Fixed-income market update

Gene Tannuzzo, CFA, Deputy Global Head of Fixed Income

Hi, I'm Gene Tannuzzo, Deputy Head of Fixed Income with Columbia Threadneedle Investments. I wanted to take a minute to give you an overview on our view of fixed income markets following a very volatile start to the year, given the Covid pandemic.

In the first quarter of the year we saw tremendous volatility as economies globally ground to a halt for shelter-in-place policies in response to the growing pandemic. But equal to the economic malaise that we've seen is a growing central bank response that has included a tremendous amount of asset purchases in addition to incredibly low interest rates once again. Now, following this incredible response from central banks we've also seen a meaningful fiscal response from governments pumping stimulus into economies. Now we have to constantly take these two pieces together to think about the size of the response relative to the size of the problem. For example, in the United States alone we saw 22 million jobs lost from February through April. In the last two months of May and June we've seen seven and a half million jobs added back. On its own, that's great progress but it's not enough to fill the hole that we that we find ourselves in.

When we look at the policy response we once again see ourselves in a period of low interest rates, and the Federal Reserve has committed itself to keeping interest rates low. Now in Europe, this is not a new thing. Interest rates have been below one percent on 10-year German government bonds for over five years. In the U.S. interest rates only dipped below one percent earlier this year, but they're very likely to stay there, in our view, for an extended period of time.

So the question becomes what does a bond investor do in this environment to generate income. For us, the first place to look are the credit markets, particularly the corporate bond markets. We think the most attractive risk adjusted return resides in the investment grade corporate market -- because for one, these companies tend to have better liquidity conditions, access to capital and the ability to weather this financial storm. In addition, the central bank in the United States, the Federal Reserve, in addition to the European central bank and the Bank of England, are all purchasing corporate bonds as part of their monetary policy support. So this additional central bank support provides an extra leg to the stool supporting the investment grade corporate market.

As we look in the high yield market, I think it's a slightly more complicated answer. The economic shutdown has put a lot of pressure on companies, particularly highly levered companies like we find in the high-yield bond market. It's our expectation that defaults will continue to rise this year, and we forecast about an eight and a half percent default rate in the high-yield market in 2020 followed by approximately another five percent of companies defaulting in 2021. To us this means we need to be incredibly careful investing in the high-yield market. There are opportunities in select industries and select companies, but we wouldn't want to buy the broad market on a passive basis.

As we think about investing and adding income, we want to focus on credit research as our core capability. Another example of that would be the structured products market. We find several examples of opportunity throughout structured products. One would be the commercial mortgage-backed securities market. We can imagine places like shopping malls and hotels are in a world of hurt given the lack of traffic in those facilities. However, if we can find opportunities to buy well capitalized assets in good capital structures, there can be tremendous opportunities to add attractive income to portfolios.

Those are just a couple of examples of places we're finding opportunity today. And we think as economies continue to improve we'll see not only income but the potential for price appreciation as well. Thank you very much.

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