

THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

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Hope on the European horizon?

Disappointing macroeconomic data and ongoing political uncertainty have weighed heavily on the euro. Does this pessimistic picture mean there's room for a rally?



Fundamentals:

Our quantitative signals point to an increase in the number of European data releases coming in below expectations. Growth has slowed: eurozone GDP grew only 0.2% last quarter, with Italy stagnant and Germany's economy contracting by 0.2%. However, we could yet see a rebound. Weakness in individual countries might be explained by ongoing idiosyncrasies (Italy is in the process of working through its political challenges, and Germany has been hit by global trade concerns and legislative changes affecting the automotive industry). The softer macro picture should also be considered in the context of last year's extremely high levels. Moreover, some fundamental measures are more encouraging. Personal income has been increasing substantially for several years now, and is showing no sign of slowing, while earnings for European companies grew around 12% in Q3. Looking ahead, oil price weakness could help to stimulate growth, and a weaker euro could help exporters. Furthermore, while political uncertainty is not likely to disappear, recent developments provide more hope of a solution to fractious issues such as Brexit.



Quantitative valuations:

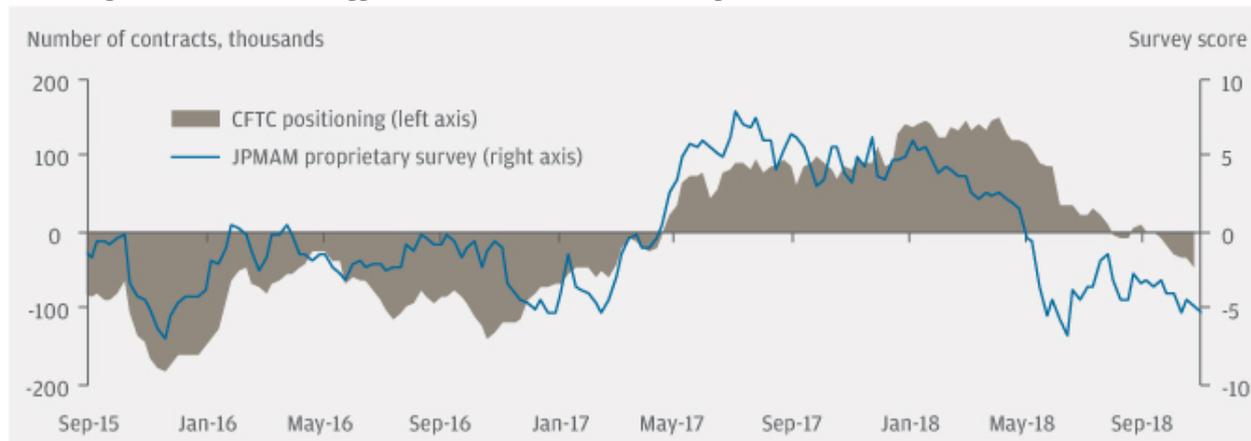
Valuations in Europe reflect the nervous fundamental backdrop. Most notably, the euro has broken year-to-date lows, as markets continue to re-evaluate the structurally bullish view for 2019. While the currency's weakness is broad-based, the contrast with the US dollar is most apparent, with EURUSD trading below 1.13 as at 14 November. Market expectations for central bank policy are also revealing: while the Federal Reserve's hiking cycle is well underway, the European Central Bank has yet to start, with forward guidance implying that policymakers will look to raise rates after the summer of 2019. As at 13 November, markets have priced only 15 basis points of rate hikes before 2020. This assessment is understandable given the softer fundamental picture, but if the backdrop improves from here we could see some revisions.



Technicals:

Technicals also mirror overall investor sentiment. The ongoing weakness in the euro has resulted in a broad short consensus among investors. The demand front has provided no support given the flow picture, which shows very little appetite for European assets. Year to date, euro- and sterling-denominated investment grade and high yield funds have seen meaningful outflows—around EUR 5 billion from European investment grade, for example. This lack of demand could be related to headline risk surrounding issues such as Italy's budget and Brexit. As these events move tentatively towards resolution, the headwind may fade.

Positioning evidence on the euro suggests consensus has moved underweight



Source: Commodity Futures Trading Commission, J.P. Morgan Asset Management (JPMAM); data as of 9 November 2018.

What does this mean for fixed income investors?

Caution is understandably the watchword in Europe at the moment, with ongoing political tensions adding to weaker economic data. That said, if we see stabilisation in the data and continued progress towards resolution of key political issues, there could be some cause for optimism. This, along with cleaner positioning and recent weakness in the currency, suggests there could be scope for a bounceback.

About the Bond Bulletin

Each week J.P. Morgan Asset Management's **Global Fixed Income, Currency and Commodities** group reviews key issues for bond investors through the lens of its common Fundamental, Quantitative Valuation and Technical (FQT) research framework.

Our common research language based on **Fundamental, Quantitative Valuation and Technical** analysis provides a framework for comparing research across fixed income sectors and allows for the global integration of investment ideas.



Fundamental factors include macroeconomic data (such as growth and inflation) as well as corporate health figures (such as default rates, earnings and leverage metrics)



Quantitative valuations is a measure of the extent to which a sector or security is rich or cheap (on both an absolute basis as well as versus history and relative to other sectors)



Technical factors are primarily supply and demand dynamics (issuance and flows), as well as investor positioning and momentum



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