



In fixed income, security selection will drive outperformance

December 15, 2020

2021 fixed-income outlook: Income will continue to be scarce, but there are strategies for finding success in the new year.

Look for income in credit products. Yields on safe-haven debt — like U.S. Treasuries — are near zero, which means that “low-risk” portfolios are increasingly susceptible to price volatility that’s driven by interest rates. Investors should consider balancing their interest rate exposures by focusing on more credit-centric areas of the bond market. The Fed’s accommodative stance will probably persist for a while, preventing yields from rising in a substantial way. A stable monetary policy environment, coupled with the prospect of continued economic growth, supports a mostly positive outlook for credit assets.

Global Perspectives 2021

The upcoming year is all about moving forward and making progress toward long-term goals. With a vaccine for COVID-19, 2021 holds the promise of a return to a more familiar world. **What will it take for investors to succeed in this environment?**

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Remain flexible and diversified. In 2020, bond prices in several sectors recovered 20% or more following a significant rally from their March lows, and risk compensation is now below long-term averages across most fixed-income sectors. No single sector stands out as obviously cheap to us, which suggests that a diversified approach to sector allocation may yield better risk-adjusted results than a narrower focus. There’s an opportunity to diversify credit risk across corporate, consumer and sovereign balance sheets — all experienced fundamental improvement since the depths of the recent crisis. It’s important for investors to remain flexible and prepared to rebalance if and when relative value changes. Staying nimble will likely be a key factor to enhance returns in 2021.

Expect informed security selection to be a key driver of outperformance. Our base case is that the economy continues to recover through 2021, though with a greater gap between the winners and losers. More than ever, it will be important to focus on security selection to avoid downside scenarios that can impair income and total return opportunities. Good credit research that identifies which trends are most likely here to stay — especially trends that result in permanently reduced demand — is an indispensable tool in today’s lower return world.



Gene Tannuzzo, CFA
Global Head of Fixed Income

► **There are three ways to seek outperformance in fixed income**

In 2021, we think that credit selection will lead the way



Managing the impact of interest rates



Underweighting or overweighting certain sectors within fixed income



Picking the specific bonds that have the greatest likelihood of outperforming

DISCLOSURES:

Diversification and asset allocation do not assure a profit or protect against loss. There are risks associated with fixed-income investments, including credit risk, interest rate risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer term securities.



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