2	3.1
Emerging Markets		445	1.4	1.4

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%)	
				Feb. 2016	YTD 2016
U.S.	1.7	EUR/USD	1.09	0.4	0.1
Germany	0.1	USD/JPY	113.00	7.5	6.7
Japan	-0.1	USD/BRL	4.02	-0.4	-1.3
Brazil	16.1				

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 like to be long the U.S. bond market, as we think U.S. yield curve will flatten after the initial re-pricing of the front end following the Fed's decision not to hike in March. Bund yields should continue to decline. Japanese yields have made historical lows, as policy makers have failed to revive the economic engine and inflation expectations have plunged. These conditions create a perfect storm for declining yields and a flatter curve.

Global Currencies

- We think the dollar's initial decline post the Fed's March meeting will slow once the full impact of ECB and BOJ easing policies is felt by the currency markets. For Japan, a weaker economy has weighed on inflation expectations, thereby bolstering the currency. The BOJ has been seriously undermined by the lack of a revival in inflation and has backed away from the view that printing money alone was sufficient to generate price increases. We look for the British pound to fall on weaker growth, a deep fiscal drag, soft inflation and "Brexit" fears.

Investment Grade Corporates

- Corporate fundamentals continue to weaken gradually. The investment grade corporate market is in the process of jettisoning its weakest commodity issuers to the high yield space through downgrades, which should bolster the profile of the remaining high-grade issuers. We expect spreads to be somewhat volatile this year in response to economic growth concerns and uncertainty regarding commodity prices.
- Corporate valuations remain attractive, but spreads are now almost 30 bps off of the wides established in mid-February; they are still about 20 bps wider than where they began 2016, however. Given the extent of the current rally, our near-term outlook is neutral.

High Yield Corporates

- The high yield market continued its rollercoaster ride in February, trading poorly for a large part of the month before rallying sharply to close the period. Technical conditions experienced a major reversal as inflows resumed and the primary market remained extraordinarily quiet. Quality was important, as BBs have been an outperformer. But the bigger story was the recent move in the metals and mining sector, which has seen substantial growth due to "fallen angels" entering the high yield market at large discounts to par after suffering multiple-notch downgrades. Metals and mining names have seen a sharp uptick in trading levels as commodity prices rallied.
- Performance going forward will likely be dominated by moves in the commodity space. The fallen angels generally have stronger balance sheets and more funding options than the lower-rated legacy high yield names and thus likely will display more staying power.

Mortgages

- Agency mortgages suffered in the first six weeks of the year as ten-year Treasuries rallied, though spreads tightened across the coupon stack as prepayment fears dissipated. Risks appear well-balanced in the near term, as rates backing away from the prepayment zone and strong overseas demand is countered by weak carry/dollar roll levels and an upcoming increase in seasonal supply.
- Legacy non-agency RMBS will continue to command the most balanced trading mix among securitized credit sectors. Although spreads have drifted wider amid the selloff in risk assets, the depth of liquidity has remained encouraging. Fundamentals also remain a positive, as upside from increased prepayments, lower defaults and stable severities will provide uncorrelated sources of return for investors.
- For CMBS, we maintain a negative tactical outlook on the sector, as challenging technicals and distorted primary market liquidity are expected to keep pressure on spreads over the near term. While CMBS has experienced sustained spread widening since mid-2015, downward moves in swap spreads and underperformance in the corporate credit markets have constrained relative value.
- Consumer ABS entered March as the only major sector in the Barclays Aggregate to post positive year-to-date excess returns. These returns are fundamentally supported by improving labor-market conditions, the availability of non-mortgage credit and a well-positioned consumer. Given the lower spread and spread duration profile of ABS, we temper our near-term outlook while retaining a longer-term positive view.

Emerging Markets

- Emerging market debt, like most other high-yielding credit markets, rallied back to levels not seen for months. This positive market momentum is cheering investors and may lead to potential inflows as long as developed central banks, China and commodities do not surprise on the negative side. While oversold commodity-sensitive credits and currencies keep reacting strongly, we expect a surge in new credit issuance in the coming weeks given that markets were practically shut down for months. On the local-currency side, we remain neutral and highly selective, as currency volatility may quickly erode the attractiveness of local yields.

Past performance does not guarantee future results.

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