

# Fixed income investing in 2020

February 21, 2020

## IN BRIEF

- While easier monetary policy helped investors in 2019, it sets up a challenging investment environment for 2020. Historically, an investor's starting yields tends to be a reliable indicator for subsequent five year returns.
- If this precedent holds with a lack of yield curve steepness, investors will likely be tempted to shorten duration and take a lower quality focus to maintain the status quo of their historical fixed income returns.
- At this late stage in the cycle, investors should focus on higher quality areas of the fixed income market. Areas of opportunity include long duration U.S. Treasuries as well as mortgage-backed securities and asset-backed securities, which benefit from their exposure to the sturdy U.S. consumer.
- While intermediate-term bond styles have historically been considered a safe haven asset class, often ticking most boxes in the above mentioned point, stringent manager due diligence should not be neglected.

## AUTHORS



Alex Dryden, CFA  
Global Market Strategist



Corey Hill, CFA  
Portfolio Insights Specialist

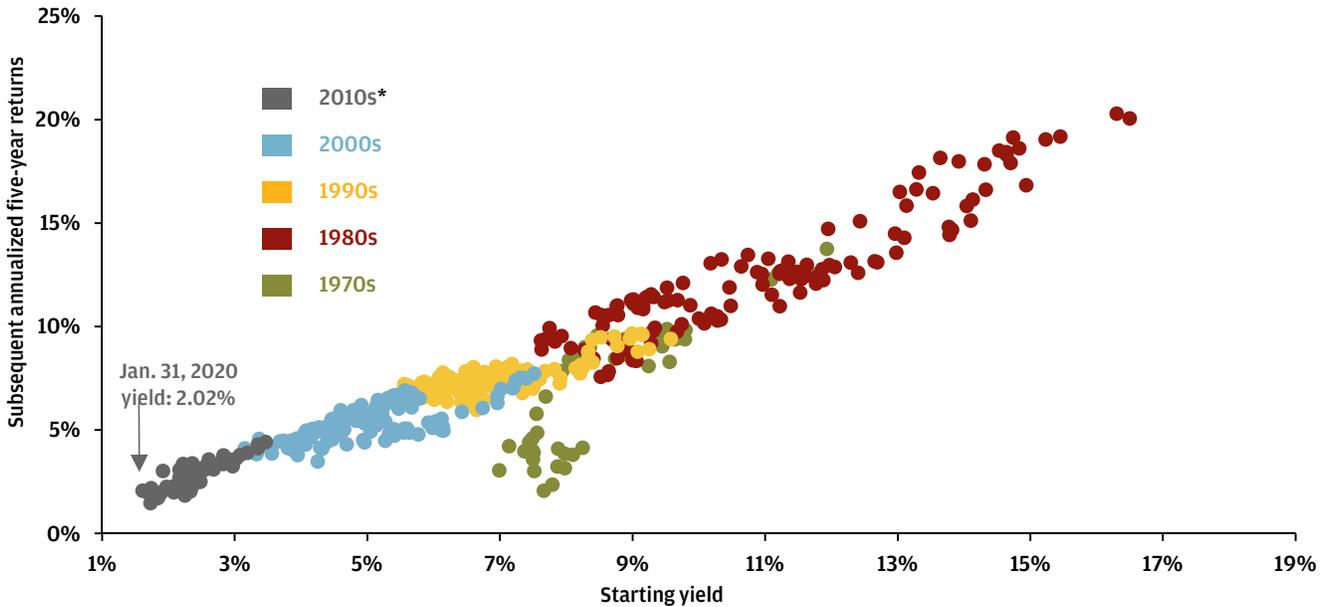
## 2020 investment outlook: Low yields, low returns

After a challenging 2018, fixed income investors caught a break in 2019 with the U.S. Barclays Aggregate returning 8.7%, its best year since 2002. Easy monetary policy from the global central banks also helped boost returns last year as 41 central banks cut interest rates 66 times between them. While this has helped stabilize economic growth and boost fixed income returns in 2019, it creates a low-yielding environment for fixed income investors in 2020.

As we highlight in **Exhibit 1**, historically, investors' starting yield explains a significant proportion of investors' subsequent five-year returns. Should this relationship hold going forward, today's starting yield implies a subsequent return of 2-3% per year for the next five years. This is considerably below what investors have received from their U.S. fixed income holdings in recent years. The U.S. Barclays Aggregate has returned 4% per year since 2009.

While past performance is not indicative of future results, loose monetary policy and subsequently low yields within fixed income creates a difficult investment environment for fixed income in 2020.

**EXHIBIT 1: Bloomberg Barclays U.S. Aggregate index**  
 Relationship between bond yields and subsequent five-year returns



Source: Bloomberg Barclays, FactSet, J.P. Morgan Asset Management. Period is from January 1976 to January 2020. \*2010s is periods from January 2010 through January 2015. Past performance is not indicative of comparable future results. Data are as of February 17, 2020.

Be wary of reaching for yield/know what you own

An initial solution to this low-yielding conundrum, is for investors to go hunting for yield in riskier areas of the fixed income markets. At this point in the economic cycle, investors would be wise to remember the diversification benefits core fixed income can provide to a portfolio, the below chart highlights this concept. **Exhibit 2**, essentially shows that higher yielding, riskier asset classes, such as high yield, may offer higher yields but this comes with stronger correlations to the S&P 500. This means that if equities fall sharply, riskier fixed income sectors will not provide investors with much protection. In short, higher yield equals higher risk.

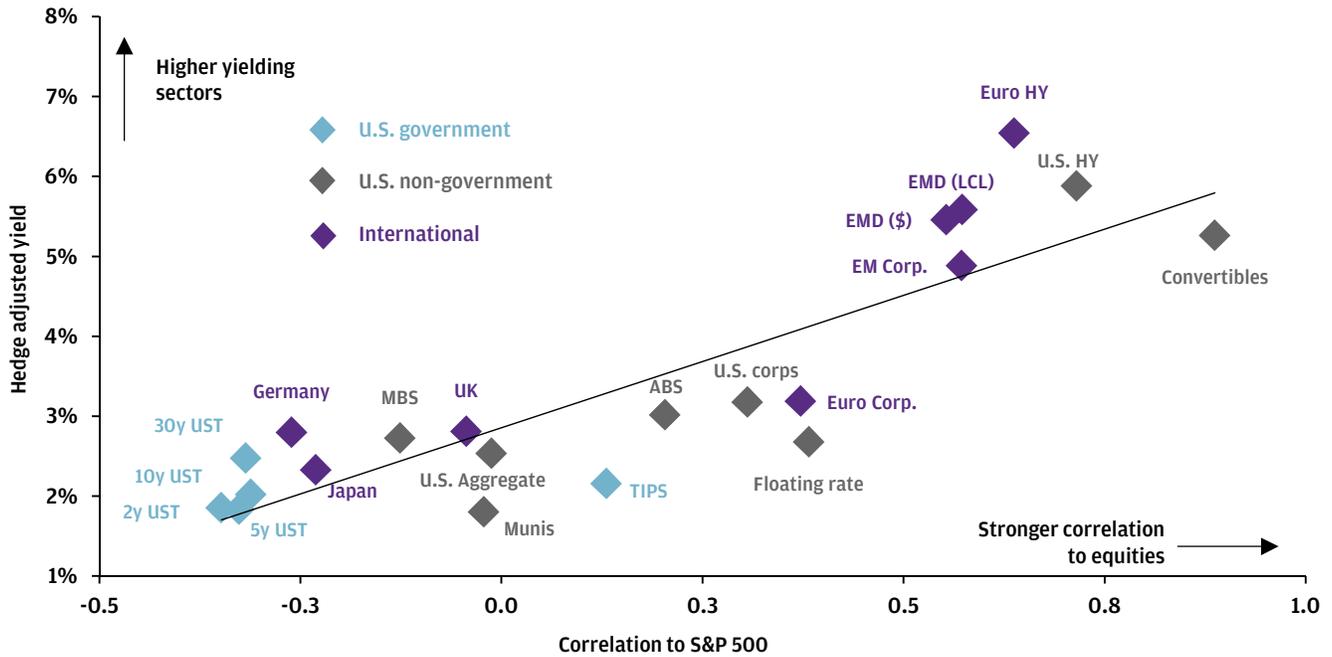
Instead, investors should focus on quality within their fixed income portfolios. U.S. Treasuries, while low-yielding, provide protection for the portfolio as a whole. In addition, mortgage-backed securities (MBS) and asset-backed securities (ABS) help leverage the financial strength and resilience of the U.S. consumer.

U.S. municipal debt has historically provided protection with reasonable yields.

By way of our Portfolio Insights team analyzing thousands of portfolios throughout 2019, we've seen investors, somewhat risk averse, have shifted toward higher quality and slightly longer duration categories. Dedicated high yield, for instance, consistently ticked down and ended 2019 at its lowest allocation of the year. Similarly, short duration styles have come down significantly from their highest allocations in the first half of 2019. While some have reallocated to more flexible managers, a vast majority trended toward the intermediate core and intermediate core-plus categories, in an attempt to insulate the portfolio.

While the surface of the water appears calm in the trend toward higher quality and longer duration categories, undercurrents insinuate investment selection will be imperative. Take a well-documented phenomenon of the growing and potentially risky BBB market.

EXHIBIT 2: Correlation of fixed income sector vs. S&P 500 and yields

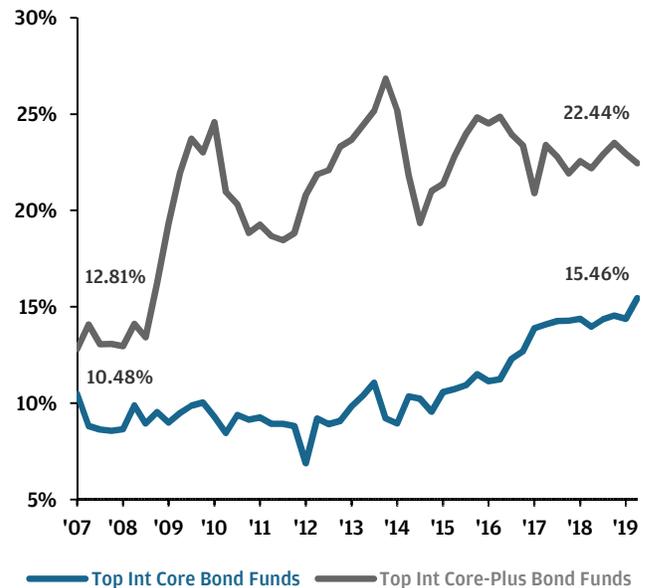


Source: Bloomberg, FactSet, ICE, J.P. Morgan Asset Management. Sectors shown above are represented by Bloomberg indices except for EMD and ABS - U.S. Aggregate; MBS: U.S. Aggregate Securitized - MBS; U.S. corps: U.S. Corporates; Munis: Muni Bond 10-year; U.S. HY: Corporate High Yield; TIPS: Treasury Inflation-Protected Securities (TIPS); Floating Rate: U.S. Floating Rate; Convertibles: U.S. Convertibles Composite; ABS: J.P. Morgan ABS Index; EMD (\$): J.P. Morgan EMBIG Diversified Index; EMD (LCL): J.P. Morgan GBI EM Global Diversified Index; EM Corp.: J.P. Morgan CEMBI Broad Diversified Index; Euro Corp.: Euro Aggregate Corporate Index; Euro HY: Pan-European High Yield Index. Convertibles yield is based on the U.S. portion of the Bloomberg Barclays Global Convertibles. Country yields are represented by the global aggregate for each country. Yield and return information based on bellwethers for Treasury securities. Correlations are based on 15-years of monthly returns for all sectors. International fixed income sector correlations are in hedged U.S. dollar returns except EMD local index. Yields for all indices are hedged using three-month LIBOR rates between the U.S. and international LIBOR and are a 12-month average. *Guide to the Markets - U.S.* Data are as of February 17, 2020.

In reviewing **Exhibit 3**, data suggests many intermediate core and core-plus bond funds are following suit with the structural market changes and/or consciously taking on more risk over time. When assessing your high quality core fixed income investments, it would behoove investors to look beyond common high level metrics such as categorization and trailing performance when seeking diversification to equity oriented risks. A handful of data points we encourage using include standard deviation, correlation to equities and performance during our stress test periods\*. With returns likely more sparse and volatility likely more frequent, knowing what you own will prove paramount with regard to portfolio construction.

*\*Please reach out to your JPMorgan representative to find out how to stress test your portfolio*

EXHIBIT 3: BBB rated bond holdings by category  
As a percentage of portfolios



Source: Morningstar, J.P. Morgan Asset Management. Data are as of February 17, 2020.

### Investment implications

- After another round of monetary policy easing in 2019, the low bond yields on offer today are likely to hamper investor's long-term returns in fixed income.
- Investors should be cautious about reaching for yield late in the economic cycle. A focus on lower-yielding but higher quality areas of the fixed income may add some important protection to portfolios.
- Investors utilizing what has traditionally been considered high quality fixed income categories should proceed with a trust but confirm mindset. If the role in portfolio is to provide protection during turbulence, now is an optimal time to ensure the instrument is positioned to fulfill that role.

---

#### Important Disclaimer

For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non-independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide.

To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at <https://am.jpmorgan.com/global/privacy>.

This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by J.P. Morgan Institutional Investments, Inc., member of FINRA; J.P. Morgan Investment Management, Inc. or J.P. Morgan Alternative Asset Management, Inc.

In APAC, distribution is for Hong Kong, Taiwan, Japan and Singapore. For all other markets in APAC, to intended recipients only.

Copyright 2020 JPMorgan Chase & Co. All rights reserved.

PI-MI-FI-Fixed income investing in 2020

0903c02a828168a4