Fixed Income Perspectives

In anticipation of the upcoming May employment report, we take a look back at last month's jobs number to put the "disappointing" results in perspective.

Bond Market Outlook

Global Rates: Long-end rates led by the 10-year Treasury will move towards 2% but not in a linear manner

Global Currencies: U.S. dollar trends weaker against DM, EM currencies

Investment Grade: Improving fundamentals as evidenced by strong earnings to support spreads despite tight valuations

High Yield: Spreads near uncomfortably tight levels, but improving fundamentals warrants adding on spread weakness

Securitized: Continue to favor securitized credit over Agency RMBS, as Fed starts "thinking about talking about" tapering

Emerging Markets: EM continues its unsynchronized growth with certain regions such as LatAm rebounding, while Asia continues to deal with virus issues

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.

Has the Economic Reopening Stalled?

Last month, we switched gears from inflation to discuss the economic reopening and the reemergence of the U.S. consumer. By all qualitative measures, the economy certainly feels to be opening up. Airplanes are full. Seating in sports arenas is reaching full capacity. Restaurants and gyms have reopened their doors.

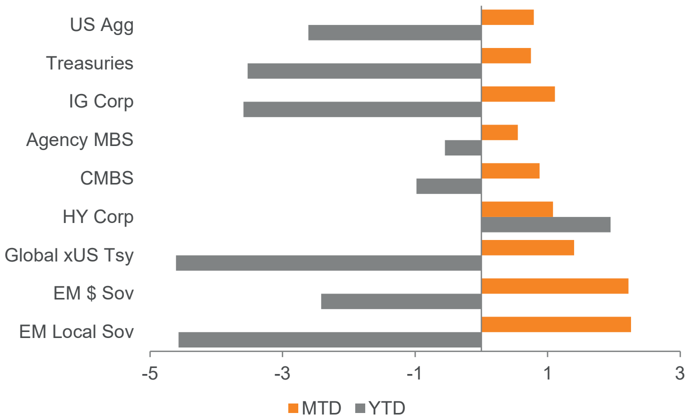
However, the employment report published earlier in May might seem to contradict this perspective and suggest that the economic reopening may not be as far along as it appears on the surface. Despite the obvious employment miss reported by the seasonally adjusted establishment survey, the payroll data does not suggest that reopening is stalling. When you look at the employment report on a non-seasonally adjusted basis, 1,089k jobs were added. In addition, reopening in the leisure and hospitality areas is clearly underway, where there has been a 2.7% increase month over month in hourly earnings, which is a sign of continued improvement in labor demand.

The percentage of people working remotely fell from 21% in March to just over 18% in April. Similarly, the number of people reporting being unable to work for pandemic related reasons fell from 11.4 million people to 9.4 million. In addition, although the unemployment rate slightly increased, it was primarily due to an increase in the overall labor force participation, which is a positive sign as people are more confident in their effort to secure employment. The employment-to-population ratio—which we view as more representative of the current labor market dynamics—also increased for the month from 57.8% to 57.9%.

Significant savings built up during the pandemic, coupled with massive fiscal stimulus, have ignited a consumption boom that we believe is in the early innings. Underscoring this point, reported first-quarter corporate earnings to date have greatly exceeded forecasts. The combination of our strategic overweights to securitized and corporate credit leave our portfolios well positioned to capitalize on the continued re-opening of the U.S. economy.

Rates, Spreads and Yields

Fixed Income Sector Total Returns



		30-Apr	31-Mar	1Y Low	1Y High
Yields	US 2 Yr	0.16	0.16	0.11	0.23
	US 10 Yr	1.63	1.74	0.51	1.74
	GER 10 Yr	-0.20	-0.29	-0.64	-0.19
	JPN 10 Yr	0.10	0.10	-0.03	0.16
	EM Local Sov	4.94	4.99	4.19	5.06
Spreads	IG Corp	88	91	88	213
	Agency MBS	7	12	7	75
	CMBS	105	112	104	261
	HY Corp	291	310	290	757
	HY x-Egy Corp	275	289	270	684
	EM $ Sov	339	354	335	610

As of 04/30/21. Past performance is no guarantee of future results. Source: Bloomberg, Bloomberg/Barclays, JP Morgan and Voya.

Sector Outlooks

Global Rates and Currencies

The dollar declined against all G10 currencies and risk appetite was generally high through April, particularly for developed market equities. The risk-on sentiment for such equities was unsurprising, given the overall – albeit uneven - notable progress of the vaccine rollout and a largely robust earnings season in which several sectors and firms beat expectations.

On the macro side, the U.S. Treasury yield curve bull-flattened across much of its structure while base inflationary effects are beginning to show up in the data, as expected. That said, both Fed Chair Jerome Powell and Treasury Secretary Janet Yellen are not expressing concern about runaway inflation.

Looking forward, we are keeping a close eye on consumer spending and the underlying composition, and movements in the employment trajectory. Furthermore, over the medium term, we expect there to be continued strong focus on fiscal stimulus developments.

Investment Grade (IG) Corporates

The fundamental picture for IG corporates remains firm, with 1Q21 results coming in better than already raised expectations. We continue to see an uptick in merger and acquisition (M&A) announcements and a gradual move towards shareholder returns; and while leverage remains high, we expect IG-rated issuers to focus on balance sheet repair in 2021. We shift to a more neutral stance on market technical factors, as supply is expected to increase in the near term. Demand should remain firm as yields sit slightly higher and currency hedging costs for foreign investors remain low with the Fed on hold. With spreads near year-to-date tights, valuations look full and we expect spreads to trend sideways. We continue to favor BBB-rated credits given the extra spread pick-up, increased focus on balance sheet repair and lower M&A risk. Additionally, the steepening in the yield curve has created idiosyncratic opportunities among high quality issuers in the 7–9 year segment of the curve. In terms of sectors, we remain overweight financials given their more defensive posture, particularly the money center banks. We also continue to like telecommunications, utilities and technology.

High Yield Corporates

High yield was off to a very strong start to the second quarter, as the market rallied early in April, led at the outset by BB-rated issues, which bounced back from their rate-induced swoon toward the end of 1Q21. Overall, risk continues to trade well, and new issue volume continues to be heavy – indeed record-breaking volumes seem to be the norm. Fundamentally, we continue to see good quarter-over-quarter momentum, and if it holds, we will start to lap some easy year-over-year comparables in most sectors, which is likely to help drive leverage stats back toward normal. So far, the year is playing out as expected: total returns are decent; excess returns are strong, and spreads are starting to get a little frothy with each rally.

Securitized Assets

Agency MBS outperformed in April on the back of dovish Fed messaging, strong demand, and lower volatility. Substantial month-end index rebalancing needs from passive investors and lower origination volumes were tailwinds. Mortgage origination's strong start to the year has already surprised most analyst expectations to the high side, as original net supply expectations were in the mid-$400 billion range, slightly below 2020's net supply of $506 billion. However, revised estimates now place 2021 net issuance at well over $600 billion due to strong HPA, elevated home sales and cash-out refinancing, and higher securitization rates.

We maintain a more cautious tactical view on mortgage credit. While rates have pushed lower since March, the potential for more rate volatility is deemed sufficient to bias investors towards expecting longer spread duration, slower de-leveraging and lower yield profiles for a bit longer. Nonetheless, housing markets are firmly in expansion mode - a clear beneficiary of the pandemic – and mortgage credit will continue to be driven positively by housing market expansion and credit availability, thus justifying our strategically positive stance.

Commercial Mortgage Backed Securities enjoyed a particularly strong start to the year and continues to command our favor. While the rally was partially derailed amidst the rate volatility that gripped fixed income for much of March the sector regained its positive direction in April, and remains cheap and poised to continue its spread recovery into a liquid market. Although the increasingly busy new issuance calendar represents a potential challenge to the favorable technical set-up, at this stage we believe it is net favorable given the positive fundamental implications. Looking ahead, reflationary impulses from monetary and fiscal policy and optimism from the vaccine roll-out remain extremely supportive of CRE fundamentals.

Non-benchmark ABS will continue to perform well fundamentally, and as a short duration sector, should outperform as rate volatility drives periodic bouts of risk aversion. We maintain our assessment as positive and increase our conviction. The fiscally improved profile of the U.S. consumer coupled with ABS structural dynamics were already believed to provide the sector with solid footing to withstand this sustained period of elevated, albeit improving, unemployment. Indeed, recently enacted stimulus is acting as a fortifying bridge to the end of the pandemic.

Emerging Market (EM) Debt

The momentum and strength of the U.S. economy coupled with the gradual re-opening in Europe is supportive of the global recovery. As such, we expect global capital flows to EM to remain positive as global financial conditions remain favorable. In April, the multi-speed and unsynchronized EM growth rebound continued, highlighting the importance of export sector and manufacturing strength, as well as government policy and vaccine roll-outs to support the macro path. Headline inflation was mixed, with commodity and food prices being the primary factors. That said, EM corporates continued to see earnings improvement, led by commodity producers that benefited from rebounding oil and metal prices. Going forward, fiscal constraints and responses remain a key issue to monitor, as consolidation may be delayed in sight of renewed lockdowns and prolonged vaccine roll-outs.

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