Credit Continuum

ANALYSIS

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We observe a return to more dovish monetary policy is providing support for credit markets

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Today's macroeconomic backdrop has changed notably from the start of 2019. After a strong first quarter, the US economy has weakened, highlighting a slowdown in momentum. In response, the Federal Reserve's (Fed) rhetoric has become increasingly dovish and we believe markets are pricing in 3 to 4 rate cuts of 25bps over the next 12 months.[1]

Meanwhile European growth does not appear to be recovering evenly across countries. Concerns about momentum in Germany and Italy rose in in the second quarter as the manufacturing sector remains depressed, although France has accumulated a few strong months.[2] In addition, the Brexit deadlock is unlikely to be solved anytime soon and is developing a negative narrative for the second half of the year. In this context, the European Central Bank is prepared for further monetary policy easing, contributing to the tailwind that is supporting credit markets. [3]

Preemptive global central bank positioning, combined with lower interest rates have resulted in a very bullish market for credit, with credit spreads tightening and high yield outperforming investment grade.[4] Emerging market hard currency corporate bonds are also benefiting from more dovish US monetary policy and a weaker US dollar. [5]

Nevertheless, going forward, we believe future performance is likely to depend on the magnitude of the global economic slowdown and how aggressive monetary policy will be in response. At the same time, in our view we are continuing to move nearer the end of the credit cycle and central bank actions are resulting in a lower for longer period for rates.

The amount of negative yielding debt has reached a new high, and investors continue to be yield hungry with inflows returning to the higher yielding segments of fixed income. [6] While credit spreads have experienced significant narrowing this year, we can envision relatively tight spreads going forward so long as the market believes the economy will improve later this year. If economic data comes in exceptionally weak over the next three months, we believe spreads are too narrow today.

1. https://www.federalreserve.gov/newsevents/testimony/powell20190710a.htm
2. https://traderscommunity.com/index.php/economy/1443-european-manufacturing-sector-outlook; https://tradingeconomics.com/france/gdp-growth
3. https://www.bloomberg.com/news/articles/2019-06-11/ecb-s-rehn-says-toolkit-still-includes-rate-cuts-and-more-qe
4. ICE BofA Merrill Lynch Global High Yield Index (HW0C), ICE BofA Merrill Lynch Global Corporate Index (G0BC), as at 15 July 2019
5. ICE BofA Merrill Lynch Emerging Market Corporate Liquid Index (EMCL), as at 15 July 2019.
6. Bloomberg Barclays Global Aggregate Negative Yielding Debt Market Value Index; Deutsche Bank Global Credit Chartbook, July 2019

Important Information

Index Description

G0BC – The ICE BofA ML Global Corporate Index tracks the performance of investment grade corporate debt publicly issued in the major domestic and eurobond markets. Qualifying securities must have an investment grade rating (based on average of Moody's, S&P and Fitch), have at least one year remaining term to final maturity as of the rebalancing date, at least 18 months to maturity at point of issuance and a fixed coupon schedule.

HW0C – The ICE BofA ML Global High Yield Constrained Index contains all securities in The ICE BofA ML Global High Yield Index (HW00) but caps issuer exposure at 2%.

EMCL - The ICE BofA ML US Emerging Markets Liquid Corporate Plus Index tracks the performance of the U.S. dollar denominated emerging markets non-sovereign debt publicly issued in the major domestic and eurobond markets. Qualifying issuers must have risk exposure to countries other than members of the FX G10, all Western European countries, and territories of the U.S. and Western European countries.

You cannot invest directly in an index, which also does not take into account trading commissions or costs.