Fixed Income Perspectives

Bond Market Outlook

Global Rates: vaccine optimism to allow ten year U.S. Treasury yield to float higher but remain in 0.8 – 1.2% range

Global Currencies: U.S. dollar trends weaker against DM, EM currencies

Investment Grade: remain cautious on spreads into year end, but look to add high quality issuers on weakness

High Yield: valuations less attractive after rally, select opportunities remain among higher-quality spreads for incremental yield

Securitized: most virus-impacted sectors such as CMBS to continue to receive bid amid vaccine optimism

Emerging Markets: 3Q20 recovery continued to build through year end but still uneven across markets, leading to select opportunities

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Voya Investment Management's fixed-income strategies cover a broad range of maturities, sectors and instruments, giving investors wide latitude to create a new portfolio structure or complement an existing one. We offer investment strategies across the yield curve and credit spectrum, as well as in specialized disciplines that focus on individual market sectors. We build portfolios one bond at a time, with a critical review of each security by experienced fixed income managers.

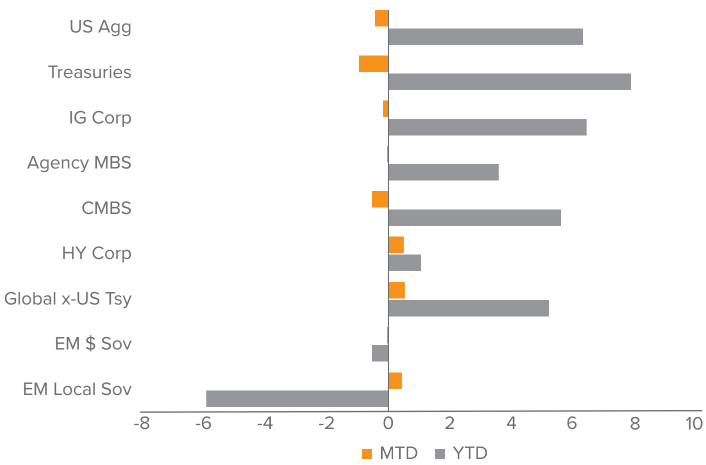
Tug of War: Vaccine Optimism versus Surging COVID Cases and Policy Uncertainty

The pandemic, and the world's response to combat it, continues to be the main driver of uncertainty across the economy and capital markets. Our base case has been, and continues to be, that we would see a swift bounce in economic activity followed by choppy global growth thereafter. We had anticipated that the choppiness would be caused by periods of uncertainty, as the policy makers grapple with how best to keep the economy open, while continuing to take measures against the spread of the virus. As we are witnessing in November, this is exactly the tug of war that is playing out. While the world has cheered news of a vaccine on the horizon, it will not be available in time to help fight the recent surge in new cases of the virus.

Treasury Secretary Mnuchin added an extra layer of uncertainty after he announced that the Treasury department would be seeking to pull the plug on most of the emergency lending facilities that were critical to restoring market functioning in April and have operated as backstops since. Like most market participants, we view the news from the Treasury Secretary as a "mild disappoint" rather than any cause for significant concern. In our view, the emergency lending facilities played a powerful and important role during the depths of the crisis but it will take a severe hit to the economy from renewed lockdowns to put the public markets in a position where they really need the backstop of these emergency facilities.

Going forward, we continue to believe that the fundamental outlook across corporate sectors is uneven, as we see the U.S. economy shifting into a "K-shaped" recovery. The resulting uneven pressures will create winners and losers with broad strokes across the fixed income spectrum. In the zero-rate world ahead, we continue to prepare our portfolios with strong security selection and maintain our bias of securitized over corporate credit.

Rates, Spreads and Yields



		31-Oct	30-Sep	1Y Low	1Y High
Yields	US 2 Yr	0.16	0.13	0.11	2.41
	US 10 Yr	0.88	0.69	0.51	1.94
	GER 10 Yr	-0.63	-0.52	-0.86	-0.16
	JPN 10 Yr	0.04	0.02	-0.18	0.08
	EM Local Sov	4.46	4.48	4.35	6.08
Spreads	IG Corp	125	136	93	373
	Agency MBS	52	61	28	132
	CMBS	164	164	84	363
	HY Corp	509	517	315	1100
	HY x-Egy Corp	464	470	272	973
	EM $ Sov	421	432	290	721

As of 10/31/2020. Past performance is no guarantee of future results. Source: Bloomberg, Bloomberg/Barclays, JP Morgan and Voya

Sector Outlooks

Global Rates and Currencies

China remains the global benchmark for activity as the first major economy to shut down and reopen. While not yet unanimous, global PMIs for manufacturing and services have returned solidly to expansion territory after a tentative move above 50 just two months ago. The peak impulse from fiscal policy has likely passed but should nonetheless be an ongoing factor in 2021. A spike in COVID cases across the globe has led to some jitters in the markets with the United Kingdom, Germany and France moving to impose lockdowns. Central banks globally are continuing to provide extra stimulus; the European Central Bank and Bank of England are likely to increase the size of their respective stimulus packages while Bank of Canada has provided a firm guidance.

The U.S. labor market's continued strong recovery and fiscal stimulus have helped fuel spending in the lower income bracket year-to-date. That said, the focus for the next few months will be on politics, cabinet appointments, COVID cases and vaccine developments. With cases rising, we are monitoring the impact of renewed lockdowns in the U.S. on growth, which should fuel the urgency for fiscal stimulus.

In contrast to the U.S., PMIs across Europe missed expectations, as a pick-up in COVID activity weighed on growth. Consistent with the post-COVID world, manufacturing continued to strengthen, but service activity dropped relative to October. The 8.2% rebound in third quarter GDP almost made for a full V-shaped recovery from the second quarter's 9.8% slump.

Investment Grade (IG) Corporates

IG spreads sold off slightly during the last week of October after tightening to 123bps, but still finished the month at 125bps, an 11bps decrease for the month. Spreads tightened despite uncertainty in the run-up to the U.S. elections and rising COVID-19 infections in the U.S. and Europe. Lighter than expected supply helped the technical environment and a strong start to the earnings season added to optimism.

October's $79 billion of new supply was modestly lower than the $90 billion average and brings year-to-date new issuance volume to $1.62 trillion. As such, supply is set to fall considerably in the last two months of the year, which should lead to a strong year-end technical environment. The Energy sector sputtered again with the new lock downs in Europe as oil fell below $40 after rallying in the first half of the month.

High Yield Corporates

October started with a very strong rally after the September sell-off pushed prices down to levels that many bargain hunters found attractive. However, the buying flurry began to fade mid-month, as COVID started flaring up again in various spots, and the uncertainty around the U.S. elections swirled. While the rally tide lifted nearly all boats, it was CCC-rated issues that faded hardest in the last week, as the risk-off tone increased. New issuance volume was moderate and fund flows in the asset class tracked closely with performance metrics.

Securitized Assets

Agency MBS outperformed comparable Treasuries, as the steepening curve toward month-end and the Federal Reserve's ongoing quantitative easing continued to support the sector. We expect the prolonged low-rate environment to drive mortgage rates lower. We foresee a continuing collapse of the primary/secondary spread by as much as 25 bps, possibly extending the refinancing wave into 2021. Nonetheless, the market will be supported by a steady Fed and bank demand as the current refinancing wave gets priced into the market. Monthly carry profile should remain attractive; long-term value will surface outside Fed purchases, but that may take several months.

Mortgage credit performance was uneven in October with some subsectors like Jumbo 2.0 maintaining positive returns, while others like CRT and legacy tranches saw widening pressure. Relative value remains and the sector should benefit with a stabilizing technical environment and pricing that reflects a more significant risk of loss than appears likely. Thus, we maintain our positive tactical outlook, as low mortgage rates, a robust housing market, and still attractive relative value support the asset class.

While CMBS remains attractive on a relative and historical basis, we feel the recent run may be due for a pause as we approach year-end. As such, we have downgraded our tactical assessment of the sector to neutral. Longer term CMBS performance is inextricably linked to the normalization of the retail and travel-leisure parts of the economy, and the recent rise in COVID cases increases the risk for more shutdowns, which could hamper market sentiment and overall fundamentals.

Asset-backed securities (ABS) have led the recovery for securitized credit, with some benchmark subsectors completely retracing the sell-off while other, higher spread subsectors still have room to tighten. The key drivers (TALF, primarily) are firmly in place and have been augmented by the global economy reopening. The rally has spread, both outward in terms of sub-sectors and downward in terms of the capital structure of ABS deals. While upside may be limited for certain higher quality segments of the ABS market, we expect the sector to remain well bid overall, even if broader markets exhibit more volatility between now and year end.

Emerging Market (EM) Debt

The recovery in Emerging Markets (EM) during the third quarter continued to build through October, as rising factory outputs, increasing trade, improving business conditions and COVID lockdowns in EM countries being either loosened or lifted altogether drove growth. EM Asian countries, in particular China, are leading the expansion, followed by LATAM and Africa. Vigilance is nonetheless high, as the sustainability of the upturn could be tested by a downturn in new export orders, high unemployment and the potential impact of a second wave of COVID infections. Monetary policy remains supportive in general across EM countries but conventional rate cuts remain limited, especially among low yielding government bonds. Also, further stimulus will depend on unconventional measures like Quantitative Easing. Finally, fiscal deterioration and related broad government support remain universal trends and a necessity across developing and emerging market issuers. For EM governments, balancing fiscal impulse while tax collections remain soft will be the ongoing concern.

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