Market Maps

Fixed Income Insight Report

FTSE Russell

February 2021 (USD Edition)

Parallels with 2016/17 steepening, but Fed confirms zero rate policy

Curve steepening, higher inflation breakevens and tighter credit spreads suggest parallels with 2016/17 reflation trade, boosted by the proposed Biden fiscal stimulus. But Covid mutations, and vaccine supply and rollout risks may restrict curve steepening in 2021 and keep central banks at zero rates in 2021/22.

Performance – Chinese and EM govt bonds the best performers over last six months; long US Treasuries weakest
Long Treasuries fell 11%, in reflation trade, while Chinese bonds gained 9% in dollar terms, since July 2020. (pages 2-3)

Macro backdrop – inflation rebound risks negative real wage growth in 2021/22
A re-run of the 2011/12 negative real wage growth may develop, given weak wage growth & inflation spike risk. (pages 4-5)

Global yields, curves & spreads – reflation trade going global, though quite distinct from 2016/17 version
Main difference with 2016/17 curve steepening is Covid regime shift and the Fed tightening then. (pages 6-7)

Cross assets & RMBS – risk assets and US housing big winners from QE and Biden fiscal stimulus
Equities and high-yield credit start 2021 strongly in response to QE and mooted US fiscal boost (9% of GDP). (page 8)

Appendix
Global bond market returns, historical bond yields, duration and market value, foreign exchange returns.

Chart 1: Benchmarking reflation trade by curve steepening shows similar US/Canada moves in 2016/17, but Fed was tightening then.

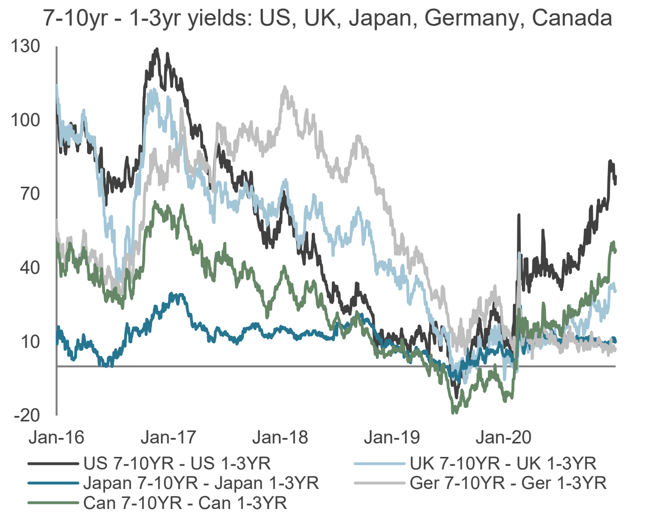
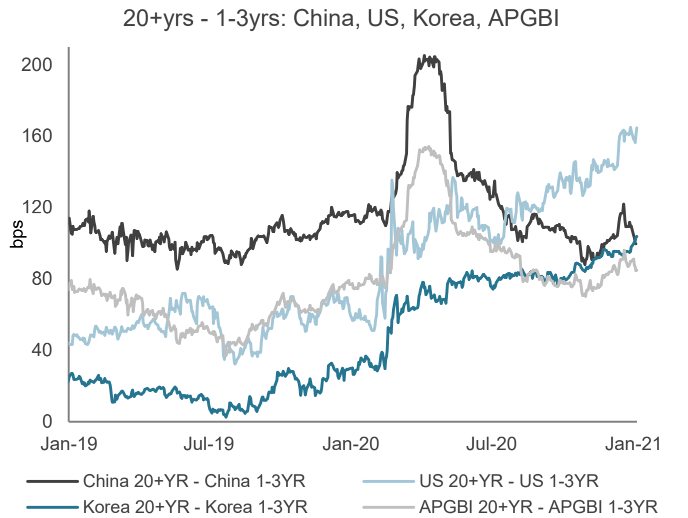


Chart 2: There are signs of curve steepening going global, led by US, though it is less marked in China, where yields fell less in 2020.



For professional investors only

Global Bond Market Returns − 6M (USD, LC, TR) as of January 31, 2021

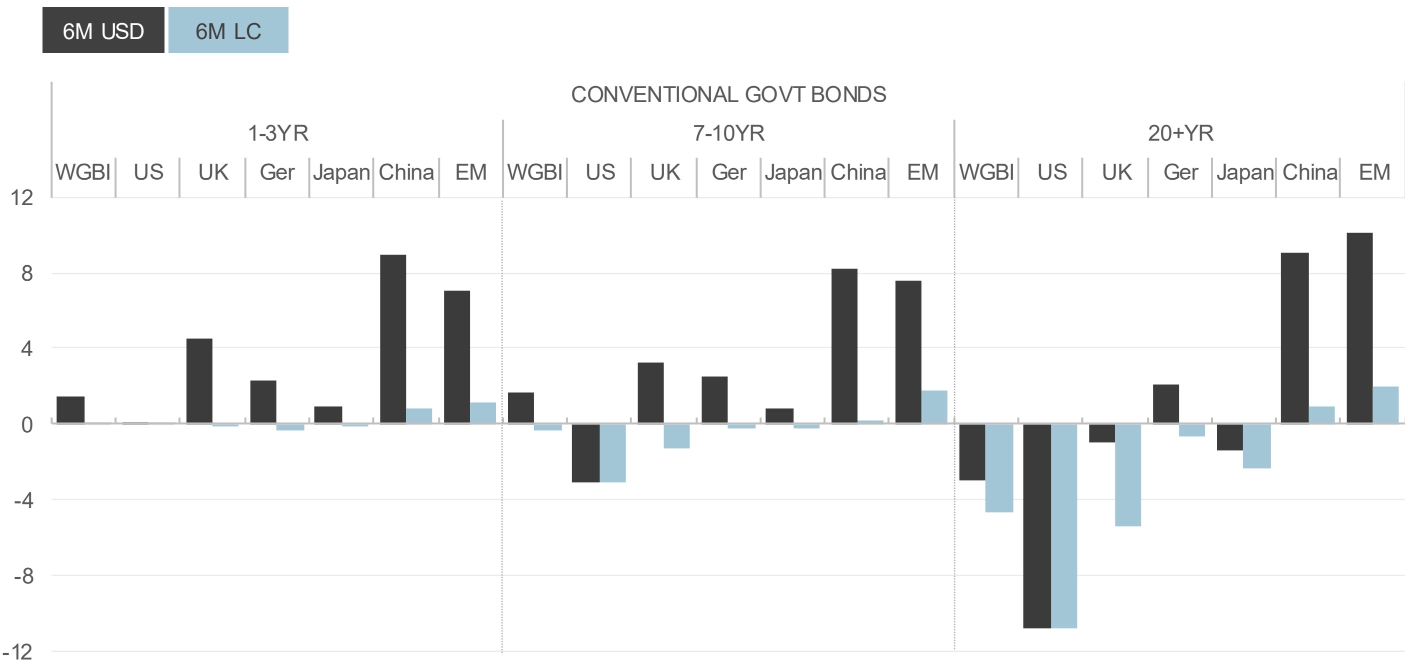
Six-month performance returns for a US dollar investor capture the reflation trade, and show the weakness in longer US Treasuries. They also show the weaker US dollar boosting returns overseas, led by China and EM govt. bonds. Credit rallied strongly, as investors rotated away from safe havens into credit and inflation protection.

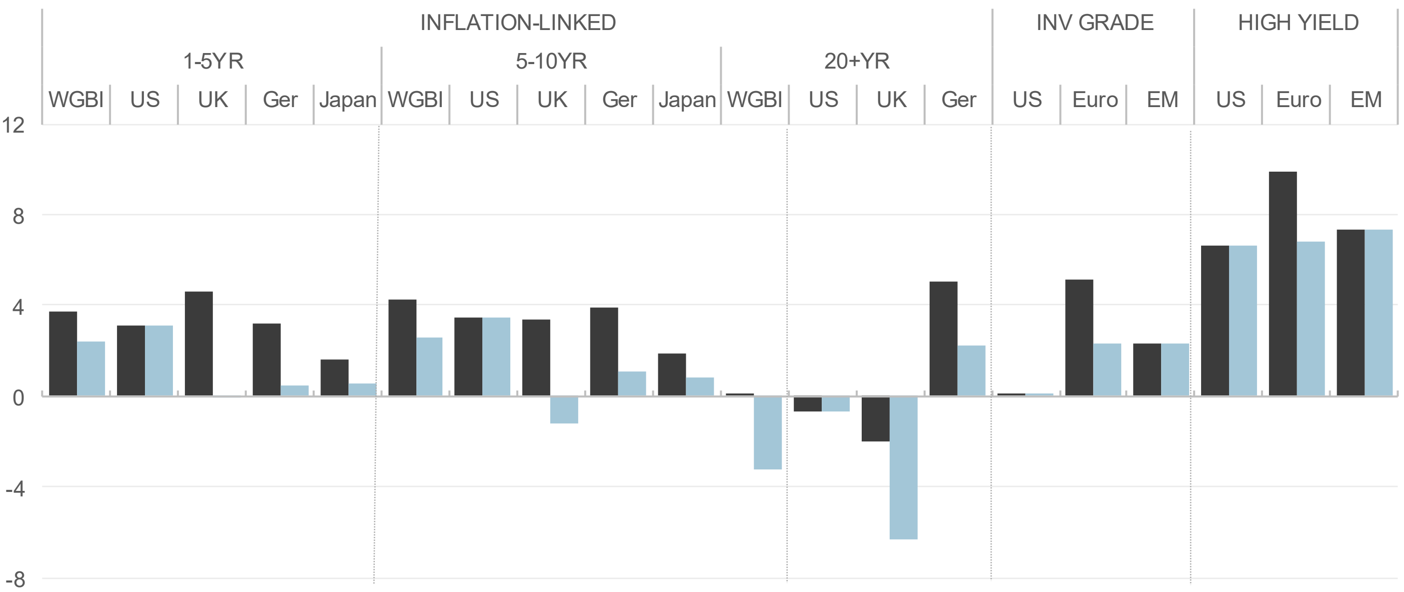
Weakness in longer dated US Treasuries, which lost over 10%, as investors' risk appetite recovered, and they rotated away from safe havens, exceeded weakness in other markets, as US Treasury spreads widened.

Chinese and EM government bonds showed strong returns, in US dollar terms, of 9-10 % on six months, helped by stronger currencies and resilient bond markets, which benefited from the search for yield.

Credit rallied strongly, as risk appetite recovered and high yield outperformed, returning up to 10% in Europe, and helped by the stronger euro.

Investors also sought inflation protection, after substantial monetary stimulus, so inflation linked outperformed, particularly US Tips. However, longer-dated UK index-linked bonds fell back, after the Chancellor confirmed a switch in the inflation index base from 2030.





Source: FTSE Russell. All data as of January 31, 2021. Past performance is no guarantee of future results. Please see the end for important legal disclosures. Bond market data is derived from FTSE Fixed Income Indexes. See Appendix Glossary for list of indexes used for each market. For professional investors only.