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 Rates: look for higher yields in U.S. and Europe; steady in U.K. and Japan

Global Currencies: U.S. dollar to strengthen vs. most developed market currencies, particularly pound and yen; weaken vs. euro, emerging markets

Investment Grade Corporates: Maintain positive bias given continued strong demand, supportive fundamentals

High Yield Corporates: option-adjusted spread (OAS) is close to full value; we remain neutral

Securitized Assets: another rate hike and potentially higher volatility could sideline demand for agency residential mortgage-backed securities (RMBS)

Emerging Market Debt: EM growth still yields attractive opportunities for select countries; however, momentum beginning to fade

Unwind First, Hike Later

- The Federal Open Market Committee (FOMC) raised interest rates 0.25% at the June meeting and reaffirmed its commitment to gradually hiking rates as the labor market strengthens. While the Fed remains committed to its hiking schedule, reducing its balance sheet has emerged as a higher priority and we expect action this September.
- In the July Humphrey Hawkins testimony, Federal Reserve (Fed) Chair Janet Yellen acknowledged the weaker link between a tightening labor market and inflation but reiterated the FOMC expects the federal funds rate to reach 3% in 2019. The unknown impact from the anticipated decline in the Fed's balance sheet combined with benign inflation readings have bond markets discounting the likelihood of an additional hike in 2017. Further supporting this, U.S. headline inflation has dropped from its recent, year-over-year peak of 2.7% to 1.9%. Average hourly earnings growth remains below 3% despite a very low unemployment rate.
- Nonetheless, second quarter GDP growth will mark the highest year-over-year rate in two years, and third quarter GDP is likely to be solid through an inventory rebuild. Yellen downplays financial stability concerns, citing that households have not borrowed much against recent financial asset gains. PMI trends continue to point toward modest growth, while U.S. policy downside risk has faded with no benefit priced for a potential tax deal. We believe the Fed's bias is to move and therefore, in addition to targeting balance sheet reduction this year, we anticipate one more 25 basis point hike.
- Elsewhere, the global outlook is firm for Europe, Japan, as well as China and other emerging markets. Like the Fed, the ECB will likely announce details on how they will taper their QE program and reduce their balance sheet later this year.
- We continue to hold modest overweights to credit, both high yield and investment grade, as well as select emerging markets. We remain neutral on agency mortgage-backed securities, while holding a preference towards non-agency residential mortgages. We believe the euro will continue to appreciate versus the dollar, while expecting further slack in the pound and yen. Finally, we maintain shorter duration postures across our multi-sector portfolios.

Spreads, Returns and Yields

Index/Sector	Percentage of Index	Spread (bp)	Returns (%)	
			June 2017	YTD 2017
Barclays U.S. Aggregate	**100.0**	**43**	**-0.1**	**2.3**
Treasury	37.0	0	-0.2	1.9
Investment Grade Corporate	25.3	109	0.3	3.8
Fixed-Rate MBS	28.2	32	-0.4	1.4
Other				
High Yield		364	0.1	4.9
Global Aggregate		40	-0.1	4.4
Emerging Markets		266	-0.2	5.1

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%)	
			June 2017	YTD 2017
United States	2.3	EUR/USD 1.14	1.6	8.6
Germany	0.5	USD/JPY 112	-1.4	4.1
Japan	0.1	USD/BRL 3.31	-2.4	-1.7
Brazil	10.5			

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 Fed and the European Central Bank (ECB) continue to view recent, weak inflation data as temporary, setting the stage for the gradual removal of accommodation. We believe Fed Chair Yellen's recent testimony was misinterpreted as dovish by the market — while acknowledging the weaker link between the tightening labor market and inflation, she did not imply a change in the Fed's rate forecasts, but did leave the door open to change course if inflation persistently undershoots its 2% target. Comments out of the Bank of England and ECB suggest the possibility of an inflection point, with three of four major central banks on their way to removing accommodation.
- Sovereign yields have jumped, particularly outside the U.S., with German 10-year Bund yields trading over 0.50% for the first time in 18 months. U.S. Treasury yields moved back towards 2.35%; we expect this trend of higher yields, both in the U.S. and Europe, to continue. Additionally, balance sheet reduction presents further upside yield risk.

Global Currencies

- The euro will continue to appreciate versus the U.S. dollar as stronger growth expectations continue to attract investors. Other developed market currencies will weaken, specifically the pound and yen. We expect the dollar to depreciate versus select EM currencies.

Investment Grade Corporates

- Corporate spreads finished June at 109 basis points, 14 tighter year-to-date. Total returns for the Index have hit 3.80% for the year, outperforming Treasurys by 151 basis points. While valuations are tight, we maintain our positive stance for the asset class and expect a move tighter in spreads given continued, strong demand, particularly from foreign investors; fundamentals that are less of a headwind; and a reasonably supportive macro environment. Within IG, we continue to hold a positive bias towards financials given attractive valuations, and midstream issuers show resiliency with lower oil prices. Additionally, we believe BBBs have further room to compress as the market grinds tighter. The long end of the credit curve, which has lagged in performance much of the year, has since rallied, leaving the credit curve slightly flatter and more fairly valued.

High Yield Corporates

- Volatility crept back in June with an abrupt oil sell-off. BB-rated bonds outperformed as quality paper remained well-bid. Fundamentals remain mildly positive though there are pockets of weakness. Technicals appear balanced as flows have moderated, but the supply calendar remains very light. Spreads remain wide of their post-crisis tights, suggesting additional room to tighten given the constructive growth environment and continued expected low defaults.

Securitized Assets

- Agency RMBS have seen weak overseas demand YTD, and net supply is expected to increase by $180 billion in 2H 2017. What's more, Fed tapering could increase net supply about $12 billion by year-end. Despite this, we remain neutral on the asset class.
- A surge of new supply will generate headwinds for commercial mortgage-backed securities (CMBS). While some fundamentals are more stressed, we maintain our overweight based on the high quality yield advantage versus other high quality sectors. Intra-month opportunities will reward nimble tactical trading.
- Our outlook for collateralized loan obligations (CLOs) is positive due to attractive valuations and improving risk profiles. As rates move higher, total return potential still favors CLOs, albeit less so than before.
- Asset-backed securities (ABS) will remain well bid and offer outperformance opportunities when market beta is negative, and vice versa. Fundamentals are becoming more of a question, because of problems among subprime auto borrowers. Performance remains strong across most other sub-sectors, however, and we believe the auto troubles will not bleed over into the entire ABS sector; we expect ABS to continue to provide stable income.

Emerging Market Debt

- Growth within emerging markets (EM) will remain robust, supported by a contained U.S. dollar, low global rates and developed market growth. While some momentum is fading, we maintain our constructive stance on EM, with a bias towards hard currency sovereign issues and local currency interest rate risk. Country differentiation remains key, with idiosyncratic risks in Venezuela, Qatar, Brazil and South Africa.

Past performance does not guarantee future results.

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