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.

Spring Hopes Eternal

- The spring forward in risk assets continues to surprise some observers given the lack of any real warming in the U.S. economic outlook. To wit, on the supply side growth is still tethered to a historically low productivity level; on the demand side, meanwhile, U.S. consumers are showing some signs of fatigue and global excess capacity remains significant. That said, we believe the primary factor inspiring the latest rally in risk assets is the same one that drove risk takers into hibernation last fall: Chinese currency movements. The rapid depreciation of the renminbi that began in November and extended into January of this year spawned fears both of excessive leverage in Chinese financial institutions and capital outflows, pushing down the prices of risk assets. In contrast, the mid-February rebound of the currency gave risk assets new life, admittedly with a boost from a more dovish Fed.
- What happens now? While there are some green shoots in manufacturing data, the U.S. story is relatively unchanged — sluggish but consistent growth. The China narrative is evolving rapidly, however. First, capital outflows from China are likely to taper off somewhat, as the need is diminishing for Chinese corporations to replace dollar debt with local-currency debt. Second, among G-20 nations there seems to be a renewed acceptance of the need to refrain from competition-driven currency devaluation; while it is unclear how long the apparent detente will last, it has dampened currency volatility. Third, China's monetary and fiscal policy stimulus efforts have been quite large and are expected to continue. While the temperature for risk assets has warmed, the Chinese economy is not completely out of the woods. The structural adjustments are slow. The resolution of nonperforming assets held by financial institutions is slow. The economy, therefore, will continue to slow.
- Going forward we believe the bid for risk assets is likely to continue in the near term, as global central banks will remain supportive and the Fed will continue to consider the stability of global currency markets when making policy decisions. Should economic data improve, however, an attendant rate hike or hikes would again chill the demand for risk assets.

Spreads, Returns and Yields

Index	Percentage of Index (%)	Spread (bps)	Returns (%)	
			March 2016	YTD 2016
Barclays U.S. Aggregate	**100**	**56**	**0.9**	**3.0**
Treasury	36.6	0	0.2	3.2
Investment Grade Corporates	24.7	163	2.8	4.0
Fixed-Rate MBS	28.0	22	0.3	0.3
Other				
High Yield		656	4.4	3.4
Global Aggregate		51	2.7	5.9
Emerging Markets		394	3.1	4.5

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%)	
				March 2016	YTD 2016
U.S.	1.8	EUR/USD	1.14	4.7	4.8
Germany	0.2	USD/JPY	113	0.1	6.8
Japan	-0.3	USD/BRL	3.59	11.8	10.3
Brazil	14.0				

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

- While the U.S. yield curve likely will steepen given signs of green shoots in the economic activities data, especially in the manufacturing sector, the magnitude of the move will be limited by the data itself. Improving numbers will increase the probability of a Fed hike and inspire renewed flattening. As such, we like rates options that benefit from low volatility of yield curve slope.

Global Currencies

- We think that dollar has more room to decline. The accommodative policies of the Bank of Japan and European Central Bank seem to be increasingly ineffective, and a Fed hike in June is still unlikely. We like to maintain our short dollar position against euro and yen while having option protection against the possibility of a surprise dollar rally.

Investment Grade Corporates

- After widening by about 50 bps to open 2016, investment grade corporate spreads are now approximately 15 bps tighter on the year as investor concerns were assuaged by better economic data along with dovish policy actions and rhetoric from global central bankers.
- The turmoil of the first quarter did not deter issuers from coming to market given the stability of all-in yields due to the Treasury market rally. On the subject of yields, it is worth noting that while the all-in yield of 3.2% on U.S. corporates may seem underwhelming, it looks good compared to Europe and Japan, at 1% and 0.3%, respectively.

High Yield Corporates

- The high yield market has extended the rally that began in late February. Most notable has been the outperformance of commodity-related fallen angels that were downgraded from investment grade during the quarter and entered the benchmark at significant discounts to par.
- The lack of improvement in overall economic growth continues to limit corporate revenue and exposes issuers to margin pressure as wages begin to tick up. As a result, credit statistics are deteriorating modestly despite a lack of meaningful intentional re-leveraging and other late-cycle behavior. We continue to believe a near-term spike in defaults outside energy and metals is unlikely, but we have seen fundamental weakness spread beyond these sectors and we are clearly late enough in the cycle that the trend in defaults is higher.

Mortgages

- Agency mortgages of late have benefitted not only from risk-on sentiment, but also from range-bound interest rates and lower rate volatility. Going forward, performance likely will be influenced heavily by the direction of interest rates and supply-demand technicals. A rate rally below 1.7% on the ten-year Treasury could put pressure on MBS spreads as refinancing activity accelerates and supply increases. Conversely, higher rates will provide relief to both of these headwinds and likely will bring back yield-based demand for the product.
- Legacy non-agency RMBS will continue to command the most balanced trading mix among securitized credit alternatives. Fundamentals also remain a positive for the sector, as upside from increased prepayments, lower defaults and stable severities will provide uncorrelated sources of return for investors.
- We have upgraded our tactical outlook for CMBS on the basis of improved relative value and resolving technicals. With primary supply expected to drop off sharply in the coming months, the technical pressures that drove spreads to their post-crisis wides earlier in the year will abate.
- The outlook for ABS remains a function of broader risk sentiment. ABS will remain well bid and offer outperformance opportunities when risk assets sell off and vice versa. Fundamentals remain strong across almost all sub-sectors, fueled by a relatively well-positioned consumer, access to non-mortgage credit and supportive labor market conditions. Over the longer term, we retain a positive view.

Bond Market Outlook

Global Interest Rates: The U.S. yield curve should steepen given green shoots in economic activity, especially in manufacturing.

Global Currencies: The U.S. dollar has more room to decline in light of global conditions and a more dovish Fed.

Corporates: Better domestic economic data and dovish global central banks has eased investor concerns.

High Yield: The rally that began in late February has persisted, though the sluggish economy has limited corporate revenue growth.

Mortgages: Agencies have benefitted from risk-on sentiment as well as range-bound interest rates and lower rate volatility. We have upgraded our tactical outlook for CMBS.

Emerging Markets: Despite ongoing global concerns, investors have returned to beaten-down emerging market assets.

Mortgage Derivatives: Our outlook for the sector remains constructive given opportunities we see at the sub-sector and security levels.

Private Credit: Demand for private credit remains consistent, and the low-yield environment continues to drive issuance.

Commercial Mortgage Loans: We are seeing pockets of weakness in certain assets and markets

Emerging Markets

- Despite ongoing global concerns related to the long-term path of economies and trade, investors decided to return to beaten-down emerging market assets, driven by a more dovish tone from the Fed and China's plans to tackle its fragile growth outlook with fiscal initiatives. Meanwhile, commodity prices have rebounded since mid-February given expectations of falling oil supply.
- The search for yield and price appreciation currently prevails, as technical factors keep improving. Inflows into emerging equity markets and ETFs have led the rally, triggering an accompanying leg up in emerging currencies. The latest political uncertainty in Brazil and South Africa was interpreted by markets participants as a positive catalyst for potential political change and structural reform. We are constructive for the asset class while taking advantage of rising volatility to increase our exposure selectively.

Mortgage Derivatives

- While mortgage rates declined sharply to start the year and prepayment speeds accelerated significantly in March, speeds remained lower than at similar rate levels in early 2015. In particular, loans with low balances, higher coupons or earlier origination dates showed a very limited reaction to the rate rally. In addition, it has become increasingly clear that the Home Affordable Refinance Program (HARP) will indeed draw to a close at the end of the year, and the potential new high loan-to-value refinancing program will be quite limited in its initial impact and scope, reducing policy risks to IOs and inverse IOs.
- With this fundamental backdrop and a less disruptive global market environment than in the second half of 2015, spreads in the sector have been flat to slightly tighter despite the risks associated with lower rates. Our outlook remains constructive given opportunities we see at the sub-sector and security levels.

Private Credit

- Demand for private credit assets remains consistent, and the low-yield environment continues to drive issuance as companies look to capitalize on historically low borrowing costs. Issuance from continental Europe was down dramatically in 2015 and the first quarter of 2016, as those issuers were (and continue to be) easily able to find competitive alternatives in their home markets. U.S. issuance was slightly up in 2015 and so far in 2016. We still believe that a distinctive movement upward in rates would drive a dramatic pickup in issuance, both in reaction to higher fixed permanent costs of capital as well as more aggressive approaches to capital spending.
- U.S. private credit spreads are relatively wide — in the 150–250 basis point range — which is a reflection of credit concerns in the overall economy and specifically some of the commodity and materials sectors. We continue to find good value in new-issue investment grade U.S. private credit, as structural integrity remains sound.

Commercial Mortgages

- We are seeing pockets of weakness in certain assets and markets. Specifically, hotels are seeing major issues due to overbuilding in markets like New York City and increasing competition from the likes of Airbnb. Hotels are also seeing a lack of liquidity in terms of financing. Multi-family is starting to feel stress in certain markets and locations due to overbuilding, and we are beginning to see leasing concessions in many markets. Some urban locations are showing weakness due to the ease of building in these markets, while assets in more suburban locations are seeing nice rental increases given that it can be harder to get construction permits in the suburbs.

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