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APRIL 2019

ACTIVE FIXED INCOME
SNAPSHOT DESK VIEWS

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SUMMARY OF POSITIONING

In government bond markets, we continue to have a modest flattening bias in the US and core Europe and retain our short duration positioning in Italy. Our long position in US inflation markets is now more modest given valuations. In cash credit, we continue to believe valuations look better in European investment grade than in US dollars, while credit default swap index valuations look somewhat stretched. High yield looks tactically attractive given inflows from the loan market and scant net supply in Europe. In emerging markets, we continue to see most value in high yield sovereigns.

EUROPE

In core Europe, we have a yield-curve flattening bias, although we have reduced it recently following significant market moves. In peripheral Europe, we continue to believe Italy is an accident waiting to happen, although perhaps not until September or October.

Following the delay to Brexit, we believe the risk of a 'no deal' Brexit by accident still cannot be ruled out. As two extensions have already been approved by the EU, seeking a third may result in some further political tensions. The outcome remains highly uncertain with the probability of a myriad of potential options – including a general election, no Brexit and a no-deal outcome – all essentially unchanged. In the midst of this uncertainty, the market is struggling to price a no-deal scenario. We continue to have a broadly neutral UK duration bias.

INVESTMENT GRADE

In euro credit, we believe valuations look attractive on a relative-value basis and the market has been supported by sizeable institutional flows, with Japanese investors notably returning in considerable size. The technical picture has also been strong, given the dovish tilt in global monetary policy. We have added risk to move closer to neutral credit risk from underweight.

Sterling credit has been supported by inflows as well as limited supply. A significant proportion of our UK-focused exposure is secured or heavily covenanted. We believe the extension of Brexit to October 31 has provided a breather to the market for now and (even though Brexit outcomes ultimately remain uncertain) may present a window of opportunity for attractive relative-pricing between sterling and US dollar and euro credit to adjust in the near term.

HIGH YIELD

We continue to have a positive bias towards high yield. There has been a return of 'tourists' (from investment grade) into BB credits. This is partly due to less appetite for floating-rate assets allowing high yield to benefit from flows out of the loan market. There has been virtually no net supply in Europe, although a few deals are expected. That being said, the primary market has been dominated by refinancings, with any M&A or leveraged buy-outs directed towards the loan market rather than high yield.

LOANS

We have a less positive view on the loan market, which has lost flows to high yield as appetite for floating rate instruments has decreased. The US market has seen notable retail outflows and a relatively muted outlook for collateralised loan obligation (CLO) creation is less positive for demand. On the positive side, supply has also dried up. We view it as an earn-the-carry environment, as valuations look close to fair value to us.

ASSET-BACKED SECURITIES

We are less tactically negative on CLOs and have generally stopped reducing our exposure. Current spread levels look relatively attractive with BBBs trading around 400bps, while AAs are in the mid-200bps. Supply has been limited, and what has come to market has been oversubscribed. In our view, relative value versus other credit markets looks attractive.

EMERGING MARKETS

We remain constructive on the asset class and our most positive view is still in sovereign high yield. We also have a long in local rates, although we have recently reduced the position modestly. In terms of FX, we feel the asset class is lacking directionality, so we see the least compelling value opportunities here.

CURRENCY

In our view, there has been limited opportunity in currencies, as volatility has been low. As such, we have relatively constrained positions and would prefer to wait for better opportunities. We are long the Australian dollar and the Japanese yen.

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