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.

Bond Market Outlook

Global Rates: trade war fears and equity volatility keep a cap on U.S. Treasury yields

Global Currencies: U.S. dollar weakens further, particularly against yen and EM currencies

Investment Grade: earnings season supports strong fundamentals, current valuations look attractive

High Yield: spreads are wider, but at current levels not sufficient to attract investors

Securitized Credit: strong fundamentals, floating-rate structure continue to support CLOs despite potential headwinds from uptick in near-term supply

Emerging Markets: growth is positive but slowing, intra-EM trade may help as U.S. and China face off over tariffs

Tug of War: Fundamentals vs. Volatility

After nearly two years of smooth sailing, volatility reappeared during Q1. In accord with our belief that the primary impact of quantitative easing (QE) was a reduction of market volatility, we entered 2018 expecting volatility to tick up as central banks began pulling back their accommodative policies. This spike in volatility is thus in line with our expectations, albeit of greater magnitude than we foresaw. Since the initial jump in February, volatility levels have trended sideways; we believe this elevated market chop is unlikely to subside. The tailwinds of QE suppressing volatility are largely gone. If global growth surprises to the upside, the result will likely be an acceleration of tighter central bank policies, which would support elevated volatility.

The sell-off began with a pickup of inflation expectations as evidenced by the 10-year breakeven rate increasing over 2% in early January, which subsequently led to higher bond yields. This then spread to the CBOE Volatility Index (VIX), which spiked shortly thereafter. The VIX remains elevated, justifying the equity sell-off and resulting decline in valuations, both in equities and in "spread" fixed income assets.

While the dark side that is elevated volatility is here to stay, there are pockets of light to help balance the force. The volatility seen thus far has been largely confined to equity markets and stemmed from inflation fears, trade turmoil and stretched valuations, but not from credit markets. Yes, spreads have widened, but to a lesser degree than in previous equity sell-offs, indicating that it is not a fundamental concern and reaffirming our cautious but not outright bearish view. Further supporting this is the lack of reckless leveraging behavior in the riskier parts of the market, as well as by consumers, as housing debt remains under control. Therefore, we remain constructive on consumer-oriented sectors such as securitized credit, while looking to capitalize on opportunities created in the investment grade and high yield corporate sectors by bouts of volatility. As global rate volatility takes hold, we are shifting our focus in emerging markets, with a preference for local debt.

Spreads, Returns and Yields

Index/Sector	Percentage of Index	Spread (bp)	Returns (%)	
			Mar. 2018	YTD 2018
Bloomberg Barclays U.S. Aggregate	100.0	41	0.64	-1.46
Treasury	37.2	0	0.94	-1.18
Investment Grade Corporate	25.3	109	0.25	-2.32
Fixed-Rate MBS	28.1	29	0.64	-1.19
Other				
High Yield		354	-0.60	-0.86
Global Aggregate		38	1.06	1.36
Emerging Markets		285	-1.99	-2.03

Country	Yield on Ten-Year Bonds (%)	Currency		Returns (%)	
				Mar. 2018	YTD 2018
United States	2.74	EUR/USD	1.23	1.07	2.66
Germany	0.50	USD/JPY	106	0.38	6.03
Japan	0.05	USD/BRL	3.31	-1.77	0.07

Source: Bloomberg, 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 Outlooks

Global Rates and Currencies

We believe the recent move higher in U.S. rates is unlikely to accelerate much further. On the one hand, fiscal stimulus from tax cuts remains a supporting factor for U.S. growth, and the rising borrowing needs of the U.S. Treasury in connection with higher deficits puts pressure on U.S. yields. On the other hand, trade war concerns and elevated equity volatility will limit a significant leap higher in yields.

Despite elevated rates, concerns over rising deficits should lead to a weaker U.S. dollar, particularly against the yen and most emerging market currencies. However, amidst higher volatility, we cannot rule out a short-lived dollar rally.

We expect rates in Germany to be range-bound as European economic data have surprised to the downside in multiple sectors, temporarily dampening fears of the European Central Bank moving faster towards an unwind of quantitative easing.

Investment Grade Corporates

The outlook for investment grade credit remains solid despite recent volatility. We believe the upcoming earnings season will support the already strong fundamental picture, with global growth providing a nice tailwind. The positive technical story remains intact as near-term headwinds subside. Demand from pension funds and foreign investors should remain strong. Given that much of the recent spread widening occurred in the more-liquid sectors, we believe valuations now offer attractive buying opportunities. We continue to favor financials as higher interest rates will support the sector, as well as communications and utilities.

High Yield Corporates

Credit fundamentals for the HY market remain mildly positive, with potential for increased momentum from changes to the tax code and added infrastructure spending. Lower equity prices and higher volatility continue to weigh on sentiment and limit risk appetite. HY spreads are now wider from year-end and yields are back above 6%, making valuations slightly more compelling. The fundamental outlook remains positive with the upcoming 1Q18 earnings season expected to show strong year-over-year growth, but there appears to be limited scope to rally given current valuations. Recently in the corporate credit space, we have shifted our attention to senior loans, which currently offer attractive relative value.

Securitized Assets

Agency residential mortgage-backed securities (RMBS) posted a third straight month of underperformance in March. Performance should remain tied to volatility with little change to fundamentals. Fed tapering will increase supply moving into spring, and uncertainty about the direction of rates could lead to greater volatility. Therefore, we remain underweight.

Non-agency RMBS continue to be driven by a recovering housing market. Upside remains as credit availability increases, home ownership bottoms and the Millennial demographic engages. These dynamics will benefit the amortizing legacy universe as well as next-generation submarkets such as credit-risk transfer securities.

Asset-backed securities remain supported by the strong fundamentals of the U.S. consumer, which is less susceptible to volatility. Despite looming concerns around subprime auto borrowers and headwinds from the used car market, credit performance remains strong across almost all other sub-sectors and we expect ABS to outperform in periods of elevated volatility.

CLOs will continue to benefit from rising LIBOR and demand for floating rate securities, despite potential near-term pressures from an uptick in new supply. The potential for future rate hikes is a positive for floaters and their underlying loans, especially relative to other risk markets. Fundamental stability in the corporate credit market will further support CLO spreads.

We maintain our overweight in commercial mortgage-backed securities (CMBS) as fundamentals remain strong and commercial real estate prices continue to climb. The supply picture looks to continue to improve, as new issuance should be manageable.

Emerging Market Debt

We expect growth within emerging markets (EM) to remain positive, though momentum is slowing. Intra-EM trade may mitigate uncertainty as the United States and China face off over tariffs. Rising trade war risk could dampen global commodity demand, though the supply discipline imposed by Chinese producers provides downside support. Solid eurozone growth and a more benign slowdown in China should support EMs. Country differentiation remains key, due to changing macro drivers, election-related risks and tighter financing conditions.

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