Fixed Income Perspectives

Matt Toms, CFA, CIO Fixed Income

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 continue to believe the Federal Reserve will raise rates in December

Global Currencies: We are looking to protect against Europe-related tail risk given the possibility of populism undermining the euro and ECB monetary policy

Investment Grade Corporates: Views on potential policy changes could cause dispersion among IG corporate sectors

High Yield: Higher Treasury yields will negatively affect BB-rated bonds

Securitized Credit: Post-election reaction was generally muted across most sectors; policy risk will influence performance in mortgages

Emerging Market Debt: Emerging markets will be under pressure due to uncertainty in future trade details and a stronger U.S. dollar

Fixed Income in a Post-Election World

- Donald Trump is President-Elect and with the Republicans now in control of all three government branches, the likelihood of significant policy change is high. As a result, the focus for investors has shifted to four key points: tax policy, deregulation, fiscal spending and trade policy.
- Tax reform under the new administration will revolve around large tax cuts, which we expect will have a positive impact on the economy over the near term resulting in increased GDP growth and higher inflation expectations. Deregulation will have a positive impact on corporate fundamentals over the near term, particularly within the banking sector. The magnitude of any longer term benefit to productivity levels is still uncertain and will be a key focus moving forward.
- As witnessed with "Brexit" and now again with the U.S. election, populism spreading across the developed world has significant implications. The near term result in the United States will be an increase in fiscal spending, which will be focused on infrastructure and defense. Similarly, we believe this will have a positive effect in the near term on growth and inflation, but when paired with tax cuts, higher fiscal spending increases concerns around long term deficit levels.
- Protectionist trade policies will lead to higher inflation expectations in the near term as the cost of imports would increase as a result of tariffs. Within emerging markets, uncertainty around trade deals, rising funding costs and a stronger dollar presents near term headwinds to growth.
- In this post-election world, we believe wages will continue to improve, which is a positive development for the consumer and U.S. economic growth. However, we believe the combination of demographics and a lingering aversion to debt will lead to an increase in the savings rate, which will subdue the consumer's overall positive influence felt on economic growth. Therefore, we believe there is potential for upside in certain risk assets; however, uncertainty in the long run does exist. Going forward, we continue to favor U.S. centric risk while also being mindful that inflationary influences are likely to bias interest rates higher.

Spreads, Returns and Yields

Index/Sector	Percentage of Index	Spread (bp)	Returns (%) Oct. 2016	Returns (%) YTD 2016
Barclays U.S. Aggregate	**100.0**	**0**	**-0.8**	**5.0**
Treasury	36.2	0	-1.1	3.9
Investment Grade Corporates	25.9	132	-0.8	8.3
Fixed-Rate MBS	27.7	13	-0.3	3.5
Other				
High Yield		477	0.4	15.6
Global Aggregate		42	-2.8	6.8
Emerging Markets		302	-0.3	12.3

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%) Oct. 2016	Returns (%) YTD 2016
United States	1.8	EUR/USD 1.10	-2.3	1.1
Germany	0.2	USD/JPY 105	-3.3	14.7
Japan	-0.5	USD/BRL 3.19	2.1	24.1
Brazil	11.4			

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.

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Sector Overviews

Global Rates

- Following the U.S. election, the Treasury curve experienced a massive "bear steepener" as the long end underperformed the front end. This was largely driven by the prospects of increased fiscal spending, tax cuts and higher inflation expectations. The current monetary policy regime under Janet Yellen could come into question and we expect a narrative of rules-based central banking to develop. In addition, the validity of extraordinary stimulus tools could be re-evaluated.

Global Currencies

- In the wake of the U.S. presidential election we are keeping a close eye on Europe. It remains to be seen what impact populism will have on the upcoming Italian constitutional referendum (December 2016), the French presidential election (April 2017) and the German election (September 2017). The risk that populism undermines the euro is real and we are looking to protect portfolios against any tail risk tied to Europe and the euro.

Investment Grade Corporates

- Immediately following the election, investment grade corporate sectors reacted differently, driven by the market's views on potential policy changes across industries. In pharmaceuticals and healthcare, spreads tightened due to expectations for lower regulatory scrutiny. High quality technology companies benefited from the prospect of a tax repatriation deal; energy companies, particularly pipelines, benefited from expectations of lower regulatory restrictions on new pipes. Spreads tightened among banks due to the impact of higher rates, a steeper yield curve and prospects of deregulation.
- We believe spreads have room to tighten in the near term. Demand from foreign buyers remains robust and supply looks poised to slow from both lower M&A and share buyback activity. Credit fundamentals have shown improvement with a solid earnings season; easing disinflationary pressures and prospects of deregulation will continue to support improvement of company balance sheets, particularly those in the financial sector.

High Yield Corporates

- While high yield initially had a muted reaction to the election, volatility increased in the days following as spreads pulled back significantly before rallying slightly. Below the surface, sectors moved based upon assumptions around President-Elect Trump's agenda. Pharmaceuticals, private prisons and coal sectors rallied and the hospital companies sold off.
- We believe the spike in commodity-related defaults is behind us and we continue to see companies take steps to improve strained balance sheets. Technical factors in the market remain positive with continued global demand for yield and fundamentals remain decent overall; therefore, we believe option-adjusted spreads around 490 basis points seem reasonable and have the potential to grind tighter. The high yield market did not seem as focused on interest-rate movement, but we believe that continued pressure on Treasuries will likely impact the longer duration BB-rated bonds; as a result, we favor B-rated issuers.

Securitized Credit

- Agency mortgages initially underperformed, led by lower coupons, as a result of the long-end rate sell-off and volatility increase. Policy risk will heavily influence performance in mortgages in the intermediate to long term; while housing reform has not been at the top of the new administration's agenda, Republican control over Congress could result in future policy changes.
- Compared to the aftermath of Brexit, trading activity and price action for CMBS were muted. Bid/ask spreads in the ABS and CLO markets started the day wider, as buyers were unwilling to step in at offer levels that were mostly unchanged. As broader markets rebounded bid side activity picked up, which led to normal trading activity and unchanged spreads on the day. We see possible deregulation and easing disinflationary pressures, as well as the health of the consumer, as positive impacts in the near term.
- The credit risk transfer (CRT) market saw spreads widen, with many investors hoping to buy on weakness that never materialized. The CRT market was created in 2013 as a way for government sponsored enterprises to transfer a portion of their credit risk to private investors. Credit risk transfer offers floating-rate coupons, relatively attractive credit spreads and the potential to increase risk-adjusted returns. We maintain a constructive view on the CRT in our multi-sector portfolios and standalone securitized credit portfolios.

Emerging Market Debt

- While domestic credit markets rallied, emerging markets came under pressure as the election results stoked concerns that the U.S. may adopt protectionist trade policies that jeopardize how developing nations benefit from global trade. Mexican assets fell most dramatically as the peso touched a record low and the benchmark, dollar-denominated 10-year sovereign yield spiked. We believe EM will underperform in the near term as a result of the uncertainty around trade, renewed strength in the U.S. dollar and rate volatility.

Past performance does not guarantee future results.

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