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 March 31, 2016, Voya Investment Management managed $129 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: We like to be long five-year, five-year forwards.

Global Currencies: Dollar weakness has reached its near-term target; greenback likely will strengthen versus yen and euro.

Corporates: Valuations look more balanced after the sharp rally.

High Yield: The magnitude of the recent rally — especially in commodities — makes us somewhat more cautious.

Mortgages: Agency RMBS appears fairly rich. Fundamentals remain supportive for non-agency MBS and ABS. We retain our positive tactical outlook for CMBS.

Senior Loans: Lower-rated and -priced credits will continue to be correlated with oil prices and other risk assets.

Emerging Markets: Dovish central banks remain the main catalyst for additional portfolio flows into EM debt.

What Does a Yellow Light Mean?

- After signs of a moderate improvement in the U.S. industrial sector in late March and April, more recent indicators are delivering a message about the state of the economy: slow down. However, we're not headed into recession any time soon; we're just chugging along at a measured pace in the face of the usual headwinds like low productivity, weak manufacturing, rising inventories, low capacity utilization and tepid consumer demand. The story for inflation is similar; despite the occasional feints toward higher rates, core PCE growth continues to come in south of the Federal Reserve's 2% target. The lethargic economy and moribund inflation have allowed the Fed to pursue a very cautious path toward policy normalization.
- While the U.S. economic backdrop remains uninspiring, actual macro drama continues to be played out in China, where the long-term economic outlook is trending down as service-sector growth is nowhere near the pace needed to offset the decline on the manufacturing side. In the meantime, the money supply and credit are continuing to expand at a robust clip, driving the renewed expansion in construction and other traditional bubble-prone sectors and sending the price of industrial materials spiking higher.
- The combination of dovish Fed rhetoric and Chinese monetary expansion have pushed asset prices higher in recent months. While there exists an obvious risk that either of these two drivers could change gear, we find it unlikely that the Fed will grow hawkish given the sluggish economic pace here at home. That leaves China as the primary risk to the rally, and statements out of Beijing suggest an easing of stimulus is a real possibility; meanwhile, a decline in the value of the renminbi could trigger another round of capital outflows. In this environment, we favor building in yield with U.S.-centric spread assets like CMBS and corporate bonds.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%)	
			April 2016	YTD 2016
Barclays U.S. Aggregate	**100**	**50**	**0.4**	**3.4**
Treasury	36.5	0	-0.1	3.1
Investment Grade Corporates	25.0	146	1.4	5.4
Fixed-Rate MBS	27.8	20	0.2	2.1
Other				
High Yield		577	3.9	7.4
Global Aggregate		47	1.3	7.3
Emerging Markets		369	1.8	6.4

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%)	
			April 2016	YTD 2016
U.S.	1.8	EUR/USD 1.15	0.6	5.4
Germany	0.3	USD/JPY 106.5	5.7	12.9
Japan	-0.8	USD/BRL 3.45	4.6	15.4
Brazil	12.5			

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

- Real interest rates have declined steadily since January. Should China pull back on monetary expansion, commodity prices likely would decline, as would breakeven inflation. Consequently, we like to be long five-year, five-year forwards.

Global Currencies

- U.S. dollar weakness has reached its near-term target. We expect risk reversals in the Japanese yen and euro, or at least for these currencies to weaken versus the dollar. As such, we are employing option strategies on the euro and yen that would benefit from large declines in the currencies.

Investment Grade Corporates

- Investment grade corporate spreads continue to rally as a supportive technical picture offsets somewhat tepid first quarter earnings. Low global yields have led to relatively stable inflows into the asset class, with Europe and Asia are key sources of demand. Limited new-issue supply is also playing a role; more U.S. companies are looking to issue debt in foreign markets, while slowing M&A activity is constraining likely second half supply.
- After one of the sharpest spread rallies in recent years, valuations now look more balanced. We expect spread tightening to take a pause in the near term.

High Yield Corporates

- The ongoing rally in high yield has pushed year-to-date returns over 7% — a nearly 12% turnaround from the mid-February lows. Performance in April was once again led by the energy and metals & mining sectors, as bonds continued to rally with the price of the underlying commodities and high yield investors scrambled to reduce underweight positions.
- The lack of improvement in overall economic growth continues to limit revenue potential for high yield issuers and exposes them to margin pressure as wages begin to tick up. We continue to believe a near-term spike in defaults outside energy and metals is unlikely; however, we have seen fundamental weakness spread beyond just these sectors, and we are clearly late enough in the cycle that the trend in defaults is higher. The magnitude of the recent rally — especially in the commodity-related sectors — makes us somewhat more cautious on valuations in the short term. Spreads will continue to tighten if the underlying commodities trade higher, but any weakness in commodity prices would raise the risk of a near-term pullback in high yield.

Mortgages

- Agency mortgages performed well to start the second quarter of 2016, thanks to marginally higher interest rates as well as low volatility and strengthening market conviction that the Fed will remain on hold in the near term. Agencies now appear fairly rich. Legacy non-agency RMBS continues 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 retain our positive tactical outlook for CMBS, citing an improvement in relative value and favorable near-term technicals. We maintain our neutral strategic outlook for CMBS on the belief that commercial real estate fundamentals, while still strong, have likely plateaued.
- ABS will remain well bid and offer outperformance opportunities when market beta is negative, 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.

Senior Loans

- April was a good month for the loan market, which built on March's positive momentum thanks to the energy rally and a rejuvenation in the CLO market. Demand for new loans continues to outpace supply here in May. In the secondary market, borrowers are being scrutinized following tepid first quarter earnings and a broader market move toward par.
- While the bid ceiling for near- and above-par credits appears to be close at hand, there continues to be room for price improvement. The movement of lower-rated and lower-priced credits will continue to be correlated with the volatility of oil prices and other risk assets.

Emerging Markets

- The spring delivered strong positive momentum for emerging market debt, as credit risk premiums and currencies rallied strongly. Continued rising demand met with growing new issuance from both sovereign (including Argentina for the first time in 15 years) and non-sovereign issuers.
- Given the magnitude of the recent rally, we may see some price consolidation as investors re-assess credit and currency valuations in this new global growth paradigm. Nevertheless, dovishness among developed market central banks remains the main catalyst for investors looking for higher yields such as those offered by EM debt.

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