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OCTOBER 2020

ACTIVE FIXED INCOME SNAPSHOT DESK VIEWS

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OUTLOOK

We see some cause for optimism from the levels of resilience shown by economies and markets since the initial impact of the virus in March and April. This is reflected in forward rates, liquidity and mergers and acquisition. It is also reflected in how in April, issuers were raising money out of necessity, but now they're raising money to playing offense by opportunistically redeeming more expensive debt and pushing out maturities. We note too that hospitalization rates for the virus are lower than for the first wave, although we recognize that a rapid recovery will only take place once a vaccine is released.

Equally there is a recognition that there are winners and losers from the impact of the virus. The winners include housing, telecoms, technology, food, supermarkets and building materials, whereas losers include airlines and restaurants.

Lastly, we note that the US presidential election is being viewed neutrally by markets; previously a Democratic win was viewed as bad for taxes on business but is now welcomed for its prospective fiscal stimulus.

GLOBAL RATES

We favor a long duration in US Treasuries, Japanese government bonds and German bunds with an underweight position in Europe overall as a bullish trade rather than as a protective position. Our largest duration is in 30-year US Treasuries. We have been reducing our positions in European peripherals, predominantly in Italy.

US CREDIT

We currently take a balanced view due to a wide range of positive and negative factors. US credit is seeing inflows from Asia searching for a real yield and this has held up valuations, although we also note that there a danger of asset allocators switching from credit to equity due to low real yields. We note that downgrades and defaults have undershot predictions for the year, but that continuing high COVID-19 numbers is a concern, as well as downside risk from the US election in November. More generally we note the large amount of issuance at low yields, sometimes used to redeem debt that has a higher coupon. Our outlook is for earnings to rebound in 2021. We expect a disparity of outcome with some issues having room to compress, while others have no place to go.

EU CREDIT

We remain cautiously positive on Euro credit till the year end, due to the market demand being the biggest factor in pricing. We see increasing demand from insurers and pension funds that seek an alternative to negative yielding government debt to cover their liabilities. A secondary factor is monetary stimulus, some of which is being used to buy corporate debt as well as government debt. Such is the demand we expect any weakness to be bought. Furthermore, we expect supply to slow down after strong year to date for new issuance due to corporates taking advantage of lower rates.

EMERGING MARKET DEBT

We have reduced some of our long positions and taken some profit, but we remain cautiously constructive. We see value in high yield sovereigns, where spreads are in the 91st percentile of relative value versus US high yield, which is close to record wides. These positions are being supported by a trickle down of the search for yield from investment grade debt. However, we will not invest in a country that does not have liquidity for at least the next 18 months due to our concerns at virus numbers worsening.

CURRENCY

Our key position is short US dollars vs Asian countries which should benefit from an upswing in global trade and or where COVID-19 infection rates are lower, particularly South Korea, Taiwan and India. Plus, if the Democrats win the US presidential election and there is the promised fiscal expansion, global growth will rise and we could see a weaker dollar.

MORTGAGES

We have a risk on position here in part due to the large program of daily purchases of mortgage backed securities by the Federal Reserve. This is leading to a 'follow-the-Fed' game where value is made by owning mortgage securities on the Fed's asset purchase scheme, or by anticipating where the Fed will start purchasing mortgages next. A concern is that returns could be cut by a growing amount of pre-pay activity, where borrowers switch to a lower mortgage rate for a fixed fee - mortgage rates are at an all-time low in the United States.

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FIND OUT MORE

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