J.P.Morgan Asset Management



THE FUTURE OF FIXED INCOME

# Weekly Bond Bulletin

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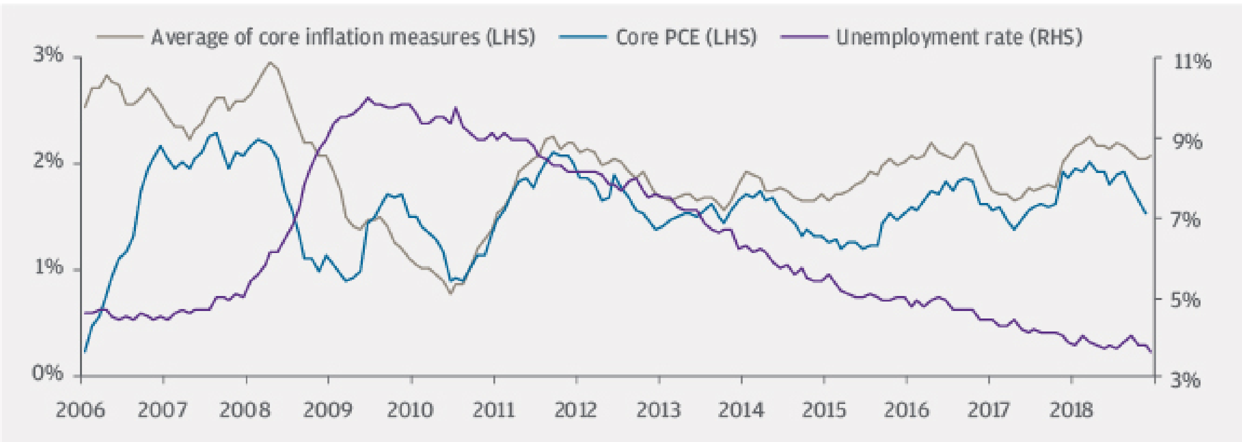
## Central banks recalibrate

Central banks across the globe recalibrated their policy stance in the first week of May, making it clear that inflation is not the sole driver of their decisions. What does this suggest for the future direction of monetary policy?

### Fundamentals:

At the recent Federal Open Market Committee meeting, chairman Jerome Powell framed current rate levels as appropriate given the transitory aspects of inflation softness, implying an unwillingness to cut rates solely because of low inflation. While US core personal consumption expenditure (PCE) is very low, the average of several core inflation measures is closer to the Federal Reserve's (Fed's) 2% target. Furthermore, the US economy continues to chug along, as indicated by the strong non-farm payrolls report for April. The Reserve Bank of Australia (RBA) and Bank of England (BoE) have also been willing to look past low inflation. The RBA left rates on hold on 7 May, vs some expectations of a cut, citing the strength of the labour market; meanwhile, the BoE was relatively hawkish at its recent meeting, despite the downward trajectory of UK inflation. Even the Reserve Bank of New Zealand—which became the first developed market central bank to cut rates this cycle when it lowered its benchmark interest rate on 8 May—acted because of the combination of low inflation and weaker economic growth. Given this recalibration from central banks, we expect monetary policy in general to be on hold for the foreseeable future—unless cracks begin to materialise in growth or labour markets.

**The Fed is weighing low inflation against the strength of growth and the labour market**




**Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Dallas Fed, Cleveland Fed, Atlanta Fed; data as of 30 April 2019.**

### Quantitative valuations:

Ten-year US Treasury yields have rallied 12 basis points from their recent peak of 2.6% on 17 April, partly on the basis of renewed concerns around US-China trade relations. The market is now pricing nearly one full rate cut by the end of 2019. While we expect the Fed's next move to be a cut, we don't anticipate this any time soon, given recent comments from policymakers and the lack of a catalyst other than low inflation. (Data as at 8 May).

### Technicals:

Positioning surveys indicate that investors have moved from short US duration in the fourth quarter last year to meaningfully long duration positions. Furthermore, the majority of the shift to longer duration has been at the front end of the curve, whereas positioning in the 30-year part of the curve remains short—a bull steepening bias. Fund flow data supports these surveys, with high-quality duration strategies such as US Aggregate funds seeing USD 3.6 billion of inflows in the week to 6 May, for a total of USD 56 billion year to date (as at 6 May). It will be worth monitoring whether this consensus positioning prevents lower rates from materialising.

## What does this mean for fixed income investors?

Inflation is still the most important factor as central banks globally determine future monetary policy. However, it has become clear that benign inflation alone is not enough to push policymakers into a cutting cycle. Therefore, the combination of muted inflation and still solid growth and labour markets should keep rates on hold for now—creating a positive backdrop for carry. Any material back-up in spreads may represent a buying opportunity.

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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