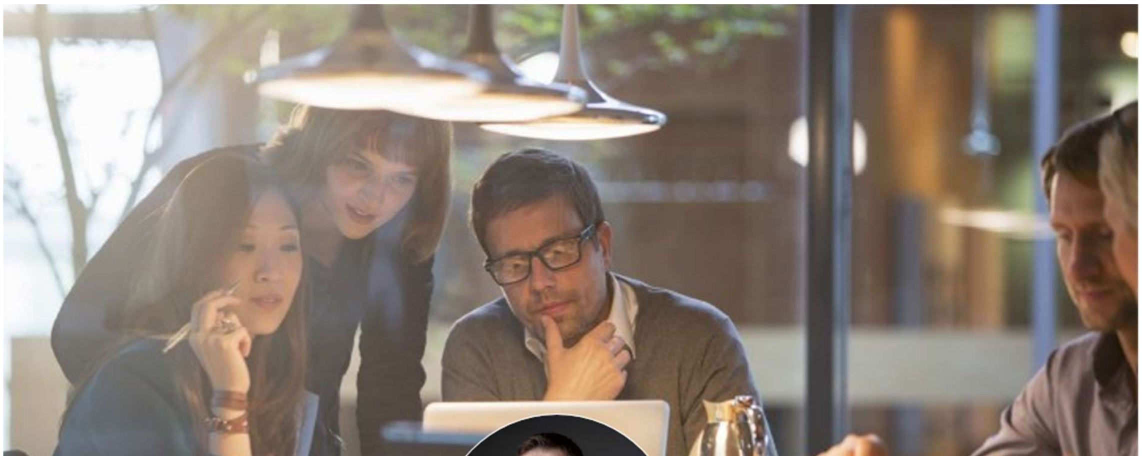
# FOCUS FIXED INCOME

January 2020



**Edouard Desbonnets**
Investment Advisor, Fixed Income

**IN A WORD:**

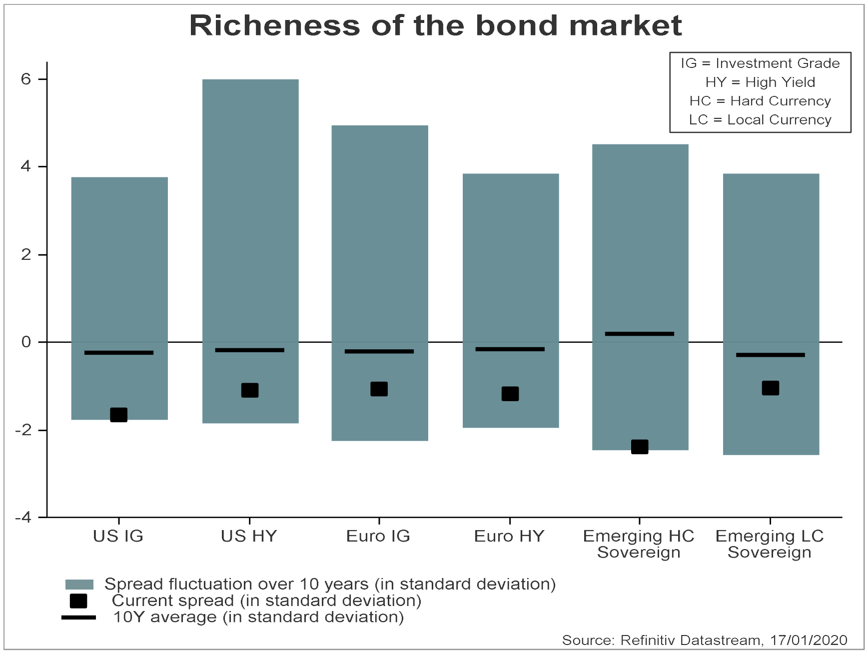
2019 was marked by a reversal of monetary policy on the part of the main central banks, with rate cuts and the return of bond buying programmes. 2020 should be the year of the rate pause for the Fed and the ECB.

Bond yields are expected to tighten slightly in the US by the end of the year, and remain relatively stable from current levels in Germany. We forecast 2% and -0.25% respectively for 10 year yields. Debt supply dynamics and the ECB's bond buying programme are downward pressure on eurozone yields.

We maintain our preference for short dated US sovereign bonds, euro and US dollar Investment Grade credit, eurozone convertibles, emerging market sovereign bonds in local currency and emerging market corporate bonds denominated in hard currency.

**Chart of the month: The high price of the bond market**

Bonds are expensive by historical standards, particularly US Investment Grade and emerging market sovereign bonds denominated in hard currency.




**Central banks: On pause**

2019 was marked by a reversal in monetary policy on the part of the major central banks, with rate cuts (131 rate cuts vs. 21 rate increases worldwide!), and the return of bond buying programmes (Quantitative Easing). 2020 should be the year of the rate pause.

- **US Federal Reserve**
    - Leading indicators of activity are holding up, domestic consumption is doing well and the job market is strong. The Fed is likely to keep rates unchanged in 2020, an election year, despite political pressures (Trump is constantly calling for rate cuts) and markets (one rate cut is expected).
    - To watch: Manufacturing and business investment, which are the two weak spots in the US economy.

- **European Central Bank**
    - The eurozone is showing signs of economic recovery and inflation is expected to remain below the 2% target.
    - Several of the governing council's heavyweights are opposed to more easing measures. More negative rates could prove counterproductive.
    - The ECB is expected to maintain its rates in 2020: 0% for the main rate and -0.50% for the deposit rate.
    - To watch: Core inflation.

**Bond yield targets**

- The decline in geopolitical risk (signing of the Phase 1 trade agreement between China and the United States, a move away from the prospect of the United Kingdom leaving the European Union without an agreement) lowers the risk premium.
- We are adjusting our 12-month yield targets upwards, by around 25 basis points, in Germany and the US.
- The central bank bond buying programme, the abundance of liquidity ready to be invested and the relatively low level of net supply of eurozone sovereign bonds this year, are downwards pressure on bond yields.

| Bond yields | Maturity (years) | 15/01/2020 | 12-month targets |
|---|---|---|---|
| US | 2 | 1.57 | 1.50 |
| | 5 | 1.63 | 1.75 |
| | 10 | 1.82 | 2.00 |
| | 30 | 2.28 | 2.50 |
| Germany | 2 | -0.60 | -0.50 |
| | 5 | -0.51 | -0.40 |
| | 10 | -0.20 | -0.25 |
| | 30 | 0.31 | 0.00 |
| UK | 2 | 0.53 | 0.80 |
| | 5 | 0.56 | 0.85 |
| | 10 | 0.77 | 1.20 |
| | 30 | 1.26 | 1.65 |

Sources: Refinitiv Datastream, BNP Paribas WM

**Euro area credit view**

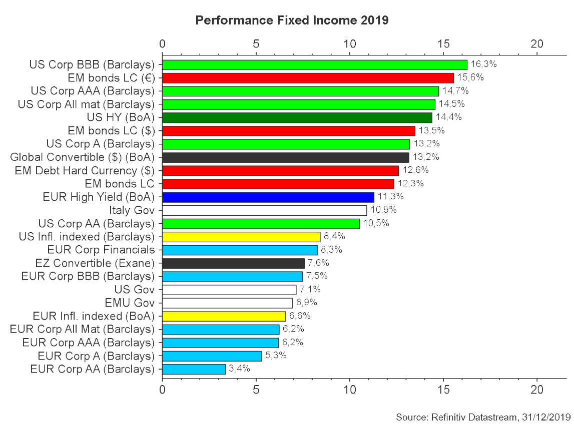
- Improving economy allows companies to improve their financial ratios.
- The ECB buys corporate bonds irrespective of price.
- Low interest rate monetary policy limits the risk of default.
- Valuations are high, but are likely to remain so.
- Expected returns for 2020 are expected to be limited, but positive.

## Our views

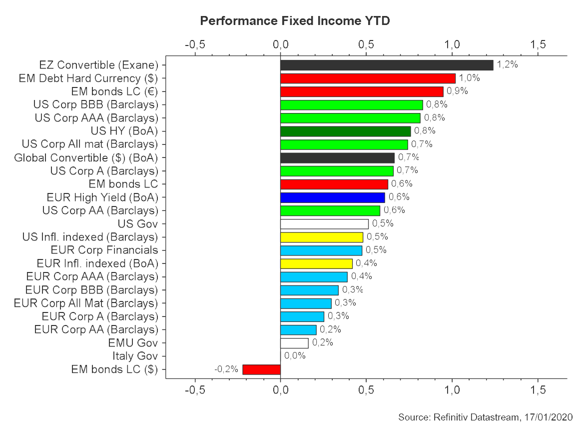
| | | |
|---|---|---|
| GOVIES | -/= | • We are negative on German govies, whatever the maturity, and on long-term US govies.<br>• We are positive on the front-end of the US yield curve for USD-based investors as short-term yields have a limited upside.<br>• We stay neutral on the periphery debt (Portugal, Italy, Spain). |
| INVESTMENT GRADE | + | • We prefer corporate bonds over government bonds.<br>• We like EUR and US IG bonds with duration below benchmark, with focus on quality credits.<br>• We are neutral on eurozone convertible bonds. |
| HIGH YIELD | = | • We are neutral on both US and eurozone High Yield. |
| EMERGING | +/= | • We are positive on EM sovereign debt in local currency and corporate debt in hard currency. We are neutral on EM government debt in hard currency. |

## Fixed Income returns

### Strong performance in 2019!




### Since 31 December 2019

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**Florent BRONES**
Chief Investment Officer

### Asia

**Prashant BHAYANI**
Chief Investment Officer, Asia

**Grace TAM**
Chief Investment Advisor, Asia

### Belgium

**Philippe GIJSELS**
Chief Investment Advisor

**Xavier TIMMERMANS**
Senior Investment Strategy, PRB

**Alain GERARD**
Senior Investment Advisor, Equities

**Pol TANSENS**
Head of Real Estate Strategy

### Luxembourg

**Guy ERTZ**
Chief Investment Advisor

**Edouard DESBONNETS**
Investment Advisor, Fixed Income

### Switzerland

**Roger KELLER**
Chief Investment Officer