

FIXED INCOME STRATEGY WEEKLY

WEEKLY ANALYSIS 24 APRIL /// #13-2017

Document intended for professional clients

Relief rally in Sovereign spreads

Key Points

- Risk asset rally after round 1 in French elections
- Shutdown risk in the US
- US GDP growth likely to soften in 1Q17
- Sell Bunds, overweight France, Spain
- Stability in credit spreads, tighter spreads in high yield and covered bond space

The outcome of the first round of the French Presidential elections, in line with the latest batch of polls, has ignited a relief rally in risk asset markets at Monday's market opening. European equity markets were up 4% early on this week. OAT spreads decreased to 50bps. Italian BTPs with 10-year maturities are now trading about 185bps despite Fitch's one-notch rating cut from 210bps in early April. The German Bund is trading near 0.35% against less than 0.20% a week earlier. The euro rebounded to \$1.085.

The yield on T-notes increased to 2.30%. Shutdown risk keeps demand for US Treasury bonds, which is the reason for continued flattening pressure.

Investment grade credit in the euro area has been remarkably stable at average spread of 120bps over Bunds. Covered bonds and agency debt securities benefit from the narrowing in sovereign spreads. High yield is supported by lower risk aversion. ITraxx crossover is now trading about 270bps.

Emerging market debt spreads appear less sensitive to however sharp changes in US and euro benchmark yields. Emerging debt spreads still hover about 315bps against USTs. In currency space, the euro is up strongly and the yen erased part of the flight-to-quality premium built in the past few weeks.

United States: modest growth in 1Q17 despite some encouraging developments

The first GDP print will be about 1%qoqa in the three months to March. In keeping with incoming data, the Atlanta Fed's Nowcast estimate predicts 0.5%qoqa growth. The New York Fed estimate stands at 2.6%qoqa whilst the cyclical indicator produced by the Chicago Fed looks consistent with trend growth (2%). Discrepancies reflect different assumptions for stock-building contribution. That being said, household consumption stalled after several quarters of growth exceeding that of income. The savings rate increased to 5.6% in February. Durable consumption likely contracted by about 1%qoqa in 1Q17. The decline in service spending (-0.1% in both January and February) appears dubious given continued employment gains and strength in service surveys. Nonetheless, the advance private consumption growth print will come in anywhere between 0.5 and 1%qoqa.

Corporate investment is picking up. Equipment expenditure and intellectual property spending (including patents, R&D) show solid growth. Residential investment has probably grown by more than 10%qoqa in the first quarter. Slower consumer spending may cut into the trade deficit. Net trade contribution to growth could be about 0pp in the January-March period. Fiscal slippage seen at the federal deficit level could signal upside surprise on public demand.

In sum, without fiscal stimulus, the situation of full employment will act as a constraint on growth. In all likelihood, US growth will come in below potential this year. Furthermore, the credit cycle that started in 2012 raises the risk of a financial crisis, hence the need to tighten monetary conditions.

Stable growth conditions in the euro area

Growth in the euro area will stay about 0.5%qoqa in the first quarter. Economic indicators should stay well oriented. For instance Germany's IFO survey stands fully 12pp above its long-term average in April. The

ECB will meet this week. According to recent comments by ECB officials, low inflation rate justifies holding on to a very accommodative monetary stance. The increase in headline prices was 1.5%yoy last month with the core rate at just 0.7%yoy in March. Mario Draghi should comment on the quarterly bank lending survey at a time when credit flows to the non-financial corporate sector no longer accelerate.

Sell Bunds, raise exposure to long on US Treasuries

The euro bond market reversed course on Monday opening after first round results of the French elections were released. Bund yields trade near 0.35%, some 10bps above Friday's close. The rebound in the euro-dollar exchange-rate to 1.085\$ may reduce SNB intervention in German debt markets. Valuations remain unattractive. On our estimates, current equilibrium value stands at 0.52%. On technical grounds, the upper bound of the current trading range observed in the apst few months is indeed 0.50%. If markets manage to keep trading above 0.33%, the most likely scenario is for higher yields. We recommend selling Bunds. Curve spreads barely budged last week. Indeed, 2s10s spread are unchanged at 105bps. We think nevertheless that Bundesbank maturity choices contribute to ongoing steepening pressure with a target of 115bps. Conversely, we cut our steepening exposure back to neutral on 10s30s spreads. The rate market correction has reduced swap spreads. We hold a neutral stance on a short-term horizon.

In the United States, shutdown risk linked to the appropriation bill vote exerts downward pressure on US bond yields. Elements of the budget bill (including Mexican border wall funding, cuts in on-military expenses) will be unacceptable to Democrats. Donald Trump could announce a tax reform sometime this week although its implementation may have to wait for the next fiscal year. Furthermore, modest growth and PCE deflator below 2% in

March will favor bond buying. The bearish consensus likely prevents a rapid rise to fair value, which we see at 2.75% on US 10-year yields. Lastly, we opt for a long bias on US T-notes, which should thus outperform Bunds.

Relief rally in sovereign space

The first round of the French Presidential elections can be characterized as market-friendly. OATs have richened vs. German Bunds as 10y spreads dipped back towards 50bps. The downtrend reverberated across euro area sovereign bond markets. Belgium spreads tightened less than that on other bonds due to rich valuations, in particular in intermediate 5-7y maturities. We are again overexposed to French bonds with maturities within 10 years. As concerns peripheral bonds, consensus derived from surveys show that final investors are neutral vs. core. Spain still entails the best risk-reward trade-off. Bonos with 2- to 10-year are thus recommended. Conversely, core spreads offer little value relative to safe-haven Bunds. The 7-10y maturity segment in Finland is one exception given the underlying improving economy and spreads close to 20bps.

Stability in credit, high yield outperform

Credit markets weathered volatility in rates stemming from political risk. The average spread on euro investment grade is near 120bps, just 3bps below year-end levels. The ECB continues to buy €1.8bn worth of non-bank corporate bonds per week. Conversely, we observe a reduction in ECB buying of covered bonds which weekly purchases averaged just 230mn€ in April. That being said, spreads have come in in both securitized debt and agency bonds. High yield bonds benefit from a risk-friendly environment early on this week.

CDS indices have narrowed in the wake of higher equity indices at market opening. However, valuations could limit the potential for further gains. European high yield is trading about 357bps above German Bunds, about 9bps below year-end levels.

Main Market Indicators

Government Bonds	24-Apr-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Bunds 2y	-0.69 %	+17	+5	+7
EUR Bunds 10y	0.33 %	+14	-7	+12
EUR Bunds 30y	1.07 %	+15	-8	+13
EUR Bunds 2s10s	102 bps	-2	-12	+5
USD Treasuries 2y	1.23 %	+2	-3	+4
USD Treasuries 10y	2.27 %	+2	-15	-18
USD Treasuries 30y	2.91 %	+0	-10	-15
USD Treasuries 2s10s	104 bps	-1	-12	-22
GBP Gilt 10y	1.05 %	+1	-15	-19
JPY JGB 10y	0.02 %	+1	-4	-2
€ Sovereign Spreads (10y)	24-Apr-17	-1wk (bps)	-1m (bps)	Ytd (bps)
France	50 bps	-23	-8	+2
Belgium	45 bps	-12	-3	+12
Italy	185 bps	-28	+3	+24
Spain	128 bps	-24	-1	+10
Portugal	323 bps	-47	-50	-33
Inflation Break-evens (10y)	24-Apr-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR OATI	128 bps	-3	-6	+1
USD TIPS	188 bps	-1	-10	-9
GBP Gilt Index-Linked	313 bps	-14	-6	+11
Swap Spreads (10y)	24-Apr-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Swap Spread	44 bps	-5	+1	-2
USD Swap Spread	-3 bps	+1	-1	+8
EUR Credit Indices (BarCap)	24-Apr-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Corporate Credit OAS	120 bps	-1	+2	-3
EUR Financials OAS	133 bps	-2	+1	-6
EUR Agencies OAS	65 bps	-4	+3	+8
EUR Securitized - Covered OAS	62 bps	-4	+1	-5
EUR Pan-European High Yield OAS	357 bps	-9	+2	-22
Currencies	24-Apr-17	-1wk (%)	-1m (%)	Ytd (%)
EUR/USD	\$1.084	+1.71	+0.35	+3.03
GBP/USD	\$1.278	+1.53	+2.45	+3.55
USD/JPY	¥109.76	-1.13	+1.44	+6.56

Source: Bloomberg, Natixis Asset Management

Selected Market Views

Government Bonds	Market View
EUR Bunds 10y	-1
EUR Bunds 2s10s	+1
EUR Bunds 10s30s	=
USD Treasuries 10y	+1
USD Treasuries 2s10s	=
USD Treasuries 10s30s	+1
Cross-Currency Spreads	Market View
USD Treasuries - EUR Bunds (10y)	+1
USD Treasuries - EUR Bunds (2y)	=
€ Sovereign Spreads - All Maturities	Market View
France vs. German Bunds	+1
Netherlands vs. German Bunds	-1
Belgium vs. German Bunds	=
Spain vs. German Bunds	+1
Italy vs. German Bunds	=
Other Bond Markets	Market View
EUR Index-Linked Bonds (Breakeven View)	= / +1
EUR Corporate Credit	=
EUR Agencies (vs. Swap Curve)	-1
EUR Securitized - Covered (vs. Swap Curve)	+1
EUR Pan-European High Yield	= / +1

Positions on a scale of "-2" to "+2", "=" stands for neutral
+1 is long (-1 is short) spread or duration or steepening view
Source: Natixis Asset Management

Writing

axel.botte@am.natixis.com

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request.

In the E.U. (outside of the UK) This material is provided by NGAM S.A. or one of its branch offices listed below. NGAM S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of NGAM S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. **France:** NGAM Distribution (n.509 471 173 RCS Paris). Registered office: 21 quai d'Austerlitz, 75013 Paris. **Italy:** NGAM S.A., Succursale Italiana (Bank of Italy Register of Italian Asset Management Companies no 23458.3). Registered office: Via Larga, 2 - 20122, Milan, Italy. **Germany:** NGAM S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Im Trutz Frankfurt 55, Westend Carrée, 7. Floor, Frankfurt am Main 60322, Germany. **Netherlands:** NGAM, Nederlands filiaal (Registration number 50774670). Registered office: World Trade Center Amsterdam, Strawinskylaan 1259, D-Tower, Floor 12, 1077 XX Amsterdam, the Netherlands. **Sweden:** NGAM, Nordics Filial (Registration number 516405-9601 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 Str, Stockholm 111 35, Sweden. **Spain:** NGAM, Sucursal en España. Registered office: Torre Colon II - Plaza Colon, 2 - 28046 Madrid, Spain. **In Switzerland** This material is provided for information purposes only by NGAM, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich. **In the U.K.** This material is approved and provided by NGAM UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258). This material is intended to be communicated to and/or directed at persons (1) in the United Kingdom, and should not to be regarded as an offer to buy or sell, or the solicitation of any offer to buy or sell securities in any other jurisdiction than the United Kingdom; and (2) who are authorised under the Financial Services and Markets Act 2000 (FSMA 2000); or are high net worth businesses with called up share capital or net assets of at least £5 million or in the case of a trust assets of at least £10 million; or any other person to whom the material may otherwise lawfully be distributed in accordance with the FSMA 2000 (Financial Promotion) Order 2005 or the FSMA 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "Intended Recipients"). To the extent that this material is issued by NGAM UK Limited, the fund, services or opinions referred to in this material are only available to the Intended Recipients and this material must not be relied nor acted upon by any other persons. Registered Office: NGAM UK Limited, One Carter Lane, London, EC4V 5ER. **In the DIFC** This material is provided in and from the DIFC financial district by NGAM Middle East, a branch of NGAM UK Limited, which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients as defined by the DFSA. Registered office: Office 603 - Level 6, Currency House Tower 2, PO Box 118257, DIFC, Dubai, United Arab Emirates. **In Japan** This material is provided by Natixis Asset Management Japan Co., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 2-2-3 Uchisaiwaicho, Chiyoda-ku, Tokyo. **In Taiwan** This material is provided by NGAM Securities Investment Consulting Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 16F-1, No. 76, Section 2, Tun Hwa South Road, Taipei, Taiwan, Da-An District, 106 (Ruentex Financial Building I), R.O.C., license number 2012 FSC SICE No. 039, Tel. +886 2 2784 5777. **In Singapore** This material is provided by NGAM Singapore (name registration no. 53102724D) to distributors and institutional investors for informational purposes only. NGAM Singapore is a division of Natixis Asset Management Asia Limited (company registration no. 199801044D). Registered address of NGAM Singapore: 10 Collyer Quay, #14-07/08 Ocean Financial Centre, Singapore 049315. **In Hong Kong** This material is issued by NGAM Hong Kong Limited. **In Australia** This document is issued by NGAM Australia Pty Limited (NGAM Aust) (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only. **In New Zealand** This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. NGAM Australia Pty Limited is not a registered financial service provider in New Zealand. **In Latin America** This material is provided by NGAM S.A. **In Chile** Esta oferta privada se acoge a la Norma de Carácter General N°336 de la SVS de Chile. **In Uruguay** This material is provided by NGAM Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Registered office: WTC - Luis Alberto de Herrera 1248, Torre 3, Piso 4, Oficina 474, Montevideo, Uruguay, CP 11300. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. **In Colombia** This material is provided by NGAM S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors. **In Mexico** This material is provided by NGAM Mexico, S. de R.L. de C.V., which is not a regulated financial entity with the Comisión Nacional Bancaria y de Valores or any other Mexican authority. This material should not be considered an offer of securities or investment advice or any regulated financial activity. Any products, services or investments referred to herein are rendered exclusively outside of Mexico.

The above referenced entities are business development units of Natixis Global Asset Management, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Global Asset Management conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of services. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. Past performance information presented is not indicative of future performance.

Although Natixis Global Asset Management believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.