J.P.Morgan Asset Management

THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

2 May 2019

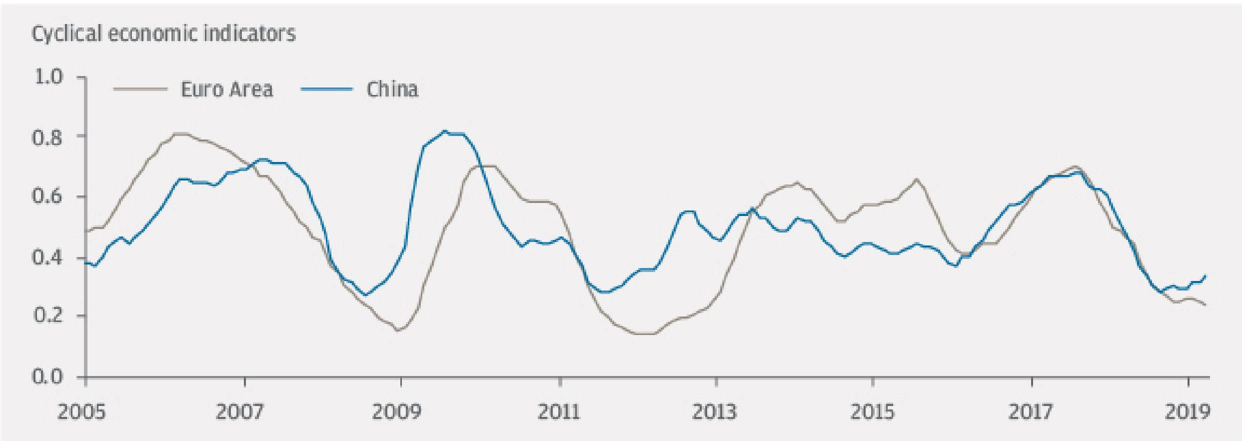
Picking up China

Despite the recent resurgence of growth worries, we maintain the view we expressed in February that Chinese growth will accelerate this year. This should be supportive for fixed income risk assets, especially if higher growth feeds through to other regions.

Fundamentals:

China's easing measures resulted in a pickup in data over Q1, with improvements in purchasing managers' indices (PMIs), GDP and industrial production in March, along with an increase in the credit impulse, going some way to restoring optimism in markets. However, the subsequent retracement of the manufacturing PMI, from 50.5 in March to 50.1 in April, has prompted questions about whether the anticipated growth pickup will in fact materialise. There are some important factors to consider here. First, although lower, the PMI remains above 50—in expansionary territory. Second, despite the drop at headline level, key components such as new export orders actually improved. Finally, seasonality plays a role, as April readings have historically dropped after the Chinese New Year period. We therefore do not see the most recent data as such a concern, especially given that the policy measures enacted tend to take time to translate to higher growth. Recent data is consistent with the expectation we have held all year for Chinese growth of around 6.3% in 2019, albeit with a lag following policy stimulus. The question is whether higher growth in China will extend to other regions—Europe, for example. If it does, there is likely to be a further lag before data in those regions picks up meaningfully.

Growth in other regions typically lags growth in China—can we expect a pickup?



Source: J.P. Morgan Asset Management; data as of 30 April 2019.

Quantitative valuations:

As fears around Chinese growth have started to subside, market sentiment has been strong, with emerging market (EM) indices doing well. US dollar-denominated sovereign debt has returned over 7% year to date (YTD) and corporates are up almost 6%. Continued improvement in China should support risk assets, and, in particular, could play a key role in boosting the laggard so far: EM currencies. FX weakness in 2019 has kept local bond returns relatively subdued, with the currency component of the EM local government bond index flat YTD and down almost 4% since the end of January. Should strength in the Chinese economy feed through as expected to other emerging markets, EM currencies should prove key beneficiaries—especially given that further US dollar strength now looks limited, with US rates likely to be rangebound this year following recent dovish action by the Federal Reserve. (All data as at 30 April.)

Technicals:

EM currency positioning appears light: our proprietary survey indicates that investor positioning has decreased to below the 10-year average. Conversely, US dollar positioning has now moved long following a period of strength, so any turnaround could help EM currencies. In terms of demand, positive sentiment is evidenced by the breadth of flows across all fixed income asset classes, with emerging markets no exception (EM aggregate fund flows stand at almost USD 21 billion YTD). An improvement in fundamental conditions, driven by the China growth story, could cause flow momentum to continue for some time yet. (All data as at 30 April.)

What does this mean for fixed income investors?

Investors are right to be cautious at this stage of the economic cycle, and a pickup in China's growth story is not yet fully confirmed. However, there are reasons not to be too pessimistic about recent data prints, and on balance it's reasonable to continue to expect a potential feed-through from Chinese policy stimulus to the wider global economy. This should benefit fixed income risk assets overall, and should present opportunities in lagging areas such as EM currencies.

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