THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

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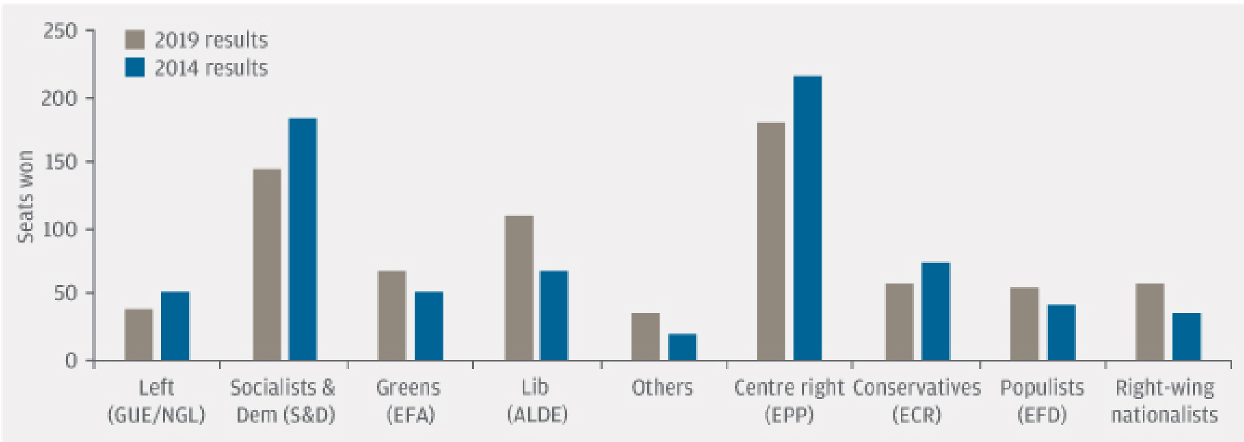
Unpopular populism

The rise in support for populist parties in the European elections has done nothing for the popularity of European risk assets. Should investors ditch Europe, or does this represent a buying opportunity?

Fundamentals:

In the European parliamentary elections, populist parties such as France's National Rally (formerly National Front) and the UK's newly formed Brexit Party won the greatest share of their respective electorates' votes, but avowedly Pro-European parties collectively performed well. In fact, if anything can be read into the results, it is that there is widespread fatigue with Europe's more established national centrist parties, rather than a consensus opposition to EU membership. One of the leading culprits for this malaise may be Europe's persistently sluggish economic performance. The macro data remains mixed, with disappointing eurozone purchasing managers' indices counterbalanced by an encouraging upturn in the European Commission confidence survey. On the corporate front, European first-quarter earnings broadly came in ahead of expectations. Meanwhile, credit metrics such as leverage and interest coverage levels give little cause for concern, particularly when credit costs are low and the European Central Bank lending survey suggests banks remain inclined to lend to businesses.

A divided but pro-European election result, albeit with a rise in populist support



Source: European Parliament; data as of 27 May 2019.

Quantitative valuations:

Benchmark rates in Europe have been in continuous decline, with the yield of the German 10-year now just 3 basis points (bps) above the all-time low of -0.19% reached in 2016. Moves for riskier asset classes in Europe have been less pronounced. Headline yields for European high yield have increased to 3.67%—a 47bp rise from the recent lows in April, but some way off the 4.90% level at which we started the year. Idiosyncratic risk has been on the rise again, with Thomas Cook and Casino the latest to be hit by large price swings, but we welcome this given the opportunities for active credit selection. (Data as at 28 May 2019.)

Technicals:

Demand for European risk assets has been lacklustre, with high yield witnessing three consecutive weeks of fund outflows since 6 May. Supply, on the other hand, remains supportive for European high yield, as we expect deal volumes to continue to run below last year's levels. The scarcity of fixed income assets yielding more than 1.5% is another support for lower-quality credit. Our concern is that the persistent low yield environment pushes investors to increase their use of leverage and boost their allocations to less liquid asset classes, such as private credit and private equity.

What does this mean for fixed income investors?

With the European election results being pro-European overall, one event risk that we have been watching is now behind us. Once the results have been digested, investors may gain comfort from this outcome and begin to take advantage of the improvement in valuations for European risk assets. The broader implications of the rise in support for populist parties are yet to be seen, but it is clear that both country and credit selection will be increasingly important to enable investors to navigate the rise in idiosyncratic risk.

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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