J.P.Morgan
Asset Management

THE FUTURE OF FIXED INCOME

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Fundamentals take the back seat

The macro backdrop has not changed significantly in recent weeks—so what is driving the risk asset bounce?

Fundamentals:

US macro data continues to hold up: January's manufacturing purchasing managers' index (PMI) print improved, while the services PMI fell less than expected and remains at an elevated level. The sharp decline in consumer confidence has garnered headlines, though it was driven by the "expectations" component—likely a reflection of negative sentiment around the US government shutdown. The "present situation" component remains at the highest level since 2001. In Europe, recent data prints point to further weakness in the growth backdrop, with PMIs broadly correlating to a Q1 2019 growth rate of 0.1% quarter on quarter. However, much of Europe's growth slowdown has been driven by weakening global trade, so progress on US-China trade talks could lead to some recovery, while the strength of the European labour market may provide stability. For emerging markets, all eyes remain on China and its poor trade data. However, policymakers are responding to the muted economic data: the European Central Bank is maintaining its dovish tone; the People's Bank of China has announced further easing measures to encourage lending growth; and the Federal Reserve confirmed its patient stance towards future rate hikes at its January meeting.

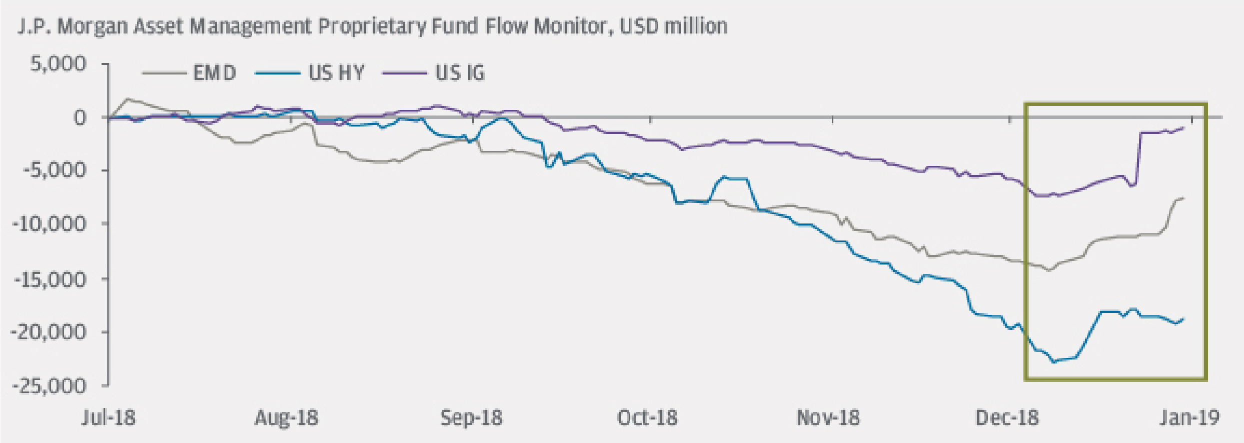
Quantitative valuations:

The cautious macroeconomic backdrop has not translated to weak bond market performance—instead, risk assets have experienced strong returns, with global high yield (HY) as well as emerging market hard and local currency sovereign debt all up more than 3% year to date. Despite this strong performance, we think value persists, as much of the move has simply reversed the December sell-off, which we believe was overdone. US HY spreads of 440 basis points (bps) are still meaningfully higher than the 2018 tight of 316 bps, and emerging market hard currency sovereign debt spreads of 368 bps are more than 100 bps above where they traded in January 2018. (All data to 29 January.)

Technicals:

We believe technicals are driving markets, with the combination of muted supply and increased demand pushing bond prices higher. Following four consecutive weeks of outflows (totalling nearly USD 13 billion), the US high grade market has seen inflows resume and even pick up pace. It's a similar picture in the higher risk sectors: US HY and emerging market debt (EMD) are on track for their first month of positive flows in four and five months, respectively, with US HY registering nearly USD 3 billion and EMD more than USD 6 billion of inflows thus far in January. Meanwhile, the usual flurry of new issues to start the year has been absent. The European HY market has only had a trickle of new issuance, while the US space has modestly re-opened, with deals trading well. In the investment grade (IG) space, US supply is undershooting expectations—USD 90 billion of new issues have printed so far this year, compared to expectations of USD 120 billion for the full month of January—driven by a lack of issuance from financials. (All data to 25 January.)

After an extended period of outflows, increased demand is helping to push bond prices higher



Source: Bloomberg, J.P. Morgan Asset Management; data as of 25 January 2019. Flow data based on past six months (rebased to 0 as at 27 July 2018).

What does this mean for fixed income investors?

More accommodative rhetoric and actions from central banks have helped to alleviate recessionary concerns, though we believe positive technical factors are also playing a key role in the bond market rebound. Importantly, though, technicals can change quickly. Therefore, we think it is sensible to be prudent, shifting up in quality and taking some profit on positions that have performed well in this risk-on rally.

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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