Fixed Income Perspectives

Bond Market Outlook

Global Rates: Long end rates, led by the 10-year Treasury, will move higher towards 2.00% although not in a linear manner

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

Investment Grade: Given tight valuations, with risk-reward skewed more to the negative, we maintain a neutral stance on IG

High Yield: Market yields near all-time lows but spreads aren't outrageously low; outperformance is possible if rates go higher

Securitized Credit: Mortgage credits will continue to benefit from housing market expansion and credit availability

Emerging Markets: EM growth remains on track, with Asia leading; we are focusing on high yield sovereigns and long 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.

Rates and Inflation: Investors Seem Determined to "Unfollow" the Fed

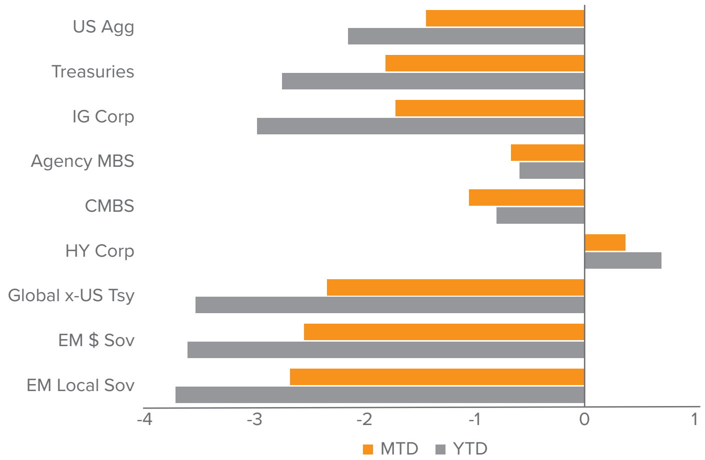
At its March meeting the Federal Open Market Committee (FOMC) reaffirmed its accommodative policy stance, leaving unchanged the fed funds rate and the pace of monthly bond purchases. The statement noted that the pace of economic recovery recently has increased, but inflation continues to run below the bank's 2% target. The Summary of Economic Projections still showed the median projection for no hikes through 2023. Yet, the 10-year U.S. Treasury yield briefly approached 1.75% the next day, and rose for an eighth consecutive week. Investors seem to be signaling disagreement with the Fed; they argue the recent inflation uptick and yield run-up will get out of hand, forcing the FOMC to step on the brakes sooner and harder than expected, shortening the expansion.

Fed officials have repeatedly said they are in no hurry to change policy until their inflation and labor market goals are realized. So far, changes in employment and inflation remain below the Fed's goals and affirm the appropriateness of low policy rates. The Fed has increased its estimates for 2021 GDP and core PCE inflation, and lowered its estimate of unemployment, but continues to view the rise in rates as commensurate with an improved economic outlook. Several recent analyses note that the current yield move-up corresponds with moves seen during recovery phases in 2003 and 2013, in which yields stabilized after rising about 120 basis points (bp). Yields have increased more than 100 bp in this cycle, suggesting that much of the move may have occurred already; accordingly, we believe further curve steepness will be limited in the near term.

By contrast, no such inflationary worries beset the Eurozone, where recovery is lagging by about a year behind the United States due to slower vaccine rollouts, lower government relief spending and coronavirus restrictions. The European Central Bank plans to step up its bond purchases, hoping to forestall premature tightening of financial conditions while businesses are still struggling. Yields on long-term government bonds have risen by about 30 bp YTD in the Eurozone, compared to about 70 bp in the U.S. With Eurozone real yields likely to remain negative, local investors have incentive to continue purchasing U.S. bonds, which should dampen the impulse to higher yields here.

Since the pandemic struck, our view has been that the Fed would not stand in the way of any economic recovery. The Fed's commentary in March reaffirms our view. We continue to expect that Treasury yields will remain range bound in the near term. The yield curve will continue to gradually steepen through year end, likely with bouts of intermittent volatility along the way.

Rates, Spreads and Yields



		28-Feb	31-Jan	1Y Low	1Y High
Yields	US 2 Yr	0.13	0.11	0.11	0.82
	US 10 Yr	1.39	1.08	0.50	1.53
	GER 10 Yr	-0.26	-0.52	-0.86	-0.19
	JPN 10 Yr	0.16	0.05	-0.16	0.16
	EM Local Sov	4.71	4.27	4.19	6.94
Spreads	IG Corp	90	97	88	373
	Agency MBS	20	18	11	132
	CMBS	94	96	94	348
	HY Corp	327	363	317	1100
	HY x-Egy Corp	305	337	292	973
	EM $ Sov	357	351	261	721

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

Sector Outlooks

Global Rates and Currencies

Most currencies in commodity-exporting countries gained against the U.S. dollar in February, while classic, "safe-haven" currencies such as the yen and Swiss franc declined. By contrast, pound-sterling appreciated on the rollout of a strong vaccination program in the United Kingdom.

U.S. Treasury yields increased meaningfully during the month, largely driven by real interest rates. Going forward, the FOMC's commentary on the Fed's response to market rates and policy shifts will be crucial in determining the trajectory of Treasury yields.

Looking ahead over the coming months, key economic statistics to monitor will be consumer spending as well as the underlying composition and movements in the employment trajectory. Furthermore, the estimated time to completing the Covid-19 inoculation of the general populace will remain front and center, while markets will continue to focus on fiscal stimulus negotiations and developments.

Investment Grade (IG) Corporates

IG spreads were 6 basis points tighter in February but closed the month slightly higher, as the move-up in rates accelerated late in the period. IG investors generally welcome higher yields, but the sharp move led to some selling, as investors tried to sidestep the negative total return impact from rising rates. Despite the negative total return for IG during the month, inflows continued, led mostly by mutual funds benchmarked to the Bloomberg Barclays U.S. Aggregate Bond index. Supply was in line with expectations at $103 billion. Given tight valuations, with risk-reward skewed more to the negative, we remain neutral on the asset class.

High Yield Corporates

A strong start to the month was cut short by the back-up of interest rates. Double-B-rated credits suffered the most, barely achieving positive total returns. B-rated credits had a respectable showing and, once again, credit risk led the way with CCC-rated credits posting another good month. Ratings have mostly stabilized and defaults are still trickling through, but a new wave is not currently on the horizon. The new issuance calendar continues to run heavy, setting new record highs for monthly volume, and subsequently dragging on overall market momentum. Many new deals are seeing downward price pressure and soft demand for those with low coupons.

Securitized Assets

Agency mortgage-backed securities (MBS) underperformance was driven by the sharp sell-off of interest rates and volatility. Mortgage valuations are now near the average levels seen when the Fed is involved in quantitative easing MBS purchases. For 2021, net supply is projected to range between $400–500 billion, based on the ongoing robust housing market and cash-out activity driven by the low rate environment, which will likely offset the headwinds of high unemployment and economic uncertainty.

While we have shifted our tactical mortgage credit outlook to negative, we nonetheless still recognize that low mortgage rates, a robust housing market and overall solid consumer creditworthiness will continue to foster sponsorship. Housing markets are firmly in expansion mode — beneficiaries of the pandemic — and mortgage credit will continue to benefit from housing market expansion and credit availability.

Momentum among commercial mortgage-backed securities (CMBS) has persisted from its solid start to the year and remains poised to continue its spread recovery. An increasingly busy new issuance calendar represents a potential challenge, but at this stage is net favorable given the positive fundamental implications. Reflationary impulses from monetary and fiscal policy and optimism from the vaccine roll-out also are extremely supportive of fundamentals. Ultimately, markets are likely to translate these factors into broader and deeper demand for CMBS risk. Near term, scarring from the transition in retail and economic shutdowns will impact particular deals, so caution from a security selection point of view remains warranted.

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

Emerging Market (EM) Debt

EM growth remains on track, supported by strong manufacturing, net exports and business optimism; fixed capital investment remains a headwind. In countries with partial lockdowns, service sector downturns have offset manufacturing output growth and private consumption is lagging. Progress with Covid-19 vaccine roll-outs and the reopening speeds of trading partners will impact the strength of the recovery. EM Asia is leading the pick-up; followed by Central and Eastern Europe, led by Turkey; Latin America and Sub-Saharan Africa are lagging. We have noted a moderation in Chinese growth after ten months of expansion. Headline inflation was mixed, with higher rates in parts of Latin America, Central and Eastern Europe and the Middle East and Africa. Fiscal behavior and strategy will remain under scrutiny, as governments weigh potential renewed support versus needed fiscal consolidation.

Disclaimer

Past performance does not guarantee future results. This commentary has been prepared by Voya Investment Management for informational purposes. Nothing contained herein should be construed as (i) an offer to sell or solicitation of an offer to buy any security or (ii) a recommendation as to the advisability of investing in, purchasing or selling any security. Any opinions expressed herein reflect our judgment and are subject to change. Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (1) general economic conditions, (2) performance of financial markets, (3) interest rate levels, (4) increasing levels of loan defaults (5) changes in laws and regulations and (6) changes in the policies of governments and/or regulatory authorities.

The opinions, views and information expressed in this commentary regarding holdings are subject to change without notice. The information provided regarding holdings is not a recommendation to buy or sell any security. Fund holdings are fluid and are subject to daily change based on market conditions and other factors.

The distribution in the United Kingdom of this presentation and any other marketing materials relating to portfolio management services of the investment vehicle is being addressed to, or directed at, only the following persons: (i) persons having professional experience in matters relating to investments, who are "Investment Professionals" as defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Financial Promotion Order"); (ii) persons falling within any of the categories of persons described in Article 49 ("High net worth companies, unincorporated associations etc.") of the Financial Promotion Order; and (iii) any other person to whom it may otherwise lawfully be distributed in accordance with the Financial Promotion Order. The investment opportunities described in this presentation are available only to such persons; persons of any other description in the United Kingdom should not act or rely on the information in this presentation. The Capital Markets Authority and all other Regulatory Bodies in Kuwait assume no responsibility whatsoever for the contents of this presentation and do not approve the contents thereof or verify their validity and accuracy. The Capital Markets Authority and all other Regulatory Bodies in Kuwait assume no responsibility whatsoever for any damages that may result from relying on the contents of this presentation either wholly or partially. It is recommended to seek the advice of an Investment Advisor. Voya Investment Management does not carry on a business in a regulated activity in Hong Kong and is not licensed by the Securities and Futures Commission. This insight is issued for information purposes only. It is not to be construed as an offer or solicitation for the purchase or sale of any financial instruments. It has not been reviewed by the Securities and Futures Commission. Voya Investment Management accepts no liability whatsoever for any direct, indirect or consequential loss arising from or in connection with any use of, or reliance on, this insight which does not have any regard to the particular needs of any person. Voya Investment Management takes no responsibility whatsoever for any use, reliance or reference by persons other than the intended recipient of this insight. Any prices referred to herein are indicative only and dependent upon market conditions. Past performance is not indicative of future results. Unless otherwise specified, investments are not bank deposits or other obligations of a bank, and the repayment of principal is not insured or guaranteed. They are subject to investment risks, including the possibility that the value of any investment (and income derived thereof (if any)) can increase, decrease or in some cases, be entirely lost and investors may not get back the amount originally invested. The contents of this insight have not been reviewed by any regulatory authority in the countries in which it is distributed. The opinions and views herein do not take into account your individual circumstances, objectives, or needs and are not intended to be recommendations of particular financial instruments or strategies to you. This insight does not identify all the risks (direct or indirect) or other considerations which might be material to you when entering any financial transaction. You are advised to exercise caution in relation to any information in this document. If you are in doubt about any of the contents of this insight, you should seek independent professional advice.

IM1582706 • WLT250007941