

Fixed Income Perspectives

Bond Market Outlook

Global Rates: Fed cuts, downward growth revisions cap upside, but negative rates are not in the cards

Global Currencies: Safe haven currencies such as dollar, yen to remain strong

Investment Grade: Maintain bias to more domestically and consumer-oriented issuers in our portfolios, with a preference towards financials

High Yield: Exploring opportunities created by indiscriminate selling while remaining underweight energy

Securitized: Sector is holding up relatively well through recent market volatility as consumer, housing market were robust heading into 2020

Emerging Markets: GDP growth no longer looks set to materially accelerate in 2020; Coronavirus, oil impacts will drive rising differentiation among EM sovereigns and corporates



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.

Assess, Don't Obsess...Navigating Tail Risks

Epidemics are said to hold up a mirror to society, revealing through our response, the good, the bad and the ugly of the environment we have collectively manufactured. From this perspective, the investment community should catch its breath. Investors' speculation about COVID-19 (Coronavirus) has created an echo chamber of noise. In periods of extreme volatility and uncertainty, there is a fine line between provocative (but valuable) insight and fear mongering, with descriptions of the Coronavirus teetering towards the latter.

Rather than join the chorus of speculation, the most valuable insight we can offer about the coronavirus at this juncture is a reminder: this market environment is exactly why we prepare for tail risk. In the near term, risk remains skewed to the downside. Interest rates can stay low and go even lower.

Indeed, building portfolios to withstand tail risk is important. It is also worth remembering, however, that portfolios should not be built *just* to withstand tail risk. Seizing opportunities when they arise is equally important and, given the dry powder we have across our portfolios, we are more inclined to be buyers of this weakness. While we remain biased towards securitized sectors (which have held up well through this volatility), we are exploring opportunities in corporate markets created from indiscriminate selling as a result of recent price action. Within our government exposures, we are allocating to TIPS, which can maintain duration with less downside than Treasuries in this environment.

While we expect a technical recession in the near term, we ultimately believe it will be short lived due to the strength of the financial system and U.S. consumer heading into this market shock. However, until more is known, expect the wild market swings to continue. Resist the temptation of the 24-hour "breaking news" cycle. In the end fundamentals will count most. Is uncertainty elevated? Undoubtedly. Is this the worst market event of our lifetime? No—but then again, we're not in the business of ranking market events by some arbitrary order of magnitude. We are in the business of analyzing the world through the lens of our rigorous research process and navigating our clients' portfolios through the ups and downs of different market cycles.

Returns, Spreads and Yields

Sector	Percentage of Index	Spread (bp)	Returns (%)	
			February 2020	FY 2020
Bloomberg Barclays U.S. Aggregate	100.0	50	1.80	3.76
Treasury	40.4	0	2.65	5.16
Investment Grade Corporate	25.0	122	1.34	3.71
Fixed-Rate MBS	26.1	54	1.04	1.74
Other				
High Yield		500	-1.41	-1.38
Global Aggregate		47	0.67	1.96
Emerging Markets		372	-0.97	0.54

Country	Yield on Ten-Year Bonds (%)	Currency	Returns (%)	
			February 2020	FY 2020
United States	1.15	EUR/USD 1.10	-0.60	-1.67
Germany	-0.61	USD/JPY 108	0.43	0.67
Japan	-0.16	USD/BRL 4.47	-4.23	-9.87

Source: Bloomberg, JPMorgan, Standard & Poor's. All spreads are to U.S. Treasuries 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

Recent market volatility was a 1-2 punch of continued concerns regarding the Coronavirus followed by unexpected events in the energy markets. Oil prices tumbled 20% after talks between OPEC and non-OPEC members failed to reach an agreement on production cuts, as Russia signaled an apparent willingness to try to price U.S. shale out of the market. This sharp downward move in oil exacerbated weakness in the global financial markets.

The downward movement in rates has been significant to say the least. 10-year U.S. Treasury yields dipped to an all-time low of 0.32% as fears of recession continue to grow. For perspective, recall that the yield on the 10-Year treasury was above 3% in October 2018.

In line with our commitment to risk-adjusted returns, we are not inclined to make significant bets on duration. However, we believe TIPS may be creating an opportunity to maintain duration while buffering loss in the event that rates go up from present levels.

Investment Grade (IG) Corporates

Overall, spreads have widened meaningfully in response to the recent volatility. Looking forward, oil prices in the \$30 range will result in a sharp decline in cash flows. However, many investment grade-rated energy issuers, particularly the larger integrated and independents, do have multiple levers to pull and do not have short term funding needs, thus making a jump to an immediate default unlikely.

As we saw during the energy crisis in 2015-2016, issuers are expected to cut capital expenditures to preserve liquidity and production will continue in the near term. We believe the hardest hit sector as a result of the sharp decline in oil prices will be oil field services—revenues in this sub-sector are derived directly from capital investments by independent upstream producers. Industries with more direct exposure to the fallout from efforts to contain the coronavirus (travel, leisure, etc.) will also experience extreme pressure.

We have been using recent volatility to selectively capitalize on opportunities. The key areas where we see potential opportunities are in the long end of the credit curve (particularly in the AA and A ratings space) and select subordinated securities, such as preferreds, of larger U.S. money center banks. Both areas have underperformed the broader market during the recent selloff and, as a result, offer attractive value at current levels. Overall, we continue to prefer more domestic- and consumer-oriented issuers in our portfolios. For example, U.S. financial companies are well positioned due to their strong liquidity and robust capitalization, which allows them to support both their own credit downside as well as the downside in the broader economy.

High Yield (HY) Corporates

The oil-related sell off was most pronounced in the high yield sector where energy-related issuers represent ~10% of the index. Reminder: oil is a notoriously volatile commodity. Recent oil price ranges include ~\$105 per barrel in September 2014 to ~\$25 per barrel in Feb 2016, and ~\$75 per barrel in October 2018 to ~\$31 per barrel as of market close on March 9. The nature of the oil

reserves in Saudi Arabia and Russia will allow them to deal with this short-term price decline. However, the decline in energy prices is accelerating a casualty in the shale space in the U.S. We expect downgrades for energy companies and while we are seeing some attractive high yield opportunities develop, we are inclined to focus our attention away from energy markets.

Securitized Assets

Relative to other spread sectors, securitized credit (ABS, non-agency RMBS, and CMBS) have held up particularly well through recent market volatility. Most of the securitized credit universe is higher in quality with less tail risk and shorter durations so price volatility has been lower than in credit markets. Not surprisingly, areas of the ABS market with the most exposure to the fallout from the coronavirus were hit the hardest (container and rail ABS). The commercial ABS sector (where we have no exposure) was particularly hard hit.

Agency mortgage backed securities also held up well despite the interest rate volatility and increased prepayment risk. While U.S. Treasury yields have collapsed, mortgage rates and been less sensitive in their decline. We would expect the mortgage rates to continue to decline, keeping pre-payment risk high, as consumers take advantage of low borrowing costs.

Emerging Market (EM) Debt

EM GDP growth no longer looks set to materially accelerate in 2020. The spread of COVID-19 and worse-than-expected high frequency data out of China have necessitated downgrades to full year growth forecasts. The impact will be most severe in commodity dependent economies as well as those in East Asia where direct trade links and supply chain integration with China are the highest. Inflation remains contained in EM with few exceptions. Risks to inflation are skewed to the downside. Policymakers in Asia have been the first to announce support packages and the trend is likely to continue in other regions. In general, the economies most exposed to this slowdown are in good fiscal shape to implement expansionary policies with some notable exceptions.

We continue to favor major LatAm countries and issuers, where we have seen fewer cases and expect a softer economic impact from virus fears. We focus on countries with stronger fundamentals and those better suited fiscally to respond to a potential economic downturn such as Colombia, Paraguay, and Peru. We are selective in Europe, where we like Turkey given the improved growth picture and will benefit from lower oil prices, as well as Russia and Kazakhstan, both of which are in strong fiscal and sovereign balance positions. Within Asia, we prefer Indonesia over sovereigns that still trade rich such as China, Philippines, and Malaysia. Finally, we are avoiding sizable allocations to the Middle East due to its exposure and sensitivity to oil prices.

Past performance does not guarantee future results.

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(800) 992-0180 Individual Investors | (800) 334-3444 Investment Professionals
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