

THE FUTURE OF FIXED INCOME

# Weekly Bond Bulletin

7 February 2019

## An ear on the Fed

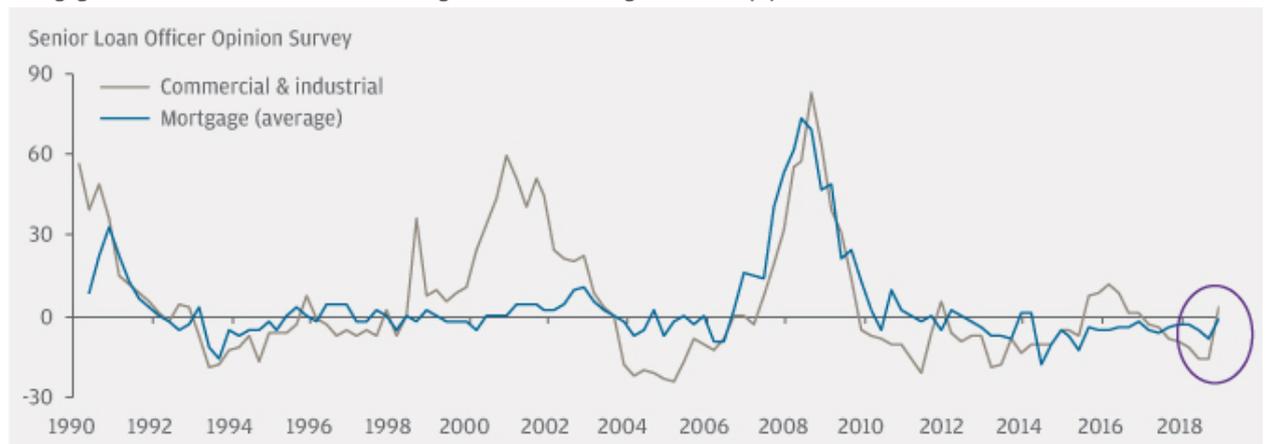
Dovish language from the Federal Reserve (Fed) has buoyed risk assets—but investors will need to listen closely this year in case of further shifts.



### Fundamentals:

Global growth data has remained broadly on a downtrend in recent weeks, with notable weakness in France, Italy and the UK. In the US, the January 2019 Senior Loan Officer Opinion Survey, a forward-looking macro indicator measuring changes in the standards of bank lending, has turned less bullish. The survey detail also shows that banks expect further tightening of standards for all business and credit card lending, as well as mortgages. While this does paint a less positive picture for the US economy, the January manufacturing purchasing managers' index and jobs report have been stronger than anticipated, and corporate earnings continue to beat expectations. Despite the muted backdrop, risk assets have continued to rally, propelled by the unexpectedly dovish stance of the Fed, which removed all tightening bias from the statement that followed its January meeting on the back of softer inflation, slowing global growth and tighter financial conditions. The change in language may suggest that Fed's focus has shifted somewhat from its dual mandate (labour market and price stability) to external factors such as global financial conditions and global growth. In light of muted inflationary pressures, the Fed's decision to abstain from further interest rate increases in the near term may help to prolong the later stage of the cycle. However, if global growth picks up and accelerating wage growth feeds into higher inflation, we don't think another hike this year would be out of the question.

### Mortgage and commercial & industrial lending conditions have tightened sharply



Source: Federal Reserve, Bloomberg, J.P. Morgan Asset Management; data as of 4 February 2019.



### Quantitative valuations:

While risk assets went through a sizeable correction in late 2018, government bonds enjoyed a significant rally, with the J.P. Morgan Government Bond Global Index returning 0.60% in November and 1.63% in December 2018 (in local currency). Derisking and the bid for safer assets helped duration to perform at the end of the year, but developed market government bonds maintained their positive trend in January, despite the strong rally in credit, returning 0.71%. Dovish global central banks undoubtedly helped to fuel the risk-on rally in January and early February, but it's difficult to expect this risk sentiment to persist without further catalysts. Meanwhile, any sign that the Fed is back on the tightening path should push the Treasury curve higher.



### Technical:

The risk-on environment so far in 2019 has been supported by muted supply and a strong bid for higher-yielding assets. On the US Treasury side, positioning surveys and anecdotal evidence suggest that underweight market positioning contributed to the positive returns of recent months; however, this tailwind has faded as investors have turned more bullish on duration. Another technical factor worth watching this year will be the Fed's ongoing balance sheet normalisation, which we expect to end in the first quarter of 2020, or perhaps before. Although its direct impact on markets is unclear, the end to the balance sheet unwind should be supportive.

### What does this mean for fixed income investors?

Weakening global macroeconomic data looks to be pushing global central banks to turn more dovish, supporting fixed income performance in 2019 so far. However, we remain cognisant that a change in technicals or central bank language could quickly turn market sentiment around. We believe this environment calls for measured risk-taking and a gradual shift to less cyclical assets.

#### 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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