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Global Fixed Income

2020 Outlook: Investment Grade Fixed Income, part 2

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Boston - Our outlook is for increased caution. We see a lot of risks in markets, both late cycle and geopolitical. While we may gain more clarity about Brexit and China, 2020 has new risks such as the US presidential election.

Our concern is that markets are too confident in the ability of global central banks to insulate the economy from these risks, and valuations are not reflecting those risks.

Cautious positioning

Given our cautious outlook, we are positioning our portfolios to increase credit quality, moving shorter in duration[1] and increasing liquidity.

We believe that the US consumer balance sheet is very strong, and we prefer to have most of our credit exposure there. US corporate balance sheets, on the other hand, are more vulnerable to late-cycle risks given some of the leverage that they have taken on. So we are much more selective in the corporate credit market.

We continue to prefer a slight underweight stance to duration. Our view is that investors are not being compensated to take long duration positions, given where valuations are.

Positive inflation outlook

We believe that the inflation outlook is quite positive, and it's not being priced correctly by markets. In our view, inflation assets offer very good relative value, as several structural components of inflation have been rising. We also think that the easing by the US Federal Reserve (Fed) in the second half of 2019 should continue to support inflation.

So we continue to favor inflation-linked sectors, such as TIPS,[2] and we prefer to position our portfolios for a steeper yield curve.

Bottom line: We believe that active management in fixed income is well positioned to outperform passive — especially over the next 12 months. There are a lot of downside risks in our outlook, and we believe that active managers should be better set up to manage that downside risk than a passive index.

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[1] Duration measures in years the sensitivity of the price of a bond to a change in interest rates; the higher the duration, the more a bond's price will drop as interest rates rise and the greater the interest rate risk.

[2] Treasury Inflation-Protected Securities (TIPS) are Treasury bonds that are indexed to inflation to help protect investors from the negative effects of rising prices.

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