Global Fixed Income Weekly

Executive Summary

- New social bond issuance from sovereigns, supranationals and agencies has been met with robust investor demand. Appetite for US investment grade (IG) and high yield corporate credit has also been healthy, with new issue concessions compressing once bonds enter the secondary market. US IG issuance remains elevated, with weekly supply surpassing usual monthly amounts. We have selectively participated in new corporate bond issues.

- Rating actions for both corporates and sovereigns remain in focus. In the sovereign space, S&P affirmed its AA+ rating and stable outlook for the US despite the recent expansion in fiscal easing and Fitch downgraded the UK from AA- to AA- last Friday citing the impact of the coronavirus and Brexit uncertainty.

- On the policy front, the Bank of Canada (BoC) lowered its policy rate by 50bps to 0.25%. We consider all G10 policy rates to be at their effective lower bound and expect further easing efforts to be centred on quantitative easing (QE) and programs designed to ease credit market stresses. The latest US Federal Reserve (Fed) data show an increase in its balance sheet size from $5.2tn to $5.8tn last week.

Chart of the Week: Severe impact of the ‘coronacrisis’ on services activity

Source: Macrobond, GSAM. As of March 2020.

Macro Commentary and Strategy

Duration: We are underweight UK rates and positioned for a steeper yield curve.

- The policymaker response to the coronavirus pandemic in March was fast and bold. Every G10 central bank policy rate—with the exception of Sweden—is at an all-time low. QE has resumed in the US, UK and Sweden, expanded in Europe and Japan and commenced for the first time in Australia, Canada and New Zealand.

- Looking ahead, we expect monetary easing efforts to be centred on QE and programs designed to ease credit market stresses. With sovereign bond yields at low levels and room for further declines limited by policy rates being—in our view—at their lower bound, we think rate volatility should moderate from current levels. The MOVE Index, a measure of rate volatility, has moderated from 164 on March 9 to 72 as of April 2 but remains above the sub-50 levels observed earlier this year.

- As expected, incoming developed market (DM) activity data has declined sharply, reflecting the sudden halt in economic activity in a large and growing number of both developed and emerging economies. The current downturn is unique in that it will likely be dominated by services sector weakness, making it truly 21st century in nature (see Chart of the Week).
Country: We are overweight Australian versus UK rates.

- US initial jobless claims rose by 3.3mn to 6.6mn in the week ending March 28. Today’s job report does not reflect the recent surge in claims. We expect further weakness in US labor market data, in part due to delays in processing applications but also given the extension of lockdown measures.

- US labor market policies—historically geared toward limiting time spent out of employment—have been adjusted to reflect the extraordinary shock that the coronavirus pandemic presents. The timeframe for benefit payments has been extended, coverage has been broadened to include the self-employed and State benefit payments (which vary considerably) will be accompanied by a Federal payment.

- Last Friday, rating agency Fitch downgraded the UK from AA to AA-, citing the impact of the coronavirus and Brexit uncertainty. This week, S&P affirmed its AA- rating and stable outlook for the US and will opine on France and Germany this evening. Large-scale fiscal expansions may be met with rating downgrades.

- The Bank of England (BoE) clarified its £200bn QE program will comprise of £190bn gilt purchases, with £10bn reserved for corporate bond buying. We expect asset purchases to be front-loaded. The UK Debt Management Office released its new issue calendar for April, which reflects a sharp uptick in gilt supply. We expect BoE QE to digest a large portion of this new supply.

Currency: We have reduced exposure to emerging market (EM) currencies and added exposure to perceived safe-havens.

- We are underweight the US dollar versus other G10 currencies, but overweight the dollar versus EM currencies. We reduced exposure to the Euro this week and added to perceived safe-haven currencies such as the Swiss franc and Japanese yen.

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

- We have reduced our looser New Zealand versus Norwegian financial conditions exposures, and continue to be positioned for looser financial conditions in Canada relative to Norway. Positioning for looser financial conditions in a particular market involves overweight rate and underweight currency exposure.

Sovereign 10-Year Yield Levels

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<th>Country</th>
<th>Range (Last 12 Months)</th>
<th>Current</th>
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<tr>
<td>Italy</td>
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<tr>
<td>New Zealand</td>
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<td>Australia</td>
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<tr>
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<td>Canada</td>
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<td>US</td>
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Source: Macrobond, GSAM. As of 03 April 2020.

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. *Past performance does not guarantee future results, which may vary.*
Sector Commentary and Strategy

Agency MBS: We are modestly overweight.
- The Fed has quickly become the main participant in the Agency MBS market. In doing so, it has created pockets of illiquidity and volatility, with performance differences emerging between MBS eligible for Fed purchases and securities that are not, even in instances where securities are similar. We think this performance divergence will normalise over time, similar to prior periods of Fed buying.

Non-Agency MBS/ABS: We are overweight.
- Following rating migrations in high yield and bank loans, we are starting to see downgrades for collateralised loan obligations (CLO). So far, rating actions have been focused on BB- or lower-rated CLOs that have exposure to Energy and sectors most impacted by covid-19. While further downgrades are likely, we think AAA- and AA-rated CLOs may be more resilient.

Investment Grade Corporates: We are overweight.
- Primary market activity remains busy, with new US supply amounting to $110bn as of Thursday, surpassing usual monthly volumes of $100bn. We have selectively participated in new issues, rotating exposure out of credit derivatives where valuations appear extended relative to cash bonds.

High Yield & Bank Loans: We are overweight.
- The US primary market re-opened, with four new issues as of Thursday being met with robust investor demand. New issue concessions have ranged from 75-100bps but have generally compressed once bonds trade in secondary markets.

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.
- In South Korea, annual trade growth turned marginally negative in March. Weak per-day exports during the last 11 days of the month could be an early indicator of further deterioration in the following month as demand-side headwinds from the US and Europe materialize.
- On the policy front, the People’s Bank of China (PBoC) lowered its reserve requirement ratio by 100bps for small-to-medium banks. This is expected to unleash around RMB 400bn of liquidity.

Sector Spreads

Source: Macrobond, GSAM. As of 02 April 2020.
Views are as of April 3, 2020 unless otherwise stated and subject to change in the future.

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Sector Spread Indexes:
- US Investment Grade Corporates: Bloomberg Barclays US Corporate Index
- US High Yield Corporates: Bloomberg Barclays US Corporate High Yield Index
- European Investment Grade Corporates: ICE BofAML Euro Corporate Index
- European High Yield Corporates: ICE BofAML Euro High Yield Index
- ABS: Bloomberg Barclays, U.S Aggregate, Asset-Backed Securities Index
- MBS: Bloomberg Barclays U.S Aggregate MBS: Agency Fixed Rate MBS Index
- EM External Debt: J.P. Morgan, EMBI Global Diversified Face Constrained Index

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