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Global Fixed Income Perspective

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Simon Warner, Head of Global Fixed Income, offers his global view of Fixed Income markets, and insights into AMP Capital's portfolio positioning. Simon brings more than 19 years' investment experience together with a wealth of knowledge in macro markets, credit markets, commercial lending and protected growth.

Portfolio strategy and outlook

It's been an interesting year. On occasion it has felt that it would have been useful to be a Doctor on everything From Russia to Gold. Events have hit markets like a Thunderball on occasion, challenging investors to ensure that their portfolios weather the volatility and to Live Twice.

There is no Secret to providing great Service to clients. It's about Forever having their best interests at heart and being transparent about our research process and the reasons for the positions in the portfolios that we manage. At AMP Capital we Live to serve our clients and I will not Let that sentiment Die. Every woman and Man in the team is working to that goal, With the knowledge that no one has the Golden rule of investing. All we can do is Spy into the data, Love the challenge of delivering outstanding investment performance and be over the Moon when we achieve that.

China has been the big story all year, and transparency of data there is lower than in some other economies. It can sometimes feel that the true picture is For others Eyes Only and pinning down a true picture is like herding eight cats. We have worked hard to get A View to the true state of the economy by locating portfolio managers into Asia and drawing upon the expertise from across the firm. There was a period when equity markets scared the Living Daylights but the mid-year volatility gave Chinese policy makers a License to boost the economy and we expect the data to be more stable into year-end. This lower downside China risk, coupled with better valuations could herald a Golden few months for credit markets. We hedged almost all of our credit risk around the middle of the year but have now lifted all those hedges. Liquidity risks are higher in the credit market for a variety of reasons but we see better risk-adjusted returns for investors into year-end.

The steady slowdown in China continues to be a headwind for Australia. The mining investment boom is about halfway through and we think that the economy will need more policy support in coming quarters. However, the uptick in business confidence means that easing will probably not be Tomorrow. The World's growth rate is Not big Enough to see the economy through its adjustment without more support. That said, we think that the inevitable Reserve Bank of Australia (RBA) easing story is probably one for Another Day in 2016. The odds of more cuts in November/December versus early 2016 are not better than those in a Casino, it's a close call. Australia can at least derive a Quantum of Solace that the Sky is not about to Fall because there is room for policy to be more supportive and for the currency to fall further and smooth the economic adjustment.

Some have raised the Spectre of a recession in Australia. We have been long Australian duration on a slow economy view for the last few months but the news is not all bad. Jobs growth is good enough to keep unemployment stable and there are pockets of strength in industries like tourism and education. Almost 50 basis points of rate cuts from the RBA are already priced in over the next year so we have taken some profit on long duration positions.

In summary, we have a greater pro-risk position now than any time since May. We are longer credit and less long duration. In many respects we are maximising yield with a belief that there is a lot of bad news priced in.

Movie of the month? Bond of course. All 24 of them. And then the 25th early next month!

Macroeconomic review

In September US data suggested that the economy continues to strengthen. During the month the US Federal Reserve (Fed) upgraded its 2015 real gross domestic product growth forecast but lowered its forecast for 2016. The central bank assessed that current "economic activity is expanding at a moderate pace", and noted that there have been "solid job gains" but that "net exports have been soft". The Fed ended up keeping interest rates steady at its September's meeting, primarily due to concerns about the global economy. Fed chair Dr Janet Yellen commented that the central bank's focus "has been on risks around China… Emerging markets more generally and how they may spill over to the US". Dr Yellen also indicated during the month that the policy interest rate would rise "sometime this year" with the intention to "continue boosting short-term rates at a gradual pace".

In the Eurozone, data was stable. The Eurozone Markit purchasing managers' index slipped back slightly in September, but remained consistent with European economic growth running at a steady annual pace. However, there remained a divergence in performance in core Europe. The European Central Bank (ECB) kept the key policy rate steady at 0.05% at September's meeting and maintained its quantitative easing asset purchase program at €60 billion per month. ECB President Mario Draghi hinted that the asset purchase program could be expanded and extended beyond September 2016. During the month Greece's national elections saw the victory of the Syriza party. This was well received by markets given the party's commitment to implement the terms of Greece's bailout program.

Chinese data released over the month continued to disappoint. The September flash reading of the Caixin/Markit China manufacturing purchasing managers' index dropped further to a 78-month low. Caixin chief economist Dr. He Fan noted that "the decline indicates the nation's manufacturing industry has reached a crucial stage in the structural transformation process". Business surveys for August were also broadly weaker due to deteriorating global trade. However, there are some signs that Q3 2015 may be the weak point with the improving property market and lagged effects of policy easing likely to show through into a mildly stronger Q4 2015.

Australian economic data released in September was mixed. Economic growth remained soft in Q2 2015 with the slump in mining investment and weak exports weighing heavily on activity. The ANZ Roy Morgan measure of consumer confidence showed a remarkable surge the week ended 20 September. The ANZ commentary indicated that the leadership spill mid-month which resulted in Malcolm Turnbull deposing Tony Abbott as Prime Minister of Australia was likely the driver of the bounce. The RBA held the official cash interest rate steady at 2.00% and conceded that Australia's economy is growing "somewhat below its longer-term average". However, the RBA of Australia Governor's statement provided no specific forward guidance, thereby suggesting no immediate prospect for another interest rate cut.

Markets review

Global government bond yields were largely stable in the first half of September and moved broadly sideways in a fairly tight range. However, following the dovish surprise at the September Federal Open Market Committee meeting, bond yields reasserted their downtrend, finishing the month 10-20 basis points lower than at the beginning of the month.

Australian bond yields followed their global counterparts and displayed a similar dynamic over the month. The three-year / 10-year yield curve continued to trade in a 10 basis point range.

Credit and equity markets weakened sharply in September due to increased volatility, weakening global macroeconomic data and further uncertainty regarding China and emerging markets. The broad-based rising idiosyncratic risks across a number of industries were also notable. Liquidity was constrained over the month due to weakened technical conditions.

Concerns regarding growth in China remained a key headline over the month, with Chinese economic data released over the month continuing to disappoint. Anticipated action by the Fed was also a major focus.

The Global Fixed Income team's blended credit spread, a barometer which measures global physical credit spread movements, was 18 basis points wider over the month. The Australian component outperformed its European equivalent, despite the China-related weakness during the month. Global high yield spreads were about 80 basis points wider.