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QUARTERLY FIXED INCOME AND CURRENCY REVIEW AND OUTLOOK

MAY 2018

Part of BNY MELLON

SUMMARY

UK GOVERNMENT BONDS // 5

Andrew Wickham, Head of Global Rates and Deputy Head of Fixed Income (London)

- Potential rate hikes move further up the agenda
- Economic and inflation data soften in Q1
- Gilts likely to remain most volatile sovereign market in G4

EUROPEAN GOVERNMENT BONDS // 6

Gareth Colesmith, Senior Portfolio Manager, European Fixed Income

- Core yield curve flattens slightly
- Peripheral spreads narrow
- Italian hung parliament outcome unclear

US GOVERNMENT BONDS // 7

Isobel Lee, Head of Global Fixed Income Bonds

- Tax cuts are acting to underpin the growth outlook
- We continue to expect three further interest rate hikes over the year
- US trade policy could exert upward pressure on inflation if tariffs are enacted

GLOBAL INVESTMENT GRADE CREDIT // 8

Peter Bentley, Head of UK and Global Credit

- Credit spreads widen from post-financial crisis tights
- Risk market volatility pressures valuations
- Volatility likely to drive opportunities

US INVESTMENT GRADE CREDIT // 10

Jesse Fogarty, Senior Portfolio Manager

- Return of equity volatility leads to back up in credit spreads
- Geopolitical risks remain front and centre
- Stock and sector selection will be key

EMERGING MARKET DEBT // 11

Colm McDonagh, Head of Emerging Market Fixed Income

- Overall global backdrop remains supportive
- Idiosyncratic risks require increased differentiation and selectivity

SECURED LOANS // 13

Ranbir Singh Lakhpuri, Senior Portfolio Manager, Secured Finance

- Technical backdrop remains strong, even with elevated issuance levels
- Strong demand for asset class likely to remain
- Documentation needs careful analysis given issuer attempts to weaken covenants

HIGH YIELD // 14

Uli Gerhard, Senior Portfolio Manager, High Yield

- High yield volatility is back as markets react to outflows, new issue supply and rising government yields
- Long-term outlook remains positive on fundamental and technical basis
- Sterling market faces Brexit uncertainty

ASSET-BACKED SECURITIES // 15

Shaheer Guirguis, Head of Secured Finance

- Technical backdrop remains highly supportive
- ABS offer compelling strategic value given fundamental credit quality and security

CURRENCIES // 16

Paul Lambert, Head of Currency

- US dollar (USD) maintains weakening trend
- Mexican peso (MXN) rallies 8.1% versus USD
- Emerging market currencies likely to remain supported by global growth outlook

Given the BoE currently sees little to no slack in the economy, this gives them the bias to continue to tighten monetary policy.

ANDREW WICKHAM

BOE TO CONTINUE TO GRADUALLY TIGHTEN POLICY

Andrew Wickham
Head of Global Rates and Deputy Head of Fixed Income (London)

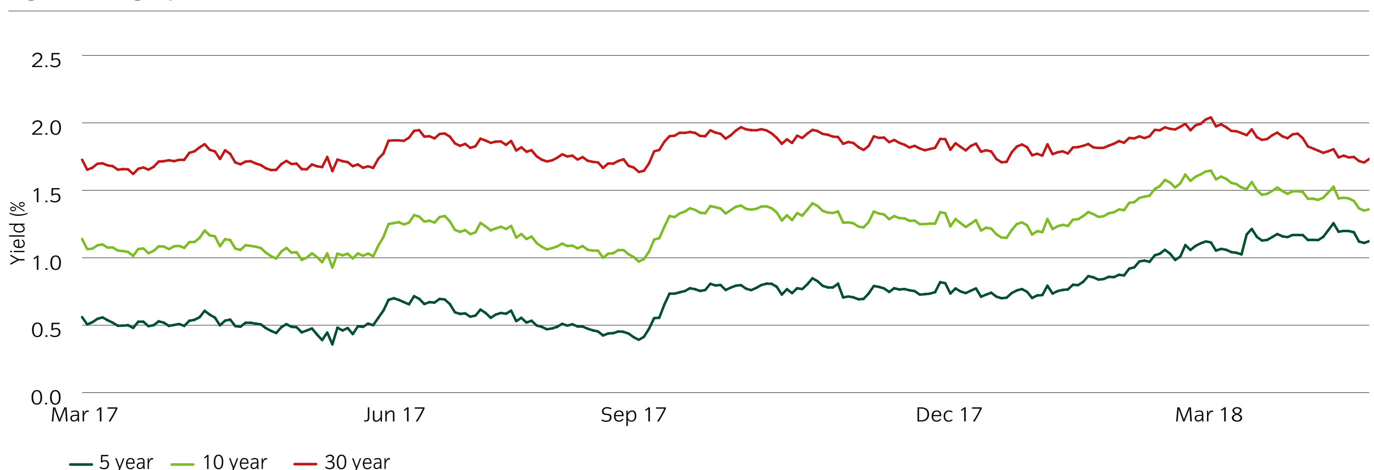
- Potential rate hikes move further up the agenda
- Economic and inflation data soften in Q1
- Gilts likely to remain most volatile sovereign market in G4

In its first meeting of 2018, the Bank of England (BoE) delivered a hawkish message. it is stated that "monetary policy would need to be tightened somewhat earlier and by a somewhat greater extent over the forecast period". In March, the central bank kept interest rates unchanged at 50bp as widely expected, however minutes from the meeting revealed that two members of the Monetary Policy Committee – Ian McCafferty and Michael Saunders – voted for a 25bp interest rate hike. These factors are increasing perceptions that the BoE will tighten policy in its May meeting. Minutes from the meeting also stated that the UK economy would suffer a "temporary" hit from the cold weather seen during the period, suggesting growth may slow to 0.3% in Q1, down from 0.4% in Q4 2017.

Inflation fell during the period – after holding steady in January, it moderated more than expected to 2.7% in February, largely due to an appreciation in sterling. Economic data releases were generally softer. UK manufacturing growth cooled in Q1 – March's IHS Markit/CIPS UK Manufacturing Purchasing Managers' Index came through at 55.1, suggesting that factory output rose at a quarterly rate of 0.4-0.5%. This is a slowdown from 1.3% in Q4 2017. A survey from the Confederation of British Industry also revealed that UK retail sales fell for the first time in five months in March. There was progress meanwhile on Brexit negotiations, with UK Secretary of State for Exiting the EU, David Davis, and EU Chief Negotiator Michel Barnier, announcing that both the UK and EU had agreed to a draft text for the UK's withdrawal. This text outlined the key principles agreed by both sides, including a transition period for the UK until the end of 2020.

Looking ahead, the BoE has forecast growth of 1.8% for this year and 2019, which is well below the UK's historical average but importantly above their current estimate of potential UK economic growth of 1.5%. Given the BoE currently sees little to no slack in the economy, this gives them the bias to continue to tighten monetary policy. Over Q1, 30-year yields fell 10bp, while 10-year yields rose 6bp. The key risk however continues to be the evolution of Brexit negotiations. We believe this will also continue to keep gilts as the most volatile sovereign market in the G4.

Figure 1: UK gilt yields



Source: Bloomberg, as at 3 April 2018.

ECB
NORMALISING POLICY

Gareth Colesmith
Senior Portfolio Manager,
European Fixed Income

- Core yield curve flattens slightly
- Peripheral spreads narrow
- Italian hung parliament outcome unclear

Economic data releases continued to strengthen in Europe. Notably, the eurozone manufacturing PMI and the German IFO confidence survey both strengthened to record levels. Although these measures cooled towards the end of the period, they remained firmly indicative of a continuing economic expansion. Inflation remained benign at 1.3% pa.

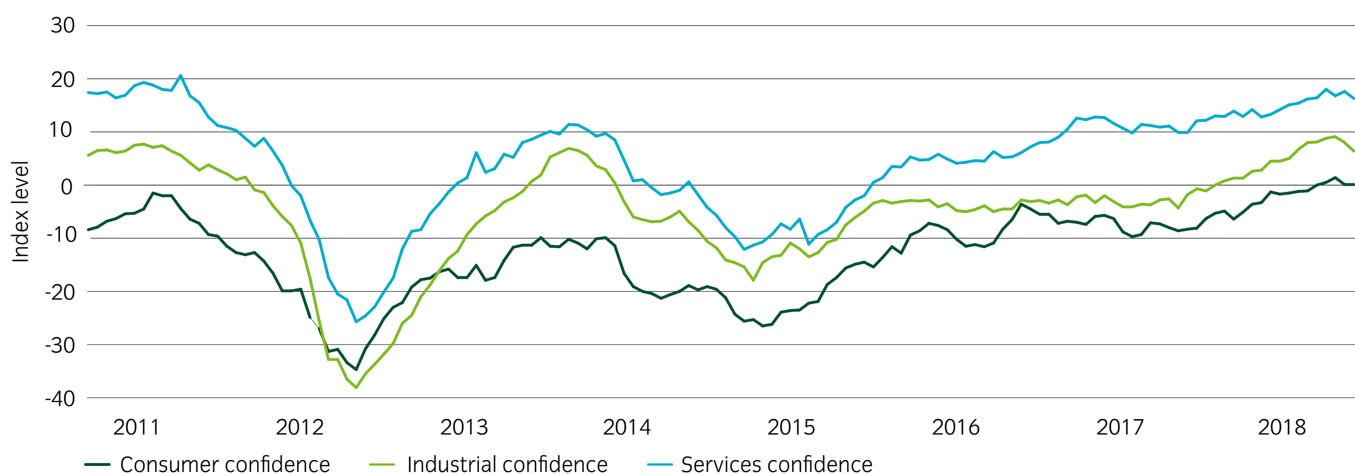
In the environment of improving strength, the European Central Bank commenced its reduction of asset purchases from €60bn per month to €30bn per month, and skewed its purchases further in favour of corporate bonds, partly given relative scarcity in government markets. The central bank also made clear that its guidance will shift towards considering the future of policy rates as opposed to the quantitative easing programme, as the latter winds down.

Politics was in focus during March with the Italian election ending in a hung parliament with anti-establishment parties performing better than expected. However, there was little clarity as to how the deadlock will be resolved. The Five Star movement was the largest party with 32% of the vote, while the Lega Nord outperformed within the centre right, with around 17% of the vote. Matteo Renzi's Democratic Party (PD) performed poorly with less than 20%. More market-friendly newsflow arrived from Germany, where the SPD party agreed to re-enter a Grand Coalition headed by Angela Merkel.

Continuing where they had left off at the end of 2017, core yields started on a bearish note. However, a sudden spike in risk market volatility in February reversed the weakness to an extent. At the end of the period, bund yields at one to 10- year maturities were 10bp higher across the curve. Further out the curve, they ended slightly lower. Core yields largely outperformed their peers in the US and the UK. Peripheral spreads narrowed materially, however. Although, following the election outcome, Italy materially underperformed Spain.

Looking ahead, we expect core yields to resume their upward trend, as they still trade at negative yields towards the front of the curve. Continued economic strength (which will also see the effects of rising capital expenditure) and falling labour market slack will continue to pressure yields. We continue to believe that a strategic short duration position looks attractive. However, where appropriate, investors may wish to take opportunities to temporarily offset this with tactical or momentum-based long exposure given the potential for yields to become range-bound. In peripheral Europe, political uncertainty will remain in Italy making active positioning look relatively unattractive for now.

Figure 2: European economic confidence



Source: Bloomberg, as at 31 March 2018.

TAX CUTS BOOST GROWTH SENTIMENT AND RATE FORECASTS BUT FISCAL DEFICIT A CONCERN

Isobel Lee
Head of Global Fixed Income Bonds

- Tax cuts are acting to underpin the growth outlook
- We continue to expect three further interest rate hikes over the year
- US trade policy could exert upward pressure on inflation if tariffs are enacted

The US yield curve shifted upwards and flattened over the quarter, with shorter-maturity yields underperforming longer-dated yields. The Federal Reserve raised interest rates by 25bp as expected in March, taking their target range to 1.50%-1.75%. At the press conference following the meeting, Fed chairman Jerome Powell stated that the Federal Open Market Committee believed that there will be "meaningful increases in demand from the new fiscal policies for at least, say, the next three years." The dot plot continued to show that the Federal Open Market Committee expect two further interest rates rises in 2018, but their expectation for interest rates in 2019 and 2020 were raised.

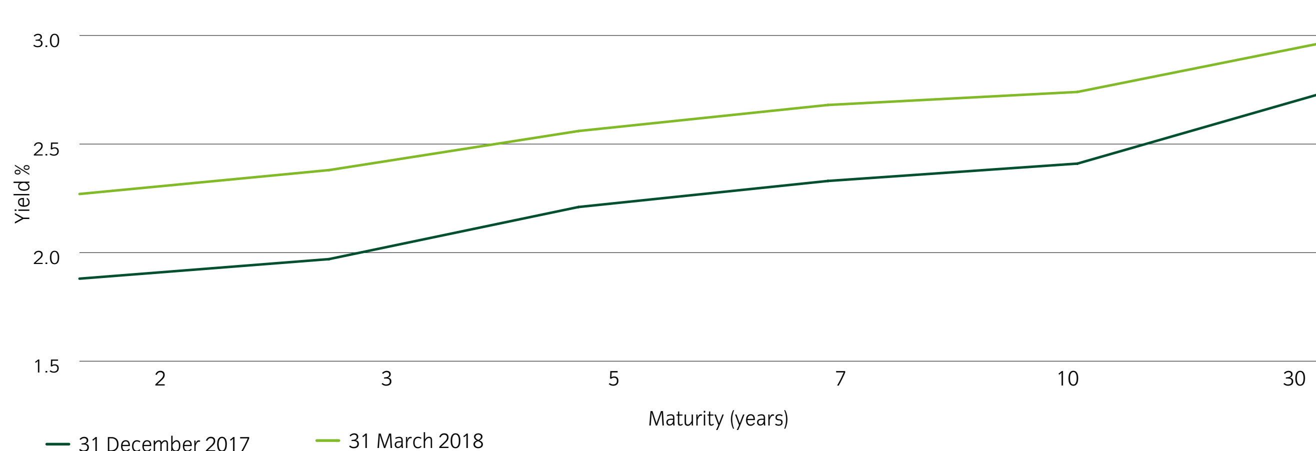
Concern regarding the outlook for the US fiscal deficit proved a further significant headwind for bond markets during the quarter. Following a brief government shutdown, Congress voted through a two-year budget bill which the Congressional Budget Office estimates adds $320bn to the US deficit over a ten-year period. The budget included significant increases in discretionary spending, including $89bn in disaster spending for Texas, Florida and Puerto Rico and $15bn to renew various expired tax breaks.

Following the announcement, credit rating agency Moody's commented that "the stable credit profile of the United States is likely to face downward pressure in the long-term, due to meaningful fiscal deterioration amid increasing levels of national debt and a widening federal budget deficit".

We expect economic growth to continue at a robust pace in 2018, underpinned by business investment and personal consumption which we expect to be buoyed by corporate and personal income tax cuts. This policy driven stimulus should continue in early 2019, but then slow in the second half of that year as the stimulus wanes and likely tighter monetary policy slows economic activity. The significant increase in the fiscal deficit at the same time as the Federal Reserve are unwinding their QE programme, poses one risk to growth. If treasury yields rise more quickly than currently expected, and yields reach sufficiently high levels, this could tighten monetary conditions and the economic outlook could deteriorate as a result.

For the Federal Reserve, inflation, or the lack of inflation, continues to be a key factor for the interest rate outlook, keeping the bank on a gradual tightening path. The upswing in global activity seen in recent years will ultimately have an impact on prices, but labour market tightness is yet to translate into significant wage pressure, and this should continue to exert a limiting effect on inflation over 2018. An oversupply of rental properties in the US is also resulting in downward pressure on rents, which will also act to moderate US inflationary pressures. However, a key risk to the inflation outlook could come from growing trade tensions. The United States Trade Representative has entered a two-month consultation period on the introduction of tariffs on $50bn of US imports from China. If these tariffs are implemented it would push inflation higher.

Figure 3: US yield curve



Source: Bloomberg, as at 31 March 2018.

NAVIGATING TIGHT VALUATIONS

Peter Bentley
Head of UK and Global Credit

- Credit spreads widen from post-financial crisis tights
- Risk market volatility pressures valuations
- Volatility likely to drive opportunities

Global credit spreads initially started the year where they had left off in 2017 – grinding tighter reaching new post-financial crisis tights. Negative newsflow such as UK construction group Carillion's liquidation was shrugged off.

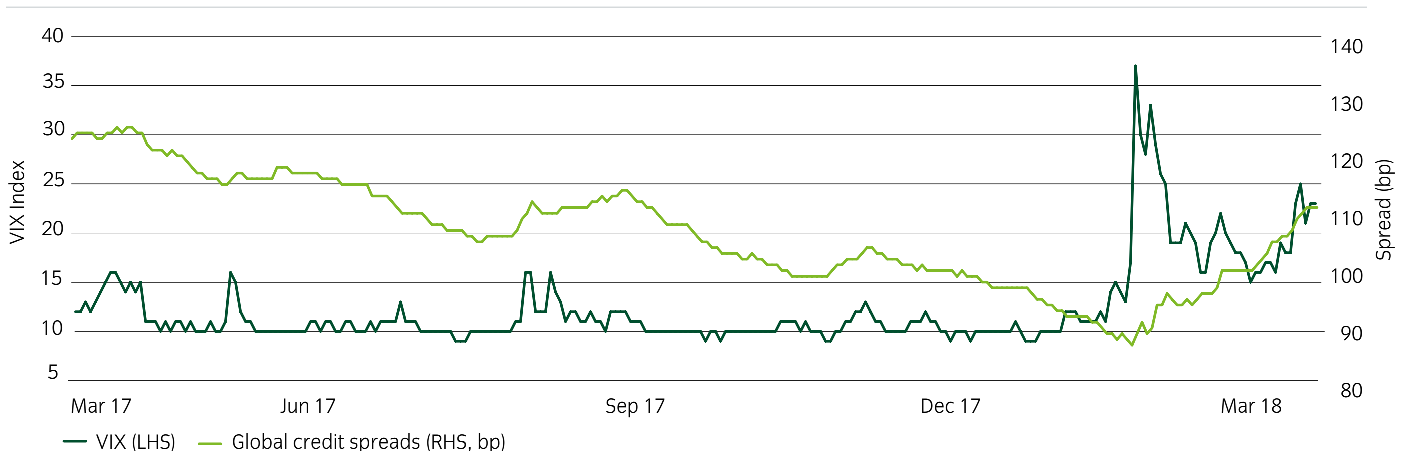
However, the picture changed from February onwards. Concerns surrounding rising treasury yields and inflation, contributed to a sharp fall in US equity markets and, in turn, a record one-day spike in the VIX index. Volatility in equity markets notably remained materially higher over the rest of the quarter relative to the record low volatility regime of 2017.

It made it a more difficult period, although volatility in credit was commensurately lower than in equities outside of the most equity-like instruments like credit default swap indices and subordinated bank debt. In general, credit spreads increased by around 10bp to 15bp across the major global investment grade markets. Notably, the euro credit market outperformed other regions on an excess return basis, in part thanks to a quiet period of supply and continued direct support from the European Central Bank, which continued buying corporate bonds in sizeable quantities.

Political concerns also led to some volatility in credit. In Europe, Italy's hung parliament led to some limited nervousness towards Italian credits. The US dollar credit market saw some volatility relating to the passage of tax reform in the US, which has the potential to lead to increased leverage ratios.

Looking ahead, it is a time to be cautious in credit. Conditions do not lend themselves either to material long or material short exposure. Volatility rising closer to historically average could justify credit spreads widening more materially from their post-crisis. However, on the positive side the fundamental picture remains very favourable, with the global cyclical upswing continuing and defaults likely to remain around record lows. A rising rate environment is also unlikely to be a threat to credit as long as yield rises remain contained and orderly. We therefore believe that a cautious and neutral or modest long position is the best strategy. Stock selection, relative value opportunities and other alpha-generation tools will be key to driving outperformance in the current environment.

Figure 4: Global equity volatiity and credit spreads



Source: Bloomberg, as at 31 March 2018.

Stock selection, relative value opportunities and other alpha-generation tools will be key to driving outperformance in the current environment.

PETER BENTLEY

NEAR POST-CRISIS TIGHTS

Jesse Fogarty
Senior Portfolio Manager

- Return of equity volatility leads to back up in credit spreads
- Geopolitical risks remain front and centre
- Stock and sector selection will be key

Market volatility returned during the first quarter of 2018. The VIX Index (also known as the 'fear gauge'), which is a measure of volatility in the S&P 500 Index, experienced its largest one-day rise ever on 5 February and breached 50 intra-day for the first time since 2015. Equity market volatility remained an outlier as volatility did not materially rise in any other asset classes.

Nonetheless, market risk premiums responded to this change in the environment, and US corporate credit spreads were no exception. Investment grade widened by 16bp resulting in -0.79% excess return versus US treasuries over the quarter. The widening move was contained, however. US credit still trades close to post-crisis lows. Most of the weakness was felt at the higher-beta end of the market, or in more-liquid synthetic assets.

The volatility appeared to be driven by increasing uncertainty as treasury yields rose and inflation threatened to make a comeback. Economic data, however, remained strong. Manufacturing PMIs remained strongly in expansionary territory. Inflation remained muted despite the unemployment rate sitting at new lows of 4.1%, although the prime-age participation rate notably increased over the period, indicating the potential for some further slack.

As ever, politics was an important factor for markets. The Trump administration stepped up its protectionist rhetoric, introducing a number of tariffs (which it has a high degree of latitude to push through), including many aimed squarely at China. This increased market concerns about this potentially escalating into a trade war. Concerns surrounding North Korea's nuclear weapons programme were also a factor during the summer, although this appeared to die down with news that breakthrough diplomatic talks between the US and the North Korean regime had been agreed.

Looking ahead, we have a tactically positive outlook. We are increasingly of the view that volatility may subside and will not spread to fixed income asset classes such as credit. The demand and supply picture looks tactically favourable over the coming quarter. Geopolitical risks may temper, as the North Korean threat is potentially contained and behind-the-scenes trade discussions between the US, its allies and China appear to reduce the risk of an escalating trade war. We believe that a modest overweight bias to credit risk is appropriate. Bottom-up stock selection will continue to be key to driving outperformance.

Figure 5: US dollar investment grade credit spreads

Source: Bank of America Merrill Lynch, as at 31 March 2018.

CONSTRUCTIVE OUTLOOK, YET INCREASED IDIOSYNCRATIC RISKS

Colm McDonagh
Head of Emerging Market Fixed Income

- Overall global backdrop remains supportive
- Idiosyncratic risks require increased differentiation and selectivity

The first quarter of 2018 exhibited contrasting fortunes for emerging market (EM) hard currency and local currency sectors. Local currency debt generated a solid, positive return in keeping with the momentum of 2017; however, both corporate and sovereign credit ended the quarter in the red, with a combination of higher spreads and treasury yields offsetting carry returns.

The year started on a strong note, the market buoyed by a succession of strong data releases and the passing in late 2017 of the Tax Cuts and Jobs Act in the US. Sentiment turned in February, however. Concerns over rising US treasury yields – the 10 year rose over 45bp versus December's close at one point – and inflation, sparked a catalyst for volatility to return to the market with the VIX index experiencing a record one-day spike. And just as markets were starting to recover, key emerging market China became embroiled in an escalating trade war with the US. Among the many exchanges, the US announced a series of levies on more than 1,300 Chinese goods, to which China responded by unveiling tariffs on a targeted list of American imports.

As we noted last quarter, 2018 stands out as a politically congested year in emerging markets. In March, Russia held its presidential election, albeit one where the re-election of Vladimir Putin was never in real doubt. While geopolitical risks related to Russia have risen, from a purely economic standpoint, we expect the implementation of pragmatic and prudent policies to stabilise the economy and financial system to persist. Colombia also held its congressional/presidential elections in March, with former leftist guerrilla Gustavo Petro and right-wing senator Ivan Duque the notable candidates progressing to May's first round of presidential elections. Polls show strong support for Duque, who barring a complete collapse in support, should be the next president of Colombia.

We remain constructive in our outlook for emerging market debt. The supportive global backdrop remains in place despite some slowing of momentum. Global growth is synchronised and robust, while sentiment indicators remain high. That being said, signs of a downshift in global activity data may serve to slow the pace of policy normalisation in key core markets. With respect to the US dollar, we see the potential for further weakness ahead given the extent of US structural trade imbalances and the dollar's use as a mechanism to help in the adjustment process. Among the risks to monitor include: the ongoing electoral cycle and in particular elections in Mexico, Brazil and Malaysia, further escalation of US-China trade tensions, and other idiosyncratic risks including further deterioration in Russia's relationship with the West. Given heightened idiosyncratic risks, differentiation and selectivity will be particularly important drivers of portfolio performance.

Figure 6: EM valuations, 3-year history

Source: JPMorgan, Bloomberg, April 2018.

...credit discipline remains key with the market being unappreciative of any challenging credits, especially in the context of weaker documentation...

RANBIR SINGH LAKHPURI

ISSUER FRIENDLY ENVIRONMENT DRIVES RECORD VOLUMES

Ranbir Singh Lakhpuri
Senior Portfolio Manager,
Secured Finance

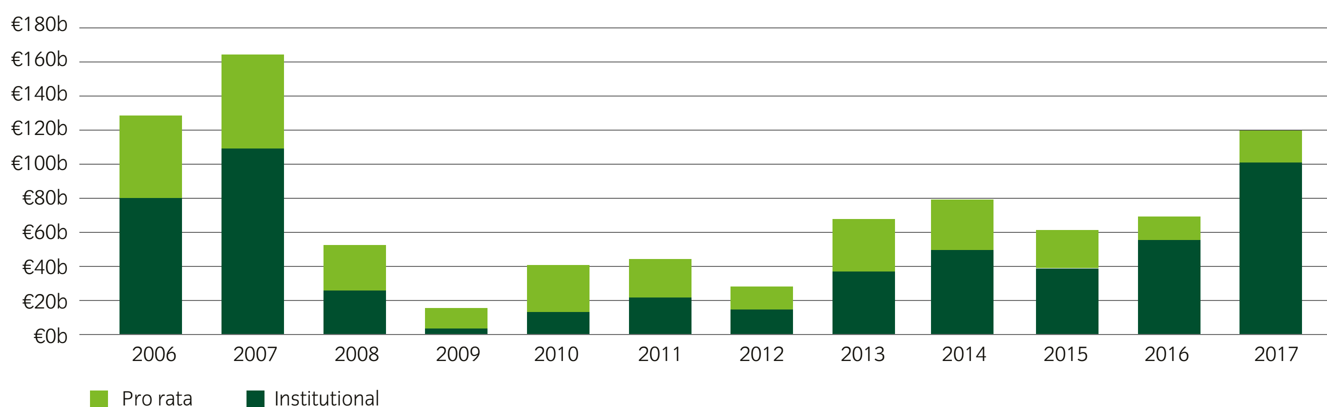
- Technical backdrop remains strong, even with elevated issuance levels
- Strong demand for asset class likely to remain
- Documentation needs careful analysis given issuer attempts to weaken covenants

The quarter started with a flurry of new deals as issuers took advantage of strong demand for the asset class carrying over from 2017. The varying credit quality of these issues, however, saw investors start to push back, particularly in terms of documentation changes. Despite that, market conditions continued to be borrower friendly, especially for BB rated and/or well liked credits. This dynamic continued through the rest of the quarter. February saw the launch of a long awaited jumbo transaction to finance the carve-out of the Flora Foods Group from personal goods giant Unilever. The size of this transaction (the euro tranche alone stood at €2bn), dominated market attention but attracted varying interest. In March the frustration amongst buyers regarding aggressive, borrower-friendly documentation again came to the fore with multiple issuers forced to improve documentation during the syndication process in order to get deals done.

Total supply in Q1 came in at €35.7bn, slightly higher than the €35.4bn seen in the same quarter of 2017. 62% of this issuance, or €21.1bn was used to finance merger & acquisition transactions, significantly higher than the 26% or €9bn of issuance used for the same purpose in 2017. Default rates at the end of the quarter were 1.2%.

Looking ahead, issuance is expected to increase in Q2, with at least 25 primary deals expected up to the end of June. Low default rates and the strong macro environment continue to bolster demand with little reason to believe this new issuance won't be easily absorbed by markets. The evolution of loan documentation is likely to continue to be a concern for investors as issuers use buoyant market conditions to attempt to lighten covenants. The technical backdrop remains very supportive for loans with a strong bid from collateralised loan obligations (CLOs) and banks, its floating rate nature and a benign macro environment. That said, credit discipline remains key with the market being unappreciative of any challenging credits especially in the context of weaker documentation and so it continues to be an attractive investment for the diligent and careful investor.

Figure 7: European leveraged loan issuance



Source: LCD, an offering of S&P Global Market Intelligence, as at 31 December 2017.

VOLATILITY RETURNS TO THE HIGH YIELD MARKET

Uli Gerhard
Senior Portfolio Manager, High Yield

- High yield volatility is back as markets react to outflows, new issue supply and rising government yields
- Long-term outlook remains positive on fundamental and technical basis
- Sterling market faces Brexit uncertainty

Volatility in the high yield market is back. After a strong start to the year, the market turned due to outflows, new issue supply, and rising treasury and bund yields. Other factors, such as the actions of the Trump administration and changes to Altice's capital structure, also had an effect.

However, in both Europe and the US, the overall impact was relatively limited. In Europe, it seems the outflows were met with limited selling as the new issue pipeline was light in January, meaning cash balances were high. In the US there were material outflows but the overall tone seemed orderly. The outflows from exchange-traded funds were funded by drawing on lines, while short-dated paper was sold by conventional high yield funds as these bonds were close to par. Specialist short-dated funds took advantage of these opportunities.

Today, the European high yield market is waiting for some direction. Credits with good results are not rallying while those with concerns are weakening, and investors are awaiting significant new supply to finance the acquisition of Unilever's spreads business and for Teva to refinance its debt. The market needs some impetus to rally from here.

For the longer term, however, we remain positive on Europe: company fundamentals have improved due to stronger growth and improved earnings, and demand remains strong from investment-grade investors continuing to focus on lower-rated securities as they seek more attractive yields. We also expect supply to shrink as Telecom Italia and Tesco are upgraded and exit the high yield market. This technical picture could become blurry if bund yields rise much further, but we do not expect this in 2018.

The US high yield market appears to have stabilised for now, and we are also positive for the market over the longer term. Fundamentals are broadly positive, and the size of the market shrank substantially in 2017 as ratings upgrades, coupon income and bond-to-loan financing more than offset new issue supply.

We continue to remain focused on short-dated opportunities and have taken advantage of recent opportunities. We believe bottom-up analysis will remain central for managing risks and avoiding defaults in 2018.

One area of concern is the UK. We believe an incoherent Brexit strategy will affect the UK economy, and more importantly, that it will present UK companies with second-order risks which are out of their control. Furthermore, we expect investors to use this as an opportunity to hold short positions – given the poor liquidity in the sterling market, this could lead to significant price movements.

Figure 8: High yield spreads backed up as volatility returned to the market

Source: Bloomberg, as at 31 March 2018.

STRONG TECHNICALS CONTINUE TO UNDERPIN THE ASSET CLASS

Shaheer Guirguis
Head of Secured Finance

- Technical backdrop remains highly supportive
- ABS offers compelling strategic value given fundamental credit quality and security

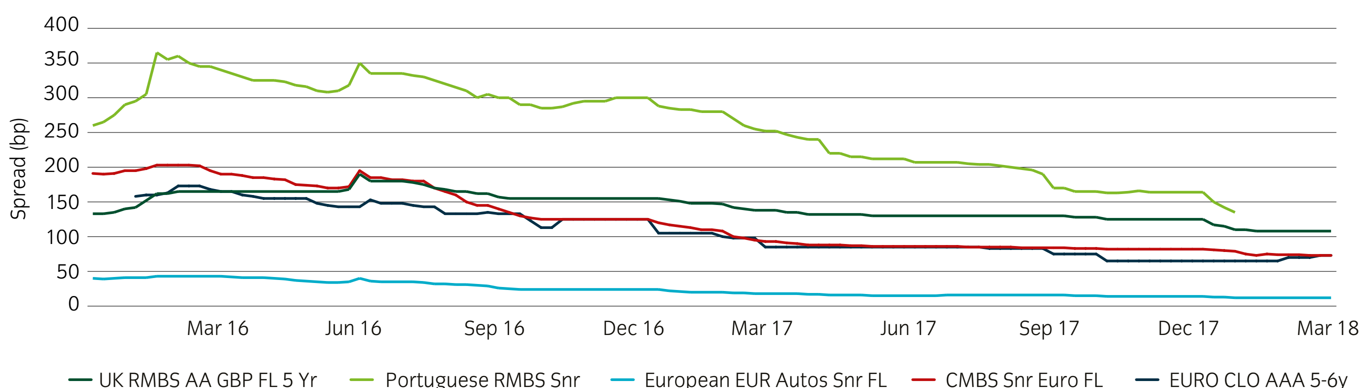
2018 opened its account on a strong note for risk assets, and credit was no exception. The US tax bill passed at the tail end of 2017 proved the key driver of initial positive sentiment, with strong rises in equities laying a positive foundation for structured credit assets to perform. Sentiment turned negative into January-end following a significant rise in US treasury yields and increasing concerns over US inflationary pressures. Investors accustomed to the benign volatility environment of recent years received a sharp wake-up call in early February when the VIX volatility index registered its largest one-day move on record. The more bearish read on inflation and its negative impact on equity valuations, weighed heavily on credit, with the biggest moves seen in higher beta names. After a period of calm early February volatility resurfaced in March as the quarter came to a close, albeit with the focus shifted away from inflation and rate pressures, to the prospect of trade wars between the US and China.

The European ABS market started the year by continuing to grind tighter – driven more by the tight supply technicals rather than fundamental changes. This strong technical picture allowed the asset class to shrug off the volatility in February and March and generate carry-style returns. Elsewhere in Europe, further calls of UK non-conforming paper continued to shrink the float of what was historically one of the widest and most volatile structured credit asset classes. The CLO market largely performed well throughout, however the BB/B rated part of the capital structure began to show some signs of weakness in February, some of which continued into March with BB tranches posting the first negative month of performance in over 12 months. European issuance came from a variety of sources over the quarter, including UK and Dutch residential mortage-backed securities, CLO and commercial mortgage-backed securities markets.

The US structured credit market performed well throughout the quarter, as demand for paper outstripped primary issuance, despite issuance in many sectors being quite significant. The fundamental picture for the market meanwhile remains robust and supportive. Higher beta segments of the market such as credit risk transfer subordinates saw weakness during the bouts of volatility, although for most of the market the strong technical bid remained supportive. That being said, material supply in the consumer ABS market during March led to modest softness at the front end of the curve.

The market has mostly been driven by technical factors, with demand outstripping supply, and we expect this strong technical backdrop to persist. We continue to believe that ABS markets offer compelling strategic value given the fundamental credit quality and security of the assets.

Figure 9: ABS spreads versus Libor



Source: JP Morgan as at 13 April 2018.

MEXICAN PESO DEFIES DECLINE IN RISK SENTIMENT

Paul Lambert
Head of Currency

- US dollar (USD) maintains weakening trend
- Mexican peso (MXN) rallies 8.1% versus USD
- Emerging market currencies likely to remain supported by global growth outlook

The USD continued to weaken. At the start of the year, domestic factors were a key contributor to this. US trade policy came into focus as Treasury Secretary Mnuchin commented that a weaker USD would be positive for US trade, but he later clarified that official policy towards the USD had not changed. Domestic politics also weighed on the currency as a failure to meet the deadline to pass a budget bill led to a temporary government shutdown lasting several days. Following a bounce back in February, the USD was weaker for much of March as the markets focused on increasing trade barriers being adopted by the US. The impact this could have on global trade – during the month the US announced that it would be imposing tariffs on steel and aluminium imports and later on that it would also be applying tariffs on Chinese imports in response to unfair trade practices. The USD fell by 1.2% on a trade-weighted basis.

The announcement also weakened risk sentiment, which hampered emerging market currency performance towards the end of the period. The MXN was a notable exception, strengthening by nearly 4% versus the USD in March, in part due to relief that the US steel and aluminium tariffs would not apply to Mexico. This boosted the currency to make it the top performer over the quarter, rallying 8.1% versus the USD. Meanwhile, the Japanese yen benefitted from its traditional safe-haven role – it rose 6% against the USD over the period due to a rise in equity market volatility in February and growing concerns of a global trade war in March.

Looking ahead, the global growth outlook remains positive, and this is supportive for growth-sensitive currencies including emerging market currencies. The strength of the US economy is resulting in rising rate expectations but for now it appears that yield spreads are poor indicators of the direction of currencies including the USD. Instead, the focus appears to be other drivers of long-term capital flows, such as valuation, where the USD still looks somewhat overvalued, and the potential demand for capital that might be generated by the deterioration of the US budget and current account deficits. As long as the focus remains on these factors it seems likely that the USD will be under downward pressure

Figure 10: MXN/USD performance

Source: Bloomberg, as at 31 March 2018.

Adrian Grey
CIO ACTIVE MANAGEMENT
Head of Fixed Income

GLOBAL RATES	GLOBAL CREDIT	EUROPEAN CREDIT	CREDIT ANALYSIS	CREDIT	EMD
INFLATION LINKED	MONEY MARKETS	US FIXED INCOME	RESPONSIBLE INVESTMENT	HIGH YIELD	CURRENCY
IMPLEMENTATION AND OPERATIONS				BANK LOANS	TRADING
PRODUCT SPECIALISTS				SECURED FINANCE	

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

The performance results shown, whether net or gross of investment management fees, reflect the reinvestment of dividends and/or income and other earnings. Any gross of fees performance does not include fees and charges and these can have a material detrimental effect on the performance of an investment.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

ASSOCIATED INVESTMENT RISKS

Fixed income

Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.

A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

The issuer of a debt security may not pay income or repay capital to the bondholder when due.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

FIND OUT MORE

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