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THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

7 November 2019

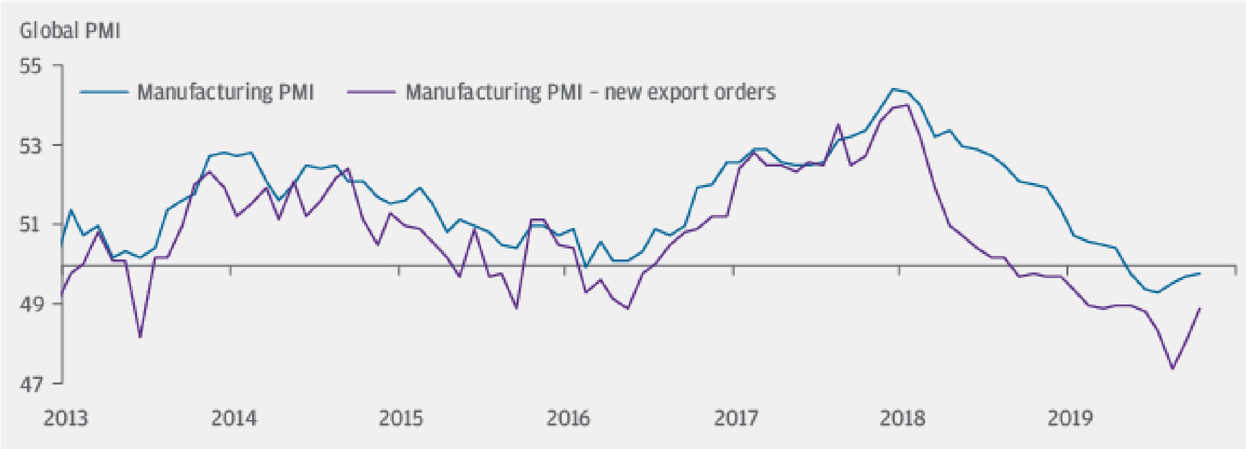
Green shoots?

Core bond yields have pushed higher since the end of October. Is the move warranted by a shift in the fundamental picture, and where could we go from here?

Fundamentals:

Bond yields have reacted to fundamental factors including US-China trade developments, improved survey data and central bank messaging. Regarding trade, while a "phase one" deal has yet to be formally articulated or agreed, overall sentiment has clearly improved, with both sides having shown some willingness to work towards an agreement. As negotiations progress, it will be important to monitor the implications not only for financial markets but also for business confidence and investment. Meanwhile, purchasing managers' indices (PMIs) have shown a notable uptick, particularly in leading indicator components such as new export orders, suggesting we may have seen the nadir in manufacturing weakness. Partly in response to this improvement in trade and data, central banks have shifted stance, with the Federal Reserve (Fed) signalling that it is on pause for now, after a year of dovish rhetoric and action. Importantly, however, the Fed maintains an implicit easing bias: while it is messaging this cutting cycle as a mid-cycle adjustment, the key difference between now and the 1995 and 1998 cycles is that we see no likelihood of rate hikes any time soon.

Leading PMI components suggest manufacturing weakness has bottomed



Source: J.P. Morgan, Bloomberg; data as of 31 October 2019.

Quantitative valuations:

US 10-year Treasury yields rose 17 basis points (bps) in just the first three trading days of November, from 1.69% on 31 October to 1.86% on 5 November. German Bunds followed suit, continuing the sell-off they experienced for much of October, with 10-year yields now 26 bps higher since the end of September. Core bond yields remain significantly lower than where they started the year, but recent moves have been meaningful. If tariffs are wound back rather than postponed, as some headlines suggest, it would constitute a material shift that could see rates sell off even further, beyond the recent peak of 1.85-1.90% on the 10-year US Treasury. That said, if US Treasury yields were to broach the 2% level, we would see it as an attractive valuation opportunity. (All data as at 5 November).

Technicals:

In a world in which global central banks are clearly signalling their intention not to raise rates, the structural case for owning bonds persists. As such, we expect the search for yield to continue propelling investors into fixed income. Our proprietary fund flow monitor confirms this trend, with inflows strong over the week to 4 November across bond markets, including USD 4.0 billion into US aggregate funds and USD 1.0 billion into developed market government bond funds.

What does this mean for fixed income investors?

Core bond yields have reacted to what appears to be a notable shift in the macroeconomic backdrop. From a strategic point of view, we remain constructive on duration given the global monetary policy landscape. However, we see the case for a tactical approach to trading the range as some of the recent developments could prove to be material and not just noise in the headlines.

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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