

NORTHERN TRUST ASSET MANAGEMENT

# Fixed Income Update

## AFA Spring Symposium

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**NORTHERN TRUST**

# TODAY'S AGENDA



**Views on  
Rates &  
Credit**



**Investment  
Grade & High  
Yield Update**



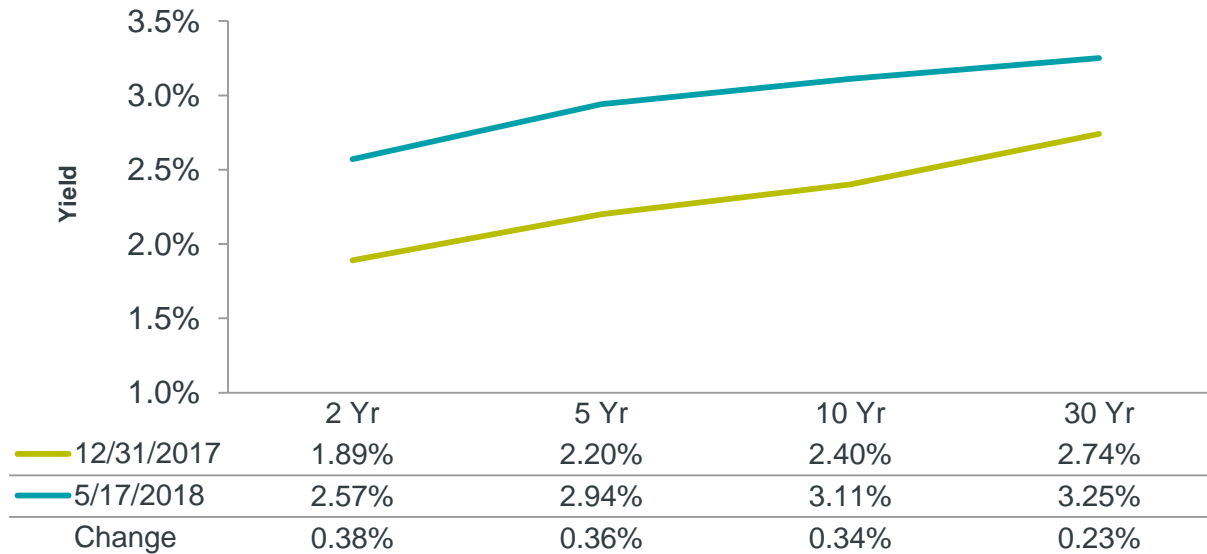
**Q&A**

# CURRENT TRENDS IN FIXED INCOME

## KEY POINTS

- Treasury yields rose and volatility returned to fixed income markets after a calm 2017.
- Inflation remained benign despite solid economic growth and declining unemployment globally.
- Corporate credit spreads widened. While company fundamentals improved and new issuance fell, investors focused on trade tariffs and tax reform.

2018 CHANGE IN TREASURY YIELDS



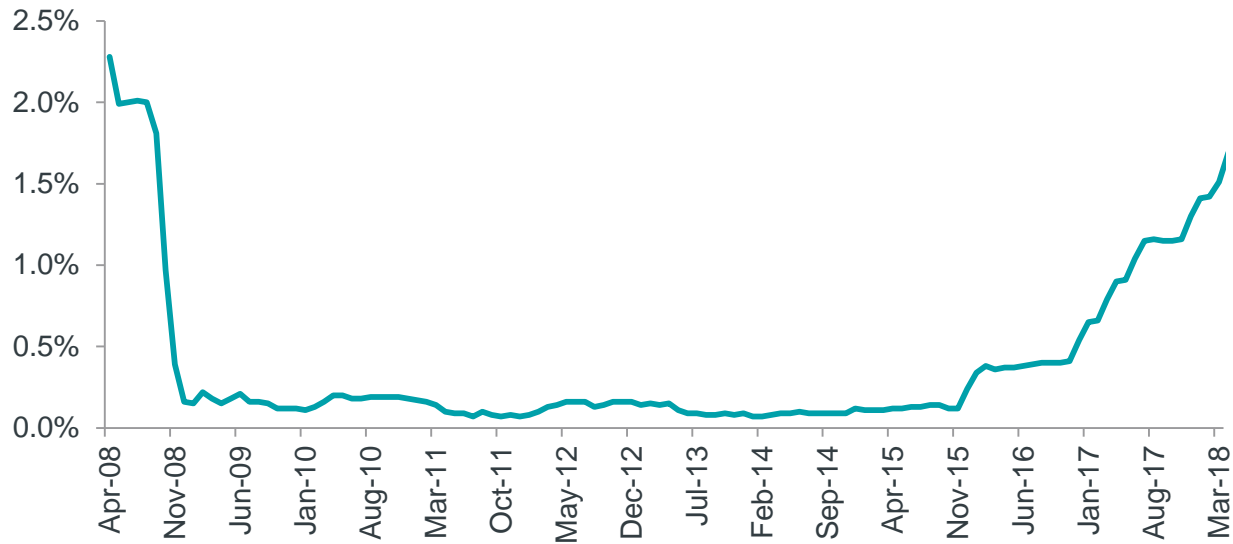
Source: U.S. Department of the Treasury

# FED POLICY

## KEY POINTS

- The Federal Reserve raised its benchmark fed funds rate 25 basis points in March. This was the fifth increase since December 2016.
- Accommodative foreign central bank policy and low inflation will constrain the Fed from aggressively increasing rates.

FEDERAL FUNDS EFFECTIVE RATE

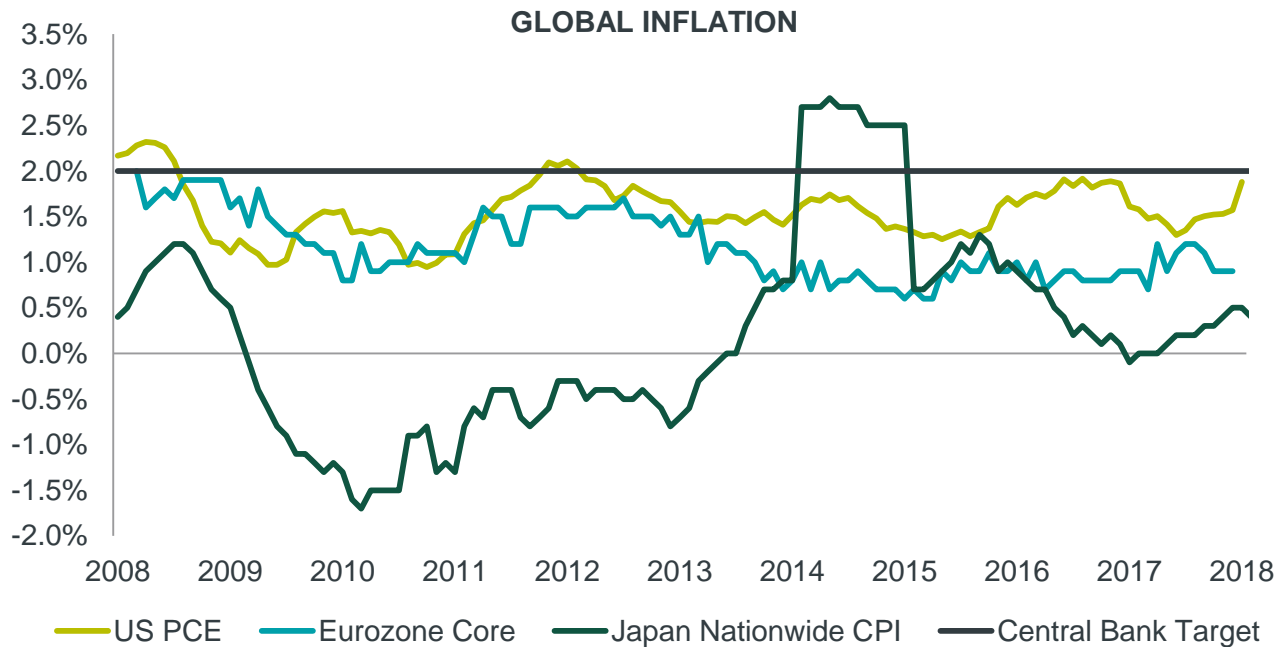


Source: Bloomberg: As of 4/30/18

# INFLATION REMAINS BELOW TARGET

## KEY POINTS

- Central Banks continue to fall short of inflation expectations. Core PCE has recently moved towards the Fed's 2% target.
- U.S. job growth remained strong, creating an average of 200,000 jobs in Q1 2018



As of 4/30/18  
Source: Bloomberg Barclays

# TREASURY CURVE FLATTENING

## KEY POINTS

- The Fed has raised rates five times since December 2016, but long rates have remained low
- If long term rates do not move higher, it may limit the Fed's ability to implement multiple rate hikes without inverting the yield curve

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US TREASURY 2-10 YEAR SPREAD

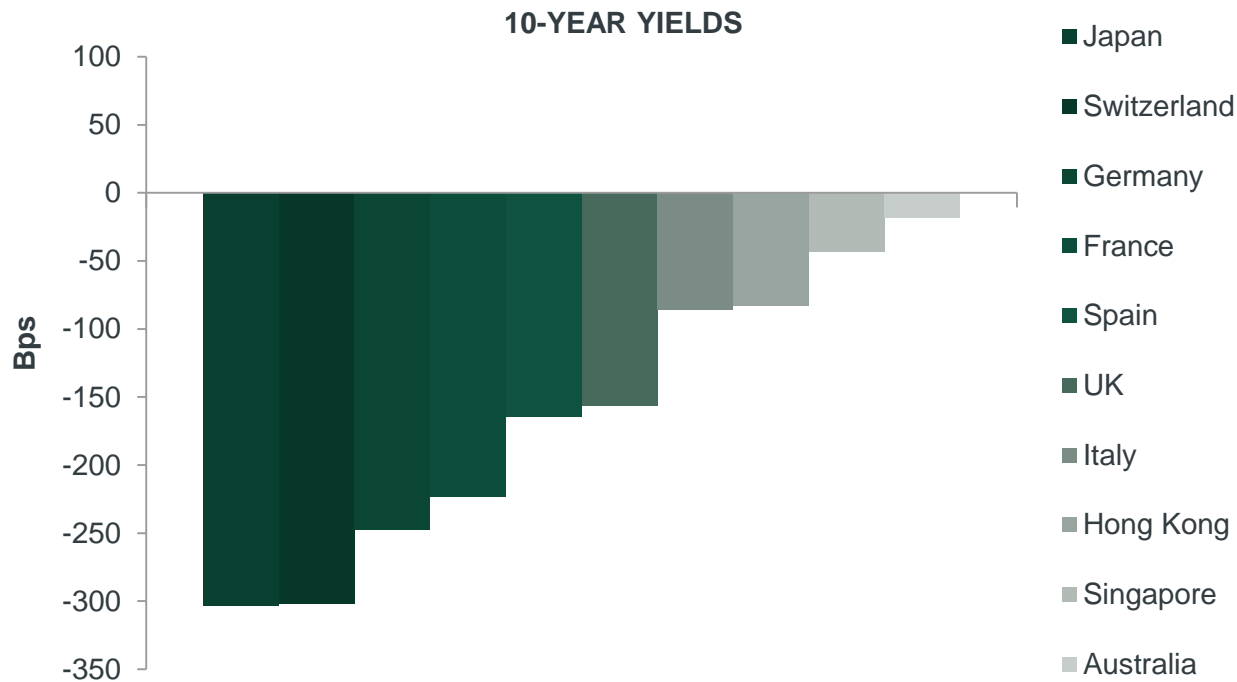


◆ Denotes Fed Hike

# U.S. YIELDS ARE HIGH – RELATIVELY SPEAKING

## KEY POINTS

- The US continues to enjoy some of the highest interest rates in the developed world. We believe the yield advantage will continue to attract interest from overseas buyers.

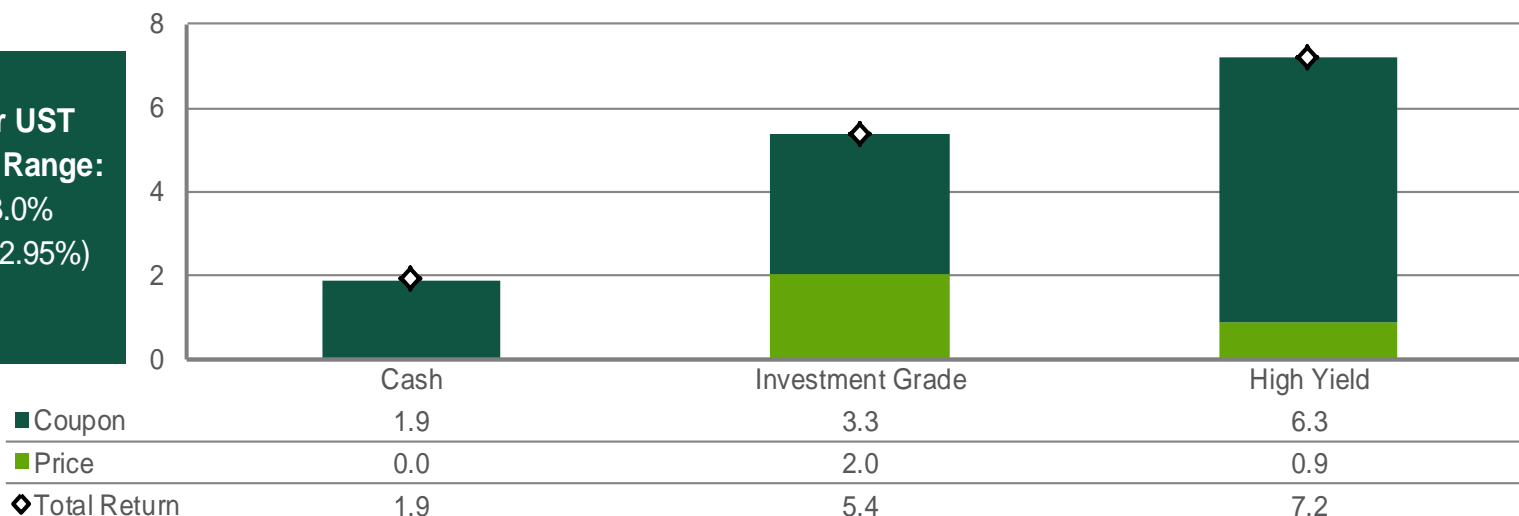


Source: Bloomberg and Northern Trust Fixed Income. Data as of 5/18/2018

# NORTHERN TRUST FORECASTS

## FIXED INCOME FORECASTS - %

**10-Year UST  
Forecast Range:  
2.5 - 3.0%  
(Current 2.95%)**



- While Northern continues to favor risk assets, we believe investment grade bonds will produce positive returns
- We believe high yield bond spreads will remain tight, providing the opportunity for attractive total returns.

Source: Northern Trust Investment Strategy, Bloomberg Barclays. 10-year yield as of 5/4/2018. Fixed income forecast data as of 5/7/2018. Equity forecast data as of 5/4/2018. NTM = next twelve months.



# LONG DURATION

## CURRENT POSITIONING

- Portfolios remain overweight corporate debt. Corporate fundamentals have improved with better sales, earnings and cash flows. Tax reform in the U.S. will be very positive for investment-grade companies and lead to accelerated growth in earnings and cash flows
- Despite improving fundamentals and less issuance year over year, credit spreads widened on increased political uncertainty and tax repatriation.
- Current positioning reflects range-bound interest rates and inflation. Duration is short to neutral relative to the Bloomberg Barclays U.S. Aggregate Index.

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## CORPORATE OPTION-ADJUSTED SPREAD

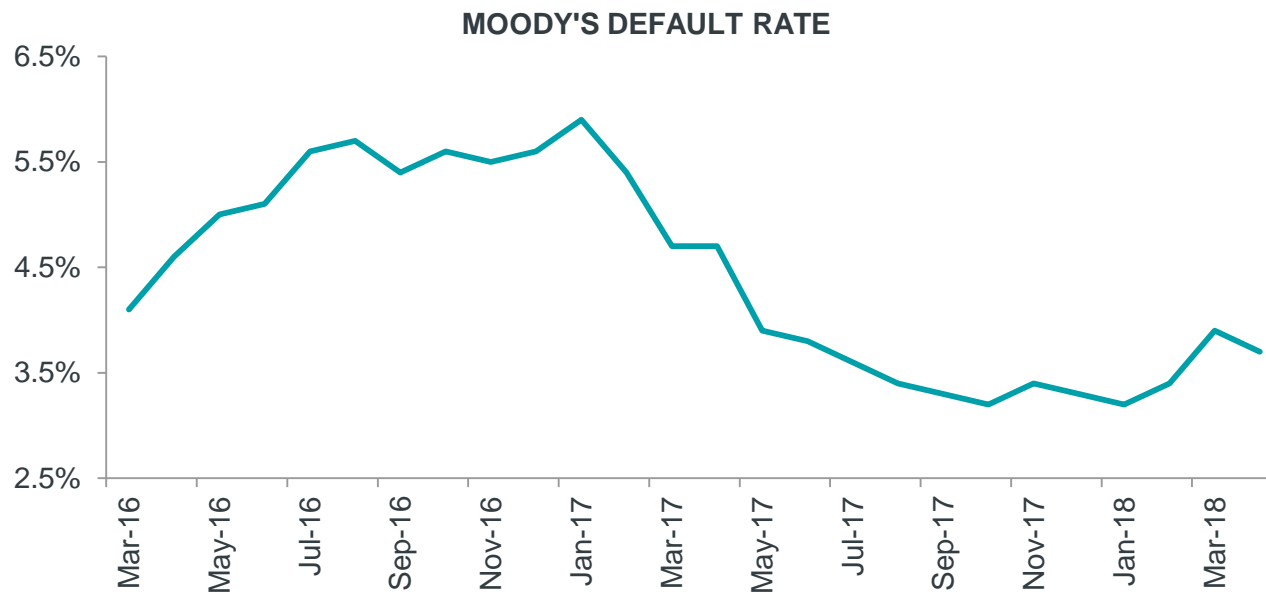


Source: Barclays Live; As of 5/17/18

# HIGH YIELD BONDS

## CURRENT POSITIONING

- Portfolios remain overweight lower quality corporate debt as company sales, earnings and cash flows are improving.
- Being overweight lower quality issuers with higher yields contributed to performance.
- Defaults have continued to fall from the elevated levels in 2016 when many commodity-related bankruptcies occurred.

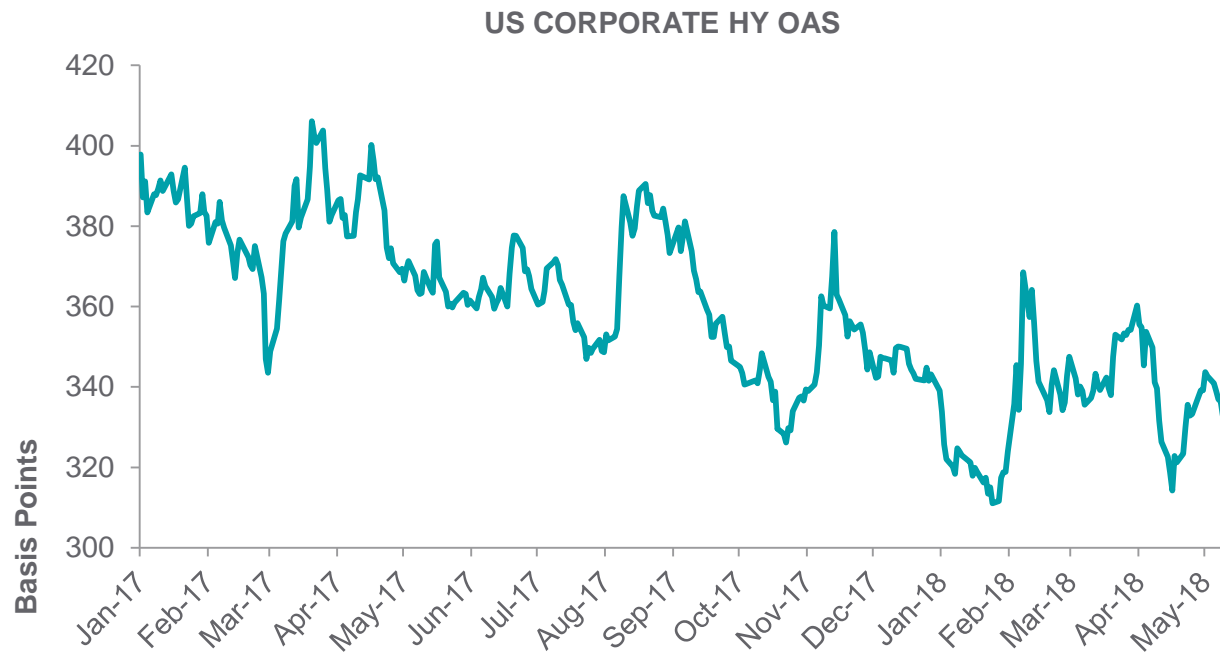


Source: Moody's; As of 5/8/18

# HIGH YIELD INDEX CREDIT SPREADS

## KEY POINTS

- High yield credit spreads widened modestly in Q1, but have remained tight despite enhanced volatility in risk assets
- We expect spreads to remain tight as fundamentals remain strong, defaults are low, and investors continue to search for yield



Source: Barclay's Live, 3/31/18

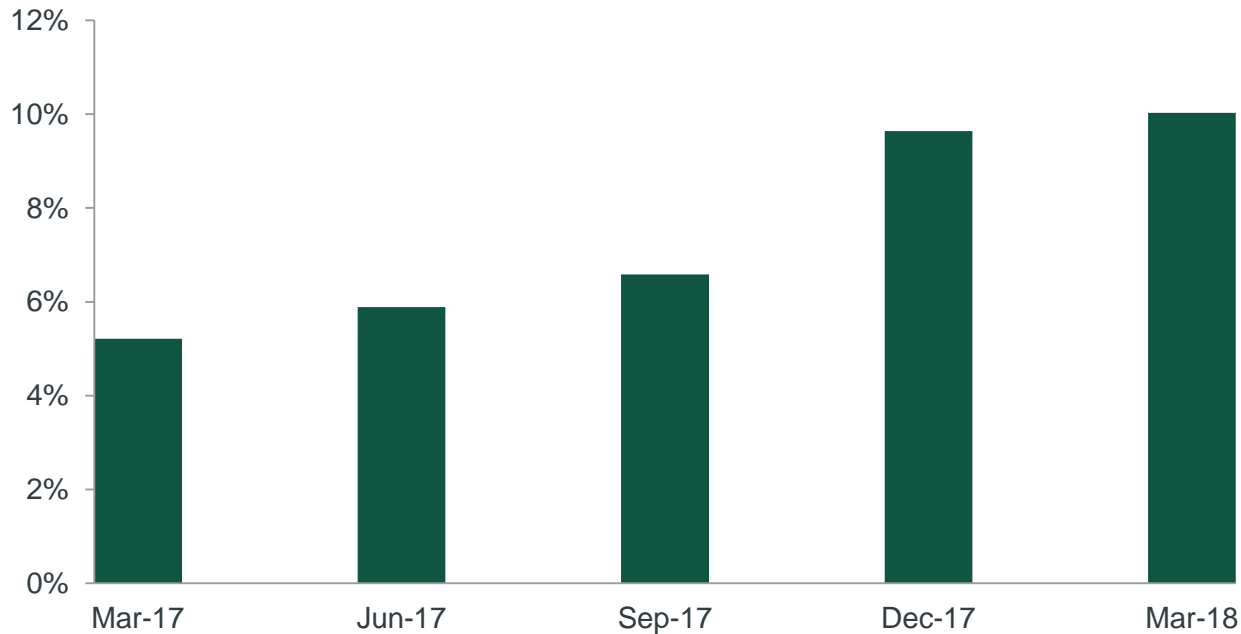
# HIGH YIELD BONDS - FUNDAMENTALS

## KEY POINTS

- Revenues for high-yield companies have accelerated, driving higher earnings and cash flows.
- Tax reform will be very positive for high-yield companies and will support tight credit spreads.

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REVENUE GROWTH FOR HIGH YIELD COMPANIES



SOURCE: Bloomberg Barclays Indices, Capital IQ

# TODAY'S TAKEAWAYS

**1**

**We anticipate fewer rate increases in 2018 than the market and the Fed**

**2**

**We continue to favor corporate debt as fundamentals remain strong and demand for spread assets is high**

**3**

**With defaults expected to trend lower and strong earnings, high yield remains attractive**

# Questions?

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