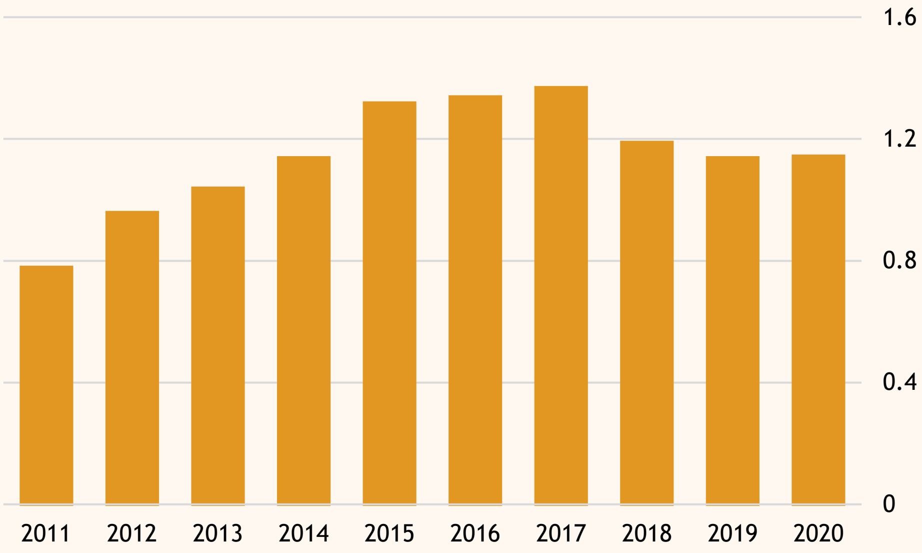
Fixed Income Weekly Summary, 19 June 2020

Key Economic Figures/Events of the Week

- The week has had a rocky start, with markets down after last week's Fed's gloomy outlook on the US economy. And the same Fed has stepped in late Monday and announced that the asset purchasing program will start to include individual corporate bonds under its Secondary Market Corporate Credit. Although the intention was announced some time ago, the US Central Bank has only added ETFs to its balance sheet to that point. This news has sent bond markets rallying. Once again, the words of the Fed have proved powerful.

US IG bond issuance already surpasses last year total (USD trillions)



Source: Bloomberg

- The rebound of the US retail sales according to the data published on Tuesday has impressed markets, as it showed a 17.7% month-over-month increase in May, following a 14.7% decline in April. The increase is considerably higher than the forecast of +8.4%. To sustain further upturn trend in consumption however, labour market recovery is needed. Initial jobless claims for the week ending 13 June, published on Thursday, have failed to live up to the expectations. The stats have come in at 1.5 million, more than the 1.3 million forecasted. Nevertheless, the trend of jobless claims decline is continuing. Impatient for a quick recovery, markets tend to overreact to any economic data and news, whether positive or negative. However, in this crisis everything is different, and the picture has to be taken in as a whole. In our base case scenario, we implied a slow gradual recovery of global economies, with few bumps on the way. Any market overreactions along the way could be used tactically to fix profits or increase exposure to certain segments.

- Mid-week, markets have been caught again in the dilemma of weighing the hope of economic recovery with the fear of a new outbreak. News about increasing hospitalizations in some US states as well as a new outbreak of infections in the Chinese capital has caused a nervous ripple in the markets. Neither governments nor public are in favor of lockdowns as the ones we have witnessed in March. Countries are now better equipped and prepared to function concurrent with pandemic. It was the lockdown measures that sent the global economy into the deep recession and froze liquidity on the markets, not the number of infections. With this in mind, the March-like scenario is highly unlikely.

- To complete the picture, the US-China trade tensions have resurfaced at the end of the week, after President Trump has issued yet another threat to 'cut ties with China'. As we have previously mentioned, we expect that the tensions will intensify as we approach US elections and will be one of the main sources of volatility and caution on the markets as economies start to rebound.

Weekly Investment Insights

- On Tuesday, India has reported 20 casualties among soldiers after a deadly border clash with the Chinese troops. The reaction of the markets has been muted and we believe the risk of a further escalation is unlikely.
- Latin America is currently the new hot spot of the coronavirus outbreak. Countries in the region have weaker healthcare systems and cannot expand public borrowing as their developed counterparts. However, the monetary response of central banks in the region has been ample and there's more room for rate cuts, given the muted inflationary pressure. The recovery of the Chinese economy and the stabilization of oil prices have also seen some pressure relief. With the stabilization of global economies, the 'hunt for yield' will likely drive flows which will support emerging markets, more so, the hard currency ones. It is worth noting that we do not invest in the local currency emerging market debt. While credit spreads have recovered from the March widest, we expect that there is potential for some further tightening in the near-to-midterm future.

Strategy

This week, given the rally, we have fixed profits on some issues, mostly high duration ones. Primary markets have started the week on halt, with several corporates cancelling their previously announced primary offers on Monday. However, they have livened up soon after Fed's announcement which has buoyed the markets. We expect the pace of issuance to slow down in the second half of the year, as many companies have already secured enough cash to withstand the crisis, having taken advantage of cheap borrowing conditions. This week we have also taken part in a new offering from Ford (BB+/Ba2) but have not received any allocation given our yield limit. We have also acquired new issues of British BP Capital Markets (A3/BBB).

We hope you will find this information useful and we will be glad to answer your questions

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