

FIXED INCOME STRATEGY WEEKLY

WEEKLY ANALYSIS 17 JULY /// #25-2017

Document intended for professional clients

Easing yields benefit risk asset markets

Key Points

- **Yellen's address before Congress unsurprising**
- **Note yields easing towards 2.30%**
- **ECB to postpone policy adjustment to September**
- **Neutrality warranted in rate markets**
- **OAT, Bonos outperform in sovereign space**

Janet Yellen's speech before Congress points to little changes as concerns the course of monetary policy in the months ahead. Unsurprisingly, US yields eased and volatility fell further last week. The yield on US 10-year Treasury bonds has reverted to 2.30% amid curve flattening. In the euro area, investors have bought back Bunds. The new benchmark is trading below the 0.60% mark. Sovereign spreads have moved tighter. France's OATs and Spain's Bonos have seen spreads narrow to the tune of 11bps and 9bps respectively.

Corporate bonds keep rallying. IG spreads hover about 95bps over German Bunds. The market is however less supportive of speculative-grade bonds, where spreads are 8bps wider compared with a month ago. That said, the iTraxx Crossover index did rebound in the wake of stronger equity markets and lower bond yields. In emerging bond markets, sovereign spreads in US dollars narrowed within 310bps whilst local-currency bond yields followed US yield gyrations.

In parallel, the dollar has fallen across the board. The euro trades above \$1.14 with sterling atop \$1.30. Mexican peso and Brazilian real both gained 2.5% last week against the greenback.

ECB: rendezvous in September?

The ECB meeting is the main event this week. Disagreements within the governing council

are quite well known. Mario Draghi will aim at reaching consensus. Monetary adjustment appears inevitable but policy changes may not be announced before September 7. In this context, Thursday's meeting should not turn out to be a game-changer. Inflation, confirmed at 1.3%yoy, still argues for monetary accommodation. Underlying inflation is barely above 1%, hardly above the average since 2013 (0.9%yoy). That being said, the euro area economy is near a cyclical peak. Growth will be close to 2% this year. Furthermore, headline inflation including import prices may not be a reliable gauge of domestic price pressures. Unemployment is down in most euro area member states. The ECB's President will comment on the bank lending survey. In the first quarter, the survey indicated slowing firm demand for loans that seemed traceable to declining mergers and acquisitions activity. Conversely, credit demand from households linked to durable good spending and housing investment remains well oriented.

Uneventful Humphrey-Hawkins testimony

The unsurprising analysis offered by Chair Yellen contributed to stabilization in US bond yields and propelled equities and credit markets higher. Gradualism applied to both rate and balance sheet policies keeps volatility at a low level that benefits carry strategies.

The Fed President indicated that normalization would be a long process that could stretch until 2022. By then, the Fed's balance sheet could be about \$2.5T. Over time, the composition of the balance sheet would evolve towards a higher share of Treasury securities compared with mortgage-backed securities. The Fed is therefore committed to a long-term policy, which will be applied unless a major crisis occurs. Inflation below target (1.6% on CPI in June) will have to be ignored by Central Bankers, at least in the short run.

Neutrality warranted on rates

Risk-free yields have fallen in response to Janet Yellen's address before Congress and a downside surprise on the June CPI. The yield on US 10-year note has drifted lower to 2.30%. Technical levels consistent with the resumption of the upward trend on yields are about 2.40%. Without a break above 2.40%, the technical backdrop will be consistent with a neutral stance. Weekly economic releases should only confirm the benign growth environment (near 2% potential) although there is no catalyst for acceleration upwards towards fair value of 2.70% on US 10-year note yields. Neutrality is recommended in US bond markets.

In the euro area, the German debt agency issued a new 10-year benchmark bond. The security trades below 0.60% at present. This week, the ECB will only postpone policy decisions to the next meeting in September. A volatility spurt is therefore unlikely. We see fair value at 0.70% on 10-year German Bunds. In addition, the T-note-Bund spread is relatively stable, although carry does favor US bonds. The euro 10s30s spread, which has tightened since early June, may narrow further. The €1bn sale of 30-year German debt is likely to be met with large demand given its relatively small size and the recent pickup in bond yields. Indeed, 30-year yields above 1.30% have not been observed in 2017 ahead of a long bond auction. However, we hold no positions in 2s10s. In turn, swap spreads seem correctly valued.

Gilts may react to inflation data to be released this week. The RPI index, which serves as reference to inflation-linked bonds issued by the UK government, may accelerate further past 3.7%yoy in June. The BoC followed the Fed on its tightening path by raising rates by a quarter percentage point. The BoE could well decide to hike rates by 25bps in August in an effort to rebalance the economy and reduce foreign imbalances. We hold a neutral stance.

OATs and Bonos outperform

In sovereign markets, the trend is still favorable. Final investor flows in the asset class have nevertheless slowed over the past few weeks. French and Spanish spreads have tightened. Ten-year OATs now evolve within 30bps of the new 10-year Bund benchmark. Japanese lifers have started to make a comeback in OAT markets. In Spain, asset managers and asset-liability management accounts are bidding up Bonos prices. That said, cash bond markets remain highly illiquid in contrast with rather high volumes in futures markets in recent trading sessions.

As concerns strategies, we hold on to our constructive stance on Spain and Portugal. French debt remains more attractive than Belgian OLOs. However, there is little value in core markets (Netherlands, Finland), outside of certain maturities (2023-2024).

Credit in high demand

Credit keeps benefitting from the slow adjustment of monetary policy. Credit spreads have dipped under the 100bp mark vs. Bunds in euro investment grade markets. Institutional accounts and asset allocators keep pouring into investment grade corporate debt despite good competition from BBB sovereign debt.

High yield markets are still trading heavy due to rich valuations presumably. The average spread on euro high yield issuers is less than 300bps. This highlights the absence of true yield premium over likely default compensation. The iTraxx Crossover index did rally in the wake of higher equity markets. The index is below 250bps.

In parallel, emerging debt fared well as US yields drifted lower. The EMBI spread is within 310bps. The premium on Brazil's debt securities shrank noticeably to less than 270bps in USD-denominated exchanges.

Main Market Indicators

Government Bonds	17-Jul-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Bunds 2y	-0.62 %	-1	+4	+14
EUR Bunds 10y	0.58 %	+4	+31	+37
EUR Bunds 30y	1.32 %	-2	+21	+37
EUR Bunds 2s10s	120 bps	+6	+27	+23
USD Treasuries 2y	1.36 %	-2	+4	+17
USD Treasuries 10y	2.31 %	-6	+16	-13
USD Treasuries 30y	2.9 %	-3	+12	-17
USD Treasuries 2s10s	95 bps	-4	+12	-30
GBP Gilt 10y	1.27 %	+0	+25	+3
JPY JGB 10y	0.08 %	-1	+3	+4
€ Sovereign Spreads (10y)	17-Jul-17	-1wk (bps)	-1m (bps)	Ytd (bps)
France	26 bps	-11	-9	-21
Belgium	28 bps	-9	-6	-5
Italy	166 bps	-8	-5	+5
Spain	101 bps	-12	-17	-17
Portugal	252 bps	-7	-12	-104
Inflation Break-evens (10y)	17-Jul-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR OATI	116 bps	-2	+9	-10
USD TIPS	177 bps	+4	+9	-20
GBP Gilt Index-Linked	295 bps	-7	+2	-7
Swap Spreads (10y)	17-Jul-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Swap Spread	37 bps	-5	-11	-9
USD Swap Spread	-6 bps	-2	-4	+5
EUR Credit Indices (BarCap)	17-Jul-17	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Corporate Credit OAS	95 bps	-3	-14	-28
EUR Financials OAS	103 bps	-2	-15	-36
EUR Agencies OAS	45 bps	+0	-2	-12
EUR Securitized - Covered OAS	47 bps	0	-6	-20
EUR Pan-European High Yield OAS	296 bps	-3	+8	-83
Currencies	17-Jul-17	-1wk (%)	-1m (%)	Ytd (%)
EUR/USD	\$1.148	+0.34	+2.86	+9.14
GBP/USD	\$1.306	+1.65	+2.48	+5.83
USD/JPY	¥112.66	+1.15	-1.1	+3.82

Source: Bloomberg, Natixis Asset Management

Selected Market Views

Government Bonds	Market View
EUR Bunds 10y	=
EUR Bunds 2s10s	=
EUR Bunds 10s30s	-1
USD Treasuries 10y	=
USD Treasuries 2s10s	=
USD Treasuries 10s30s	=
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	=
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)	=
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.