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 believe Treasury yields are low and have room to move higher

Global Currencies: We believe the dollar has reached the end of its rally against developed market currencies

IG Corporates: Spreads have room to tighten given supportive macro, fundamental and technical backdrop

High Yield: We expect the high yield rally to continue based on improving fundamentals, prospect of nominal growth

Securitized Assets: Policy risk is high for the mortgage market, further spread tightening for agency mortgages is unlikely

Emerging Market Debt: Higher oil prices and an overall strong risk appetite will remain supportive

Looking Ahead to 2017

- As 2016 comes to a close, we would like to look ahead to what should be another eventful year in 2017. With the Donald Trump administration set to be sworn into office in a matter of weeks, changes are most certainly on the horizon. Looking domestically, we believe the expectations of tax cuts, deregulation and fiscal policy will result in near-term acceleration of economic growth in the United States. This increase in incrementally higher nominal growth will likely lead to improved corporate revenues and earnings, creating a constructive environment for corporate credit and supporting tighter spreads. However, structural issues such as subdued productivity and the consumer's ongoing aversion to leverage will continue to limit the upside of potential growth. While we expect near-term global inflationary pressures will continue to build, demographics and the persistent savings glut should keep inflation expectations contained over the long term.
- As expected, the Federal Reserve voted to increase interest rates by 25 basis points at its December FOMC meeting. Janet Yellen detailed the Fed's plan for 2017, projecting increased GDP and a lower employment rate, and highlighted by the possibility of three rate hikes for the year. While this may sound hawkish, this tone is in fact historically dovish. Therefore, we believe the Fed will maintain its cautious pace of rate normalization, as guided by market expectations. Globally, near-term cyclical tailwinds and easier fiscal policies should reduce the need to rely so heavily on global monetary policy accommodation. From a policy standpoint, the European Central Bank (ECB) is near the end of viable options and will begin stepping away from existing measures.
- Continuing to look abroad, we expect green shoots within emerging markets to take root, facilitated by developed market stability and local structural reforms. We believe these opportunities will take hold despite the headwinds of an incrementally stronger U.S. dollar and higher global interest rates. Against this backdrop, we continue to favor U.S.-centric risk, while opportunities may present themselves within emerging markets (EM).

Spreads, Returns and Yields

Index/Sector	Percentage of Index	Spread (bp)	Returns (%)	
			Nov. 2016	YTD 2016
Barclays U.S. Aggregate	**100.0**	**0**	**-2.4**	**2.5**
Treasury	36.1	0	-2.7	1.1
Investment Grade Corporates	25.8	129	-2.7	5.4
Fixed-Rate MBS	28.0	16	-1.7	1.7
Other				
High Yield		455	-0.5	15.0
Global Aggregate		45	-4.0	2.6
Emerging Markets		314	-3.1	8.6

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%)	
			Nov. 2016	YTD 2016
United States	2.4	EUR/USD 1.06	-3.6	-2.5
Germany	0.3	USD/JPY 114	-8.4	5.0
Japan	0.0	USD/BRL 3.39	-5.7	17.1
Brazil	11.8			

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

- At current levels, we believe U.S. Treasury yields are low and have further room to run higher, given the upgrade to growth and lower risk of secular stagnation. Further driving our view is our belief that this is not a bond market tantrum, rather that the selloff was underway before the election due to a rebounding global economy, growing industrial production, and accelerating global trade.

Global Currencies

- We believe the U.S. dollar has limited upside against developed market currencies, but will continue to strengthen against EM currencies whose economies are not reliant on commodities. Additionally, we expect the euro to appreciate from its current depressed level due to tapering by the ECB, better inflation data and improving fundamentals. Continued bond buying by the Bank of Japan, steadying growth in Japan, and increased purchasing of foreign assets will lead to further depreciation of the yen.

Investment Grade Corporates

- The latest earnings season revealed an improvement in fundamentals as revenue and EBITDA declined at the slowest rate in over a year; excluding commodity sectors, these measures were stable year-over-year. Furthermore, leverage has stabilized in non-commodity sectors, indicating that fundamentals will likely be less of a headwind going forward. Technical factors remain supportive due to a slowdown in new issue supply in December and continued strong foreign demand. Given these factors, in addition to our economic outlook, we believe spreads have room to tighten despite being at year-to-date tights. Going forward, we maintain our preference to financials and see opportunities for further gains in the longer maturing bonds.

High Yield Corporates

- Our economic growth expectations could be the impetus for nominal growth to finally increase beyond its anemic level, which would be a strong positive for the high yield market and would provide fuel to continue the rally. We believe the spike in commodity-related defaults is behind us and we continue to see companies take steps to improve strained balance sheets. Demand has remained solid and we expect flows to balance out as risk appetite grows approaching the final wave of issuance before year-end.
- Current spread levels are reasonable given our beliefs that the credit cycle is not rolling over and have room to tighten further if stronger fundamental and economic scenarios develop. This will most likely manifest itself in the lower quality buckets of the market as better growth prospects tend to benefit the most highly levered companies, while the possibility of rising interest rates will pressure higher-rated issuers.

Securitized Assets

- The near-term outlook for agency MBS remains negative as banks and overseas demand will likely be suppressed through year-end. Additionally, further rate hikes by the Fed will increase financing costs. Looking ahead to 2017, policy risk is high with reform of government sponsored enterprises, mortgage insurance premium cuts and changes in leadership at various government agencies causing concern throughout the mortgage market. Furthermore, our negative outlook for 2017 is a reflection of the high degree of uncertainty the new administration brings. Therefore, at current spread levels, further tightening is unlikely and outperformance is limited to its coupon component.
- Within securitized credit, we expect non-agency RMBS will continue to be driven by a housing market that recovers. Upside remains as credit availability increases, home ownership bottoms and the burgeoning millennial demographic engages. While CMBS looks attractive in the near term due to supportive relative value and favorable technicals, we maintain our neutral long-term outlook as fundamentals, while strong, have broadly plateaued. Looking at ABS, tailwinds stemming from risk sentiment, strong fundamentals across almost all sub-sectors, and a relatively well positioned consumer will support tighter or stable credit spreads as structures continue to de-lever. Finally, potential relative total return performance favors CLOs as rates and 3M LIBOR move higher, enhancing coupon carry, and foreign demand continues to rise.

Emerging Market Debt

- While market participants are analyzing the long-term impact of the Trump administration, EM fixed income, particularly oil credits and currencies, is performing well on the back of the OPEC agreement and related rally in oil prices. Higher growth prospects in the U.S. in 2017 are supporting the current risk appetite, including EM credits and higher yielding currencies. Lastly, year-end positioning and lower liquidity will drive the markets until investors reach a better understanding of the trade and foreign policies of the new administration.

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