THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

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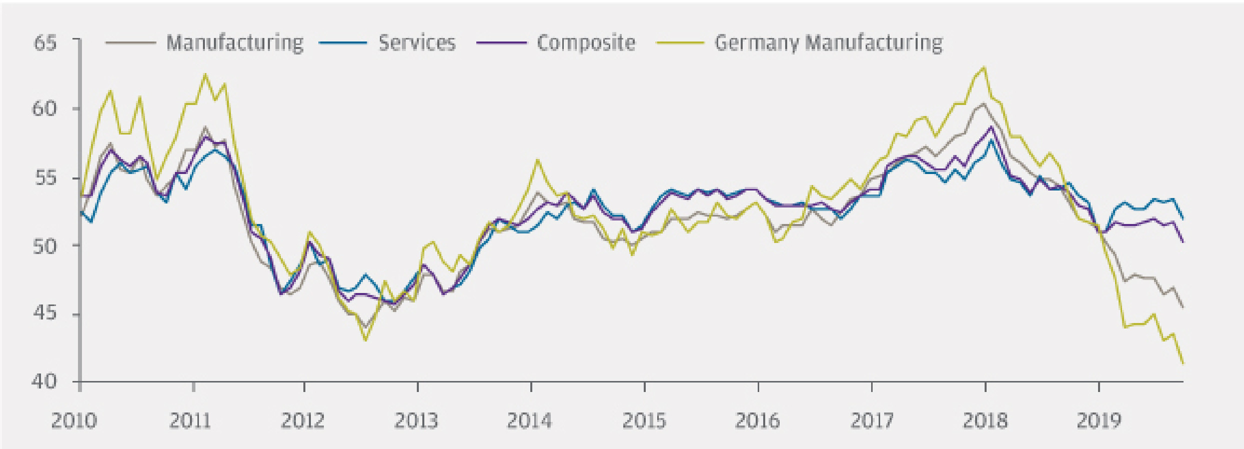
Hawks increasingly scarce

As one central bank after the other announces cuts to interest rates, we continue to believe that buying duration will be worthwhile for investors, even with yields close to record lows.

Fundamentals:

The majority of central banks now seem to be singing from the same hymn sheet, with a dovish tilt being the norm. For instance, the Bank of Japan has shifted towards further easing, pointing to its October meeting as a potential decision point. Its options are limited but a rate cut appears to be the most feasible. Similarly, the Reserve Bank of Australia is likely to cut rates at its meeting in October, as Governor Philip Lowe highlighted further easing may be required following disappointing data, including a rise in the unemployment rate to 5.3%. In Europe, the Bank of England is dovish at the margin and the European Central Bank is likely to be even more so after a weak September Purchasing Managers' Index (PMI) reading. German manufacturing led the way down, but it is also unsettling to see a downturn in the services sector. In the US, meanwhile, the Federal Reserve (Fed) delivered a 25 basis point rate cut in September, but there was a significant divergence of views in the Federal Open Market Committee's (FOMC's) dot plot, with the median plot implying that the Fed may be done with easing. We are of the view, as is the market, that there is more easing ahead, especially as we think the core of the FOMC expects to cut further.

Eurozone PMI surveys were much weaker than expected in September



Source: Bloomberg; data as of 23 September 2019.

Quantitative valuations:

The beginning of September provided a reprieve for US interest rates, which have been in steady decline this year. Having ended August at 1.50%, the US 10-year benchmark government bond yield rose to a high of 1.90% in mid September. We felt this was a short-term correction due to overbought conditions, and not a wholesale reversal of the trend, which created an opportunity to reengage in the market. Since then, rates have come back down to 1.65% (24 September), as investors continue to grapple with negative rates (which now account for close to 30% of the global bond market), weakening data, and dovish central bank rhetoric. Even at these low yield levels duration remains an important component of portfolios, both as a risk hedge and, particularly in the case of US Treasuries, a chance to earn a capital gain as yields move lower.

Technicals:

Demand for positive yielding assets, especially high quality ones given the stage of the credit cycle, continues to provide support for a strong technical backdrop. According to EPFR, US and European high grade funds have now witnessed 37 and 29 weeks of consecutive inflows, respectively. Meanwhile, gross supply has exceeded expectations so far in September, but this has been well digested and US supply in particular is expected to slow down meaningfully through October. (Data as of 20 September 2019).

What does this mean for fixed income investors?

Investors are increasingly tasked with finding value in a world where bond yields continue to decline and much of the bond market is now witnessing negative yields. But the potential for yields to decline further continues to support a duration overweight in our view. Trade tensions appear to be here to stay, and are increasingly feeding not only into manufacturing but also the broader economy. As conventional wisdom would suggest, this is not a time to fight against the stance of central banks. As long as dovishness remains the status quo, we think it will pay off to be structurally long duration.

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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