THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

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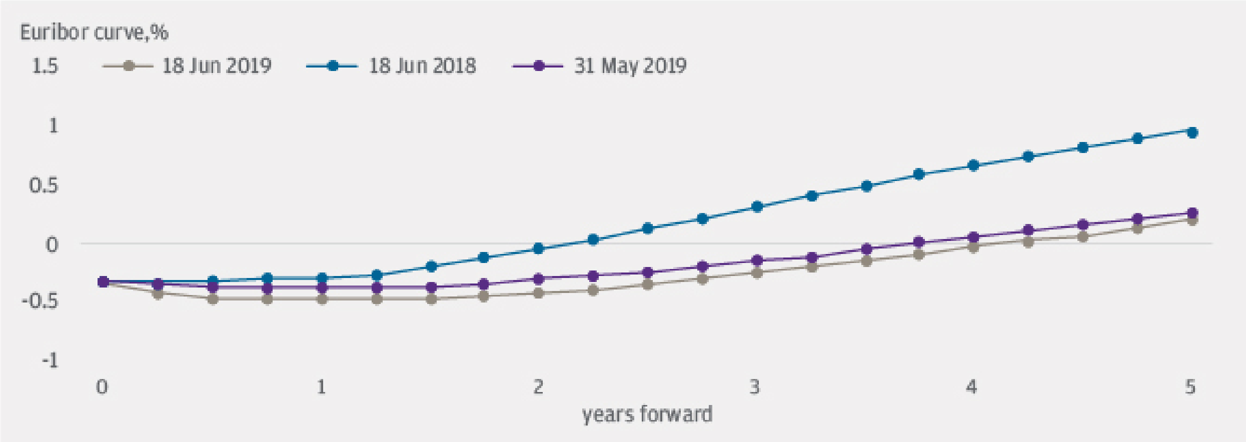
Time to reopen the ECB toolbox?

With inflation stubbornly weak, the European Central Bank (ECB) is now expected to act. What would more monetary stimulus mean for investors?

Fundamentals:

The ECB's annual forum in Sintra, Portugal marked a clear turning point for market expectations, with 15 basis points (bps) of rate cuts now priced in for 2019, vs. 7bps before the event. Outgoing ECB president Mario Draghi struck a more dovish tone than expected in his speech, referencing the underwhelming levels of growth and inflation, and suggesting that more stimulus would be a base case. Prior to the speech, persistently low inflation in the eurozone had led inflation expectations (as measured by the 5 year, 5 year EUR swap forward rate) to reach an all-time low of 1.12% on 14 June. Global growth weakness, which has so far been concentrated in trade and manufacturing, has the potential to feed through to the wider economy, so we expect central banks overall to remain accommodative. With trade tensions still at the forefront of investors' minds, the Trump-Xi meeting at the upcoming G-20 summit is a potential market catalyst.

The Euribor curve is pricing about 15bps of cuts by the end of this year



Source: Bloomberg; data as of 18 June 2019.

Quantitative valuations:

Benchmark German 10-year yields reached record lows after Draghi's speech, ending 18 June at -0.32%. At the same time, European credit assets benefited from a reinforced risk-on environment, with European investment grade and high yield markets now having returned 4.92% and 6.87%, respectively, year to date. With over 20% of the Bloomberg Barclays Global Aggregate index in negative yield territory, and with more quantitative easing now potentially on the cards, the strong performance of high-yielding assets is no surprise, and the grab for yield looks set to persist. (All data as of 18 June.)

Technicals:

Technical conditions continue to support credit markets. On the demand side, investors have leaned towards high-quality assets given the late stage of the cycle and the gradual pickup in idiosyncratic risk. In the European high yield market, BBs remain in favour, with continued interest from insurance companies and multi-asset investors. Meanwhile, European investment grade has seen broad-based fund inflows, benefiting from demand for aggregate and unconstrained strategies. Flows into credit, as measured by EPFR, have been positive for 15 weeks, with the pace accelerating in the two weeks to 12 June. Investment grade issuers have been taking advantage of low rates in Europe as a source of funding; however, the elevated supply has been well digested.

What does this mean for fixed income investors?

Growth and inflation remain persistently hard to come by, causing central banks to lean more heavily towards accommodative monetary policy. Risk markets should continue to be beneficiaries, with the credit cycle having the potential to extend further. That is not to say that tail risks are absent, though. If anything, they have picked up, with an increasing number of idiosyncratic credits becoming stressed. This environment supports both the demand for high quality assets and the importance of an active approach. Investors will need to keep a close eye on central bank actions, as if policymakers dip back into their toolbox, markets could move again.

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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