Global Fixed Income Weekly

Executive Summary

- Sovereign bond yields declined sharply and risk assets sold off on global growth concerns given downside risks posed by US-China trade tensions. In response, central banks continue to ease policy in order to preserve economic expansions. The Reserve Bank of New Zealand (RBNZ) lowered its policy rate by 50bps against consensus expectations for a 25bps rate cut. Rates also moved lower in India, Thailand and Singapore.

- We have added relative value overweight exposure to high rate markets such as Australia, New Zealand, Canada and the US. Sovereign yields in these markets have more room to rally—relative to already low rates in markets such as Europe and the UK—as market-implied pricing moves to reflect likely dovish monetary policy outcomes.

- Elsewhere in macro markets, we remain overweight select emerging market (EM) currencies and we have diversified our funding currency for these exposures away from the US dollar and into the euro and Asian currencies that we expect to weaken amid trade policy uncertainty.

Chart of the Week: EM Asian Central Banks are in Easing Mode

Macro Commentary and Strategy

Duration: We are neutral on US rates and underweight UK rates.

- The US ISM non-manufacturing index declined in July, against consensus expectations for an increase. The composition of the report was soft on net, with an increase in the employment component, but declines in the business activity and new orders components.

- Renewed US-China trade tensions pose downside risks to global growth which faces ongoing headwinds from an unresolved Brexit, Italian political and fiscal policy uncertainty, and a manufacturing sector slowdown. As a result, we think central bank policy will remain accommodative.

- In particular, we think the US Federal Reserve (Fed) may deliver a deeper rate cutting cycle than implied following last week’s meeting outcome where Chairman Powell described the central bank’s easing stance as a “mid-cycle adjustment”.

- We continue to think UK nominal and real rate valuations are extended due to elevated expectations of a “no deal” UK departure from the European Union. In our opinion, more likely near-term scenarios include an elongation of the Brexit impasse or a democratic process such as an early general election or another referendum.

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Country: On a relative value basis we are overweight Antipodean, Canadian and US rates while underweight Scandinavian and UK rates.

- The RBNZ lowered its policy rate by 50bps against consensus expectations for a 25bps rate cut. The dovish policy action was beneficial for our overweight relative value exposure to front-end rates in New Zealand. As a small open economy, New Zealand has a high beta to global growth and trade flows; we expect further easing ahead.

- More broadly, we have added relative value overweight exposure to high rate markets such as Australia, New Zealand, Canada and the US. Sovereign yields in these markets have more room to rally—relative to already low rates in markets such as Europe and the UK—as market-implied pricing moves to reflect likely dovish monetary policy outcomes.

Currency: We are overweight select emerging market (EM) currencies and the Norwegian krone.

- Cyclical currencies that have received large investor inflows in recent weeks depreciated amid risk off market moves. We have used weakness in select currencies as an opportunity to add to our overweight exposure to high carry currencies including the Norwegian krone and Turkish lira.

- In addition, we have diversified our funding currency choice for these overweight exposures away from the US dollar—which may benefit from continued political uncertainty in the near-term despite Fed rate cuts—and into the euro and Asian currencies.

Cross Macro: We hold relative value positions across rates, currencies and credit.

- We used the recent rally in US rates as an opportunity to close our macro hedge which consisted of overweight exposure to US versus European rates. Elsewhere, we remain overweight corporate credit versus rates in Spain and France (versus Germany).

Sovereign 10-Year Yield Levels

Source: Bloomberg, GSAM. As of August 9, 2019. The economic and market forecasts presented herein are for informational purposes as of the date of this presentation. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation. Past performance does not guarantee future results, which may vary.
Sector Commentary and Strategy

Agency MBS: We are tactically overweight.

- Agency mortgaged backed securities (MBS) spreads were relatively resilient amid the recent risk asset sell-off. As a result we have scaled back our overweight exposure which we implemented following underperformance earlier this year, which considered to be outsized relative to associated prepayment risks.

Non-Agency MBS/ABS: We are overweight securitized credit.

- We have reduced exposure to Federal Family Education Loan Program (FFELP) asset backed securities (ABS) amid firm investor demand as we see limited catalysts for near-term spread tightening. We also think UK residential MBS (RMBS) spreads look attractive relative to other high quality ABS sectors; in particular, we think shorter spread duration exposure at senior parts of the capital structure offer investment potential.

Investment Grade Corporates: We are modestly overweight.

- Spreads widened on the week amid trade policy uncertainty. Weakness was characterized by curve steepening, higher quality cohorts outpacing lower quality and underperformance in Autos relative to other sectors.

- We remain overweight and our performance was somewhat insulated amid the selloff due to our strategy of pairing overweight spread sector exposure with overweight rate exposure and due to our exposures being centered at steep portions of credit curves to take advantage of attractive carry and roll down potential.

High Yield & Bank Loans: We are overweight and have a preference for high yield bonds over loans.

- US high yield corporate credit had delivered a total return in excess of 10% through to July. Strength in the sector has retraced partially in early-August due to US-China trade tensions. As a result, outflows from high yield bond funds have picked up, though the year-to-date trend has been one of inflows as investors have rotated out of floating rate assets such as leveraged loans on dovish central bank outlooks.

Emerging Markets: We are neutral to slightly overweight external emerging market debt (EMD) in multi-sector fixed income portfolios and see value in both external and corporate debt in dedicated EMD portfolios. Across local currency debt, we continue to identify idiosyncratic opportunities.

- Policymakers in India, Thailand and Singapore lowered policy rates this past week. More broadly, 60% of EM Asian central banks are in easing mode as a dovish Fed outlook has paved way for policymakers to lower rates in order to support growth (see Chart of the Week).

Sector Spreads

Source: Bloomberg, Barclays, J.P. Morgan, as of August 9, 2019.

View s are as of August 9, 2019 unless otherwise stated and subject to change in the future.
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