NOMURA

Fixed Income
Market Outlook and Portfolio Positioning

Outlook

Speaking to a client recently, I confidently predicted that fixed income and equity returns would be at least as strong in 2020 as they have been in 2019. It did not take her long to realise I was joking.

The year ahead may not be as spectacular but we still see many reasons for optimism. There is one key reason for this, and it is something that our entire fixed income team is united in believing: central banks have no choice other than to remain highly accommodative in 2020.

Our investors believe that you will see anaemic but positive growth from the US in particular in 2020. A key risk to that view would be a deterioration in global trade caused by increased tariffs. Although the US/China trade tensions appear to be less intense following the agreement on Phase 1 of the proposed deal, tensions could easily rise between the US and other global "partners" (or "rivals", depending on your politics), notably Europe.

Increasingly in Europe, the importance of economic stimulation through fiscal spending is recognised at the political level. The recently installed Head of the ECB, Christine Lagarde, has continued the rhetoric of her predecessor: monetary policy must not be the lone tool used to create economic stability and growth. However, fiscal stimulus in Europe is fraught with difficulty, hampered by both the politics of Germany (where fiscal discipline is greatly prized) and by the debt load of Italy in particular. We therefore expect the emergence of fiscal spending as a significant driver of growth in Europe to take years.

However, it may emerge in the UK rather more quickly. The UK Parliament now seems highly likely to vote through the Brexit deal agreed with the EU and the Conservative Government have vowed to raise public spending. This could lead to a steepening in yield curves, which would be negative for government bondholders but could lead to improved opportunities for banks to generate revenues. However, the road to an orderly Brexit will be long and the valuation applied to UK risk will be vulnerable to headlines.

Positioning

Nomura's Global Dynamic Bond Fund heads into 2020 positioned to benefit from a further recovery in UK and European financials and selected Emerging Markets. The Fund is highly flexible, and uses that flexibility to hold the deeply subordinated debt of banks and insurance companies. These bonds will benefit from steeper curves and the introduction of Basel 3 legislation that increases the likelihood of call dates being honoured. The Fund also holds significant risk positions in the sovereign debt of both Egypt (in hard currency) and Russia (in local currency).

Nomura's more traditional fixed income strategies hold positions in currencies and rates that reflect our positive view. Our portfolios are underweight duration, particularly in the long end of the US curve (yield steepening expectations once again), and the US dollar is held long against the Euro – monetary policy is expected to be more deeply accommodative in the Eurozone. Meanwhile, the Japanese Yen is overweighted across portfolios; not only is the Yen undervalued relative to fundamentals, but our position helps to balance portfolios from potential risk-off behaviour that could damage the duration position.

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