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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 expect lower U.S. yields and a flatter Treasury yield curve.

Global Currencies: no reflationary impact from Bank of Japan or European Central Bank monetary policies; valuations support continued U.S. dollar depreciation.

Corporates: technical factors remain supportive and valuations appear mildly attractive.

High Yield: attractive spreads among ex-energy and metals issuers, near-term default spike unlikely.

Mortgages: tight spreads and increased supply likely keep agency MBS performance subdued; supportive conditions for non-agency MBS.

Emerging Markets: we favor carry (yield premium) of EM sovereign and corporate bonds, looking to invest opportunistically in EM local currency bonds.

Summertime Blues

- Who would argue the U.S. economy will escape the growth downturn this year? It's Hard to believe By the Numbers. Manufacturing, capex, retail sales, payrolls, exports and imports have all weakened. Payroll growth has now fallen to a 27-month low. This begs the question: is the Federal Reserve (Fed) hiding behind an Eminence Front or have its actions just been poorly conceived? If the Fed were tightening for financial stability reasons it would not be so patient to hike; perhaps the Fed has committed a policy error by starting the tightening cycle several months into softer growth. The Fed's policy risks are clear: downside inflation is more detrimental to its mandate than upside inflation. Despite the Fed's hawkish tone in May, we've since seen weaker payrolls; long-dated interest rates have not increased and inflation markets have weakened.
- We expect U.S. yields to fall further for several reasons. First, payroll growth is in a downturn. Corporate profits and aggregate sales lead payroll growth, and both are in contraction. Wage growth is slowing with no indication of demand or supply pressure based on leading factors. Second, we see significant downside risk to GDP: we anticipate that the second quarter (2Q16) will register peak growth for 2016, with 3Q16 and 4Q16 slowing to 1% and 1.5%. While economists are predicting a robust 2.75% for 2Q16, this already is fully discounted in market valuations. Third, core CPI likely peaked in February and we expect it to maintain a benign 2–2.2% pace through 2016 and 2017. This implies core PCE below 2%, the Fed's target inflation level.
- Finally, while retail investors swear they Won't Get Fooled Again, flows into commodity mutual funds have served as a contrarian indicator of commodity prices. With renewed inflows into these funds, we expect negative returns for commodities to add downward pressure on rates.
- What's more, we see no Magic Bus outside the U.S. for the global economy to hop on and drive up economic growth. European growth has moderated, U.K. GDP is slowing and Japan's growth remains near zero. We expect China's growth to remain stable through 2016.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%)	
			May 2016	YTD 2016
Barclays U.S. Aggregate	**100.0**	**51**	**0.0**	**3.5**
Treasury	36.3	0	0.0	3.1
Investment Grade Corporates	25.2	149	-0.1	5.3
Fixed-Rate MBS	27.8	18	0.1	2.3
Other				
High Yield		566	0.6	8.1
Global Aggregate		48	-1.3	5.9
Emerging Markets		366	0.0	6.4

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%)	
			May 2016	YTD 2016
U.S.	1.9	EUR/USD 1.11	-3.4	2.4
Germany	0.1	USD/JPY 110.68	-3.8	8.5
Japan	-0.1	USD/BRL 3.61	-2.1	15.5
Brazil	13.0			

Source: Barclays, JPMorgan, Standard & Poor's. All spreads are to U.S. Treasurys and are option-adjusted except for emerging markets, which are nominal. All returns are total returns including dividends, expressed as percentages, in U.S. dollars.

Sector Overviews

Global Rates

- The market recognizes that a full-blown tightening cycle is improbable. We expect U.S. yields to fall further and reduce 2017 and 2018 tightening expectations. We expect ten-year rates to fall farther and the Treasury yield curve to further flatten.

Global Currencies

- U.S. dollar weakness since March has achieved new breakout levels. BoJ and ECB monetary policies are creating no meaningful reflationary impact on fixed income and foreign exchange markets. The dollar is down 5% YTD and should continue depreciating.

Investment Grade Corporates

- Sales and profit growth remain weak but a depreciating U.S. dollar could alleviate some pressures. Corporate leverage continues to increase but is most prevalent within low-leverage or less-cyclical industries. Margin pressures from wage growth upticks have been confined to select industries; we are watching for signs of broader pressures.
- Market technical conditions have been firm due to inflows from Europe and Asia; low global yields should sustain demand in the near term. We view valuations as mildly attractive within the context of improved growth sentiment.

High Yield Corporates

- The high yield rally has slowed from the pace seen in recent months. The energy and metals and mining sectors again led performance, even as the underlying commodities rally stalled.
- Credit statistics (ex-commodities) showed signs of stabilization in 1Q16, but results remain uneven and leverage is still trending higher. We continue to believe a near-term spike of defaults outside energy and metals is unlikely, but fundamental weakness convinces us that we are late in the cycle and that a pick-up in defaults is possible.
- Spreads in the low 500s ex-energy and metals seem reasonably attractive given our belief that the credit cycle is not rolling over. If the underlying commodities continue to trade higher, spreads will continue to tighten, but any weakness in commodity prices would raise the risk of a near-term pull-back in high yield.

Mortgages

- Agency mortgages have been surprisingly resilient, fueled by range-bound interest rates and strong demand for high quality assets. Performance in MBS is further supported by suppressed levels of volatility. Ten-year Treasury yields have been stuck in a narrow range for several months, helping strategies that sell rate options (such as owning MBS). Agency MBS, specifically GNMAs, also benefited from strong buying by investors in markets whose local yields were negative, such as Japan. Tighter yield spreads and expected supply increases during summer could subdue further performance.
- Legacy, non-agency residential mortgage-backed securities (RMBS) will continue to command the most balanced buying and selling. Fundamentals are supportive with increased prepayments, lower defaults and stable loss severities. Credit risk transfer performance faces potential bouts of volatility with upcoming supply. We retain our positive tactical outlook for commercial mortgage-backed securities (CMBS) on favorable near-term technical factors. CMBS spreads remain attractive relative to corporates and collateralized loan obligations (CLOs).
- Asset-backed securities (ABS) outperform when market beta is negative and vice versa. Fundamentals remain strong, fueled by a relatively well positioned consumer, access to non-mortgage credit and supportive labor market conditions. Increasing certainty in the near-term economic backdrop creates the potential for consumer ABS to underperform.

Emerging Markets

- As the U.S. dollar rallied local currency debt sold off; hard currency debt outperformed thanks to inflows and improving technical factors. Supported by these strong inflows, EM sovereign and quasi-sovereign issuers made a large-scale return to the markets.
- Oil price declines have driven Middle Eastern entities back to issuing debt after not needing to for years. This fresh wave of issuers has allowed investors to diversify away from Latin America and Asia. New Argentine and Brazilian issuers have been supported by rising investor confidence. As long as the Fed postpones rate normalization the demand for EM fixed income will not abate. Still, we expect volatility given the political issues in Europe and long-term impacts of the Chinese economy on commodities and global trade. We favor carry offered by EM sovereign and corporates and would invest opportunistically in EM local currency where volatility remains elevated.

Past performance does not guarantee future results.

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