GLOBAL FIXED INCOME: QUALITY CALLS

"It's clear that the best of times for the credit cycle are behind us. 'Safe' yield remains a coveted asset in a world where rates are still very low and inflation unusually subdued. We see more sobering results in 2015. Our message for the next 12 months is simple: Go for quality."

– Hans Mikkelsen, Head of U.S. High Grade Credit Strategy

Our view

Two sides to liquidity: Central bank liquidity poses challenges, but for very different reasons in our view. In the U.S., with the Federal Reserve no longer in easing mode, the story of 2015 may be outflows for both retail and institutional investors and wider investment-grade spreads. Across the Atlantic, though, the European Central Bank is going "all in" to counter 1% growth and the risk of deflation, which leads to tighter credit spreads in investment grade.

Flat rate? The days of 7% total returns for investment-grade credit are sadly gone, in our view. We see U.S. investment-grade bonds having a total return of zero. Meanwhile, investment grade in emerging markets should return 2.4%; in Europe, 1.5% to 2%; and in Asia, 1.4%.

Pockets of optimism: Looking for some causes of cheer? Go no further than high-yield bonds. Total returns for high yield could finish around 6% in Asia and the emerging markets, and around 5% in Europe.

Event risk hovers: High levels of event risk may continue, primarily because of liquidity, and create opportunities for alpha. The end of cheap funding conditions in the United States could lead to more aggressive corporate behavior (such as mergers). Fundamental risk could arise from Europe's huge influx of debut issuers over the last 18 months.

Key calls

The higher-conviction ideas from our global team include:

- **United States**: As rates rise, our favored trade is the 10-year/30-year spread curve flattener. Our key underweight is banks, as we worry about outflows by retail investors at the front-end of the credit market.
- **Europe**: We like corporate over senior financials, core corporate over peripherals. In high yield, while we expect compression of BBs to BBBs, we think it's time to embrace single Bs, selectively.
- **Asia**: We favor BBBs, bank capital and corporate perpetual. In high yield, we go for BBs and the stronger Bs. Also appealing: China and Indonesia.

- **Emerging markets**: Regional performance should be led by Latin America, followed by the EMEA nations (Europe, Middle East and Africa) and Asia. We consider high yield preferable to investment grade due to carry and value.