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 December 31, 2014, Voya Investment Management managed $125 billion in fixed income strategies in the United States.

Bond Market Outlook

Global Interest Rates: With the Fed on hold and ECB QE in play, we expect interest rates to be range-bound with the potential to go lower in the near term.

Global Currencies: The dollar has cooled off, but we continue to favor it over the euro and yen with the Fed still in play in 2015. The path of EM currencies versus the dollar is still down.

Corporates: Given above-trend growth, low inflation and supportive fundamentals in the U.S., domestic corporates look attractive, especially with European QE now underway.

High Yield: Return prospects are limited in the near term, but with the U.S. economic recovery intact and credit metrics still reasonable, we remain constructive on the asset class.

Mortgages: With rates potentially going lower, we are less constructive on agency mortgages; we continue to favor CMBS and non-agency MBS.

Emerging Markets: While our overall outlook is negative, easing in China, commodity stabilization and a dovish Fed are helping to improve the technical backdrop.

Macro Overview

- Punxsutawney Phil won't be adding "economic soothsayer" to his resume this year. The prescient marmot saw his shadow on Groundhog Day, which typically prognosticates six more weeks of winter. But if the latest U.S. Federal Reserve announcement was any barometer of the economic climate, it would be superstitious to believe in a spring of interest rates anytime soon.
- While the improving labor market points to sunnier days ahead, the Fed's dovish tone confirms that job growth is being overshadowed by the realities of low wage inflation, a strong dollar and collapsing oil prices. And though snowy weather was partially to blame for housing starts falling in February, the decline was the largest in four years — evidence that the housing market is cooling off.
- The removal of "patient" from the Fed's latest announcement implies a shift in policy could happen in 2015. But with forward guidance gone and the emphasis squarely on the economy the message is clear: the Fed will not be impatient about raising rates. Job growth alone likely isn't enough to offset the weak global growth forecast. On the other hand, a weaker euro and quantitative easing by the European Central Bank are reviving growth prospects in Europe. Keeping Fed policy on hold allows more time for U.S. labor market improvement to percolate into other areas of the economy. Low commodity prices and a strong dollar restrain inflation and are also positive tailwinds for consumers.
- We believe supportive policy globally will help smooth over economic and seasonal noise. With a quiescent Fed for now, we maintain our bias for U.S. dollar-denominated spread sectors, which we expect to benefit from the strength and stability of the U.S. economy and from capital seeking more attractive yield than can be found elsewhere. Rates are likely to be range-bound and interest rate volatility to decline in the near term. If clearer signs emerge that the economy is heating up, we could see rising volatility and a spring of interest rates later this year.

Spreads, Returns and Yields

Index	Percentage of Index	Spread (bps)	Returns (%) Feb. 2015	Returns (%) YTD 2015
Barclays U.S. Aggregate	**100.0**	**43**	**-0.7**	**1.1**
Treasury	36.1	0	-1.3	1.0
Investment Grade Corporates	23.6	123	-0.8	2.0
Fixed-Rate MBS	28.2	18	0.0	0.7
Other				
High Yield		426	2.4	3.1
Global Aggregate		37	-0.8	-1.0
Emerging Markets		362	1.0	1.6

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%) Feb. 2015	Returns (%) YTD 2015
U.S.	2.0	EUR/USD	1.11	-1.3	-6.7
Germany	0.2	USD/JPY	119	-1.7	0.7
Japan	0.3	USD/BRL	2.84	-3.2	-3.5
Brazil	13.2				

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

- The Fed continues to move in the opposite direction of other central banks. We still expect the Fed to move off zero this year, but it will likely be along a lower path and not until late 2015 given its recent dovish messaging and overall assessment of the economy.
- Europe is showing signs of improvement, with the most recent PMI data surprising to the upside, and political risks with Greece and Spain have faded for now. The implementation of QE in Europe could drive higher inflation expectations while serving as a price control. We expect European rates to be range-bound with potential to go lower in the near term, and potentially more negative in some cases.

Global Currencies

- The relative strength of the U.S. economy and the opposing direction of Fed monetary policy versus the rest of the developed world will continue to support the U.S. dollar. The dollar has lost some steam with the Fed on hold, but strategically we continue to favor it over the euro or yen with a Fed rate hike still in play for 2015.

Investment Grade Corporates

- Leverage has been on the rise in recent quarters. Corporate revenue and earnings growth have remained fairly stable for the past few years, however, and we do not see an inflection point on the horizon for the credit cycle. Excluding metals and energy, corporate spreads have moved back into the range of their cycle lows, but flows have been positive and demand remains sound despite heavy issuance.
- Though changes in Fed language are a concern, above-trend growth in the U.S. and low inflation expectations in Europe lead us to believe that domestic corporates are attractive and able to generate positive excess returns.

High Yield Corporates

- Fundamentals generally remain in good shape, though leverage has begun to creep higher. The risk of a near-term default spike remains very low. Nonetheless, a sustained period of low oil prices could increase energy defaults over a two- to three-year horizon, which could push the overall default rate above expectations. The technical environment remains supportive: positive fund flows have outpaced supply, and equity markets have remained strong.
- Stabilizing oil prices have allowed the energy sector to rebound off its lows, resulting in spread tightening for the broader asset class led by the higher-quality part of the market. The credit curve remains quite steep as a consequence, with BBs no longer looking particularly cheap versus BBBs. This suggests any further market rally will depend largely on the lower-quality tier of the market. In our view, near-term return prospects are limited by the recent rally; but with the U.S. economic recovery intact and credit metrics still reasonable, we remain constructive on the asset class.

Mortgages

- While the ECB's asset-purchase program and demand from abroad are supportive, with the Fed on hold and rates potentially going lower we anticipate that prepayment expectations will pick up in the near term. Therefore, we are less constructive on agency mortgages, which we expect will continue to trade directionally with interest rates.
- The relative value in commercial mortgage-backed securities is still in play. The heavy new-issuance calendar remains a concern, but risk appetite in the search for yield remains robust and underlying fundamentals provide a supportive backdrop. These factors should be supportive of the CMBS market in the near term.
- We also remain constructive on non-agency MBS, as the housing market is strong overall and credit access continues to improve across borrower types. Furthermore, insulation from risk factors outside the U.S. promotes price stability and continued investor interest in these securities.

Emerging Markets

- We retain our overall negative outlook on emerging markets, though monetary easing in China and commodity price stabilization are improving the technical backdrop — particularly for corporate bonds. While the path of EM currencies versus the dollar is still down, expectations of a delayed rate hike in the U.S. are helping to mitigate dollar strength. What's more, ECB asset purchases increase the attractiveness across EMs from a yield standpoint. It is crucial, however, to be selective about countries and sectors within the asset class and to manage overall volatility.

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