

Is the Defensiveness of Bonds Reliant on Quantitative Easing?

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Views expressed are those of the author and may change

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Investing in Fixed Income: Two Competing Narratives

Case for Caution – Risk Off

Fundamentals: uneven growth, goods vs. services

Valuations: spreads compressed

Geopolitical Risks: US-China conflict; US policy uncertainty

Market Fragility: dependence on central bank support; credit market liquidity

Case for Optimism – Risk On

Liquidity Injections: unprecedented monetary and fiscal stimulus

Vaccines: efficacy high; herd immunity in G7 by mid-summer 2021

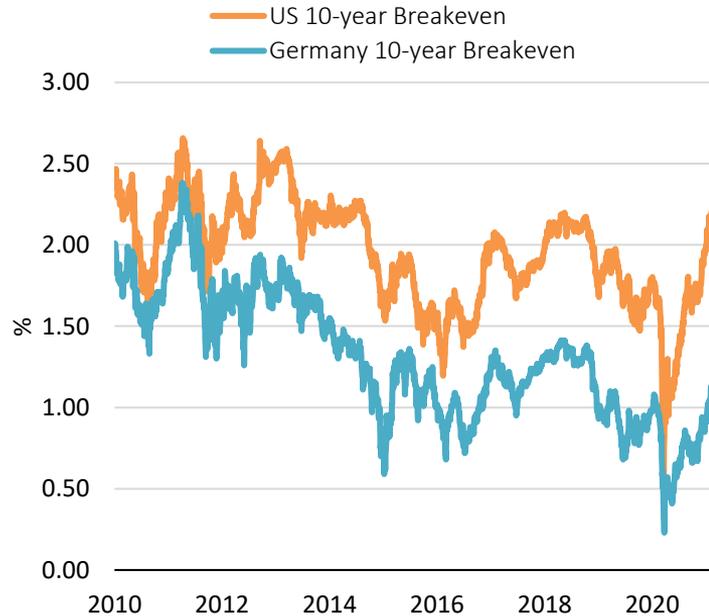
Technicals: reduced new issuance; central bank backstop; credit inflows

Reflation concerns: higher inflation tail risk

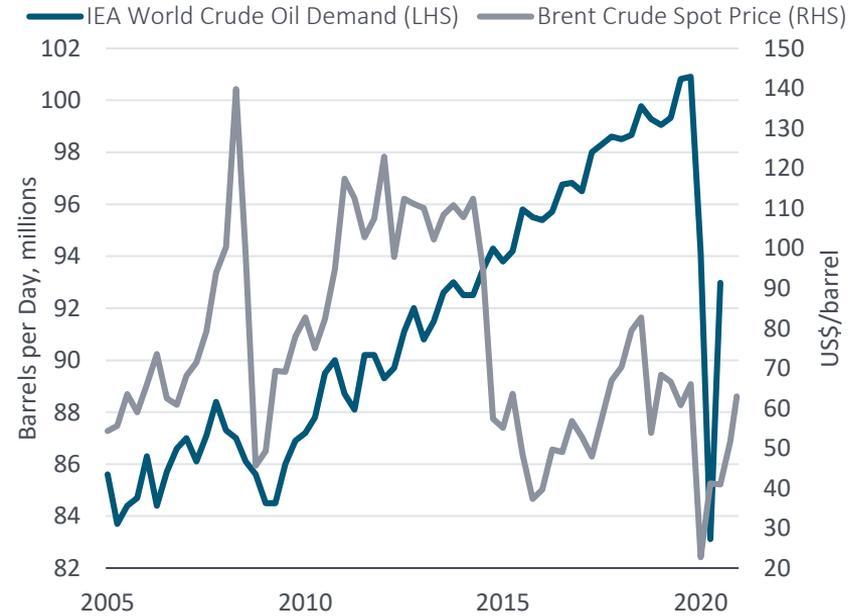
Security selection is key in the current environment where fundamentals appear to matter less.

Macro Conditions Suggest Inflationary Pressure Emerging

Market Forecasts of Inflation



Crude Oil Demand vs. Crude Spot Price



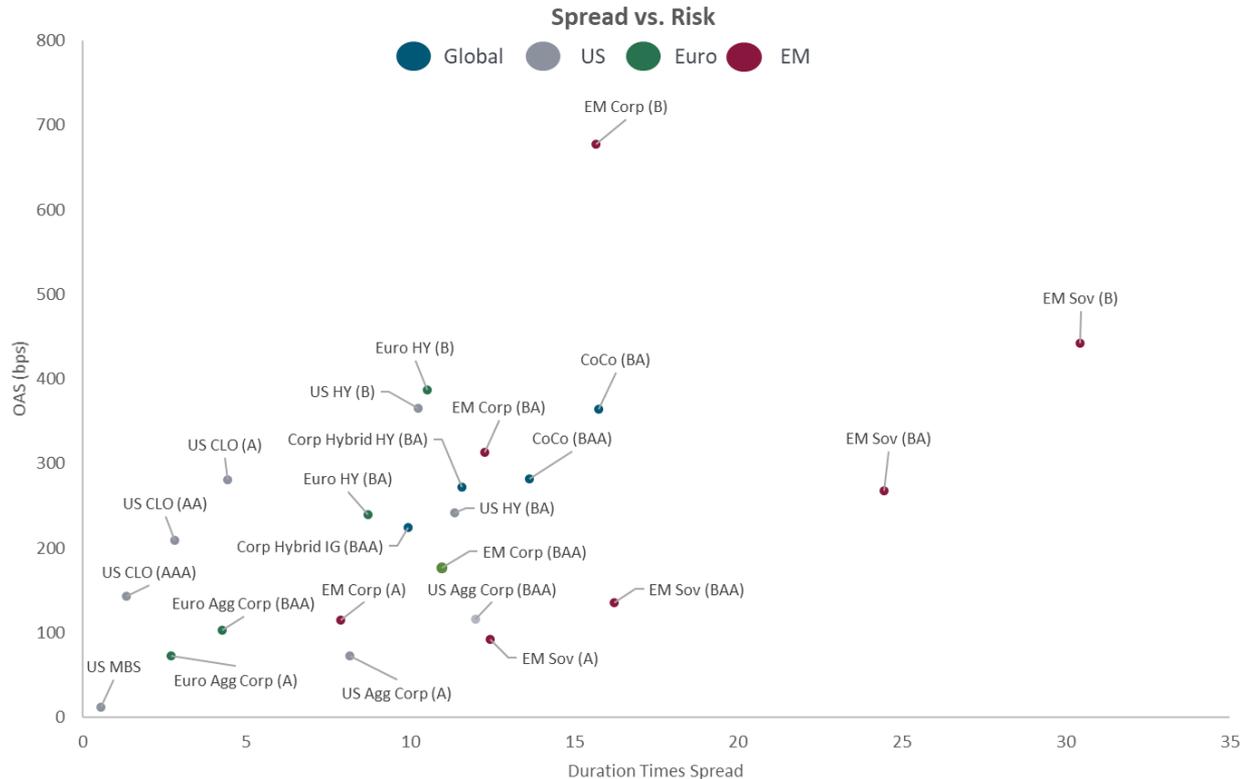
Signs of reflation are evident in the wake of the significant liquidity injections.

Source: LHS – Bloomberg. Daily data from 1 January 2010 through 19 February 2021. RHS – Bloomberg. Quarterly data from 31 March 2005 through 30 September 2020 (for crude demand) and 19 February 2021 (for Brent spot price).

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In Search For Yield: Spreads vs. Risk

First layer of hunt for yield compares spreads to a broad measure of risk



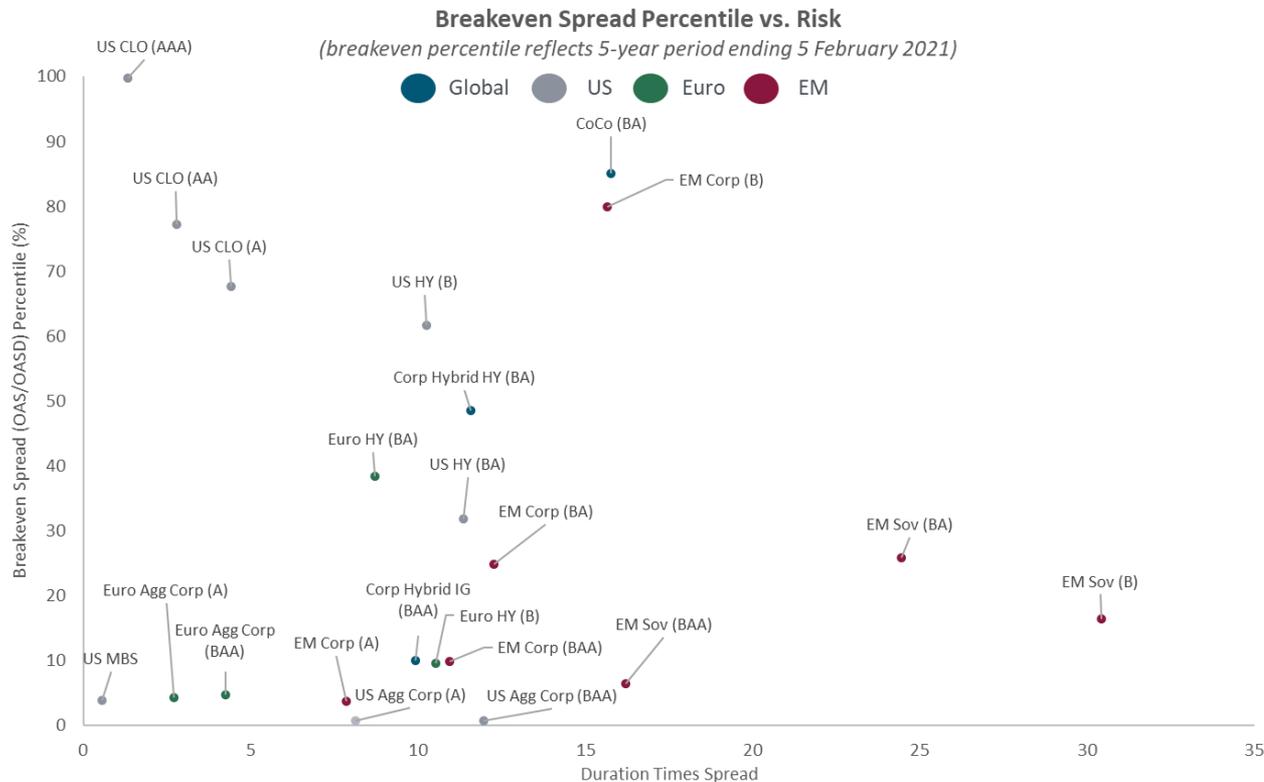
In general and as expected higher risk is compensated with higher spreads.

Source: Bloomberg Barclays, J.P. Morgan and ICE BofA as of 5 February 2021. Corporate hybrids reflect ICE BofA indices. CLOs reflect J.P. Morgan indices. All other asset classes are Bloomberg Barclays indices.

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In Search For Yield: Breakeven Spreads vs. Risk

A more nuanced approach focuses on breakeven spreads and their percentile history



Some higher spread sectors appear less attractive under this screen.

Source: Bloomberg Barclays, J.P. Morgan and ICE BofA as of 5 February 2021. Corporate hybrids reflect ICE BofA indices. CLOs reflect J.P. Morgan indices. All other asset classes are Bloomberg Barclays indices. Breakeven spread percentile reflects the 5-year percentile rank (as of 5 February 2021) for each asset class' breakeven spread. Breakeven spread = option-adjusted spread / option-adjusted spread duration.

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Thank You

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