

Fixed Income Briefing

May 2022

Higher yield cushions emerging amid rising rate risks

The US Federal Reserve lived up to market consensus and raised its benchmark interest rate in May by 50 basis points (bp), to a target range of 0.75%-1%. Fed Chair Jerome Powell indicated that more 50 bp hikes were likely, but that 75 bp increases were not on the table at this stage. The US central bank now plans to cut its holdings of Treasury and mortgage-backed securities by up to USD 47.5 billion each month, starting 1 June, and to double the size of that reduction from 1 September. The yield on the benchmark 10-year US Treasury note held steady around 2.98% after the release of the Fed's policy statement, suggesting that much of the news had already been priced into bond markets. The big winner so far this year has been the USD, which is up by about 8% against a basket of major currencies as measured by the ICE US Dollar Index. The central banks of Australia and Sweden are the latest to join the global tightening cycle, raising interest rates for the first time in many years. Meanwhile, the JPY has weakened about 12% against the USD year-to-date, as the Bank of Japan said it would continue its market operations aimed at capping the yield on 10-year Japan government bonds at 0.25%. And China's RMB was down by more than 4% against the USD in April, the steepest monthly drop since the end of its USD peg in 2005. The EUR also weakened against the USD

by more than 4%. Germany's 10-year bund yield has climbed up to 0.95%, while Italy's equivalent yield is around 190 basis points higher, despite the European Central Bank lagging behind the Fed in tightening policy. As the euro area's reported and expected inflation metrics rose by more than anticipated in April, euro inflation-linked securities have been one of the few bond markets to record limited losses year-to-date, alongside euro and US floating-rate notes. Amongst spread assets, those with higher duration and therefore higher interest-rate sensitivity are underperforming year-to-date. US investment-grade corporate credit and emerging-market hard-currency sovereign debt are the most notable – their indexes now offer a yield cushion of more than 4% and 7%, respectively, against further rates-driven losses. In emerging markets, sovereign spread dispersion has increased, with commodity-exporting countries outperforming net commodity importers. In corporate credit, while spreads are wider across the board, rate moves account for a greater share of year-to-date negative returns than a deterioration in credit worthiness. With almost half of investment-grade US companies having already reported quarterly results, sales and earnings have come in higher than expected on average, and revisions to future earnings look fairly benign so far.

Indicative market indices Data as at 4 May 2022	Total return YTD 2022 (%)	Total return April 2022 (%)	Total return 2021 (%)	Yield- to-worst (%)	Effective duration (years)
Euro inflation-linked bonds	-0.20	-0.84	6.35	-1.09	8.4
US floating-rate notes	-0.21	0.01	0.52	1.37	0.2
Euro floating-rate notes	-0.35	-0.01	-0.11	-0.04	0.3
China government and policy bank bonds	-2.29	-3.40	7.71	2.69	4.3
Asian investment grade	-8.19	-2.50	-0.01	4.60	5.0
Euro investment grade	-8.21	-2.77	-1.02	2.15	5.1
Euro high yield	-8.22	-2.88	3.35	5.40	3.7
US high yield	-8.37	-3.65	5.36	7.17	4.4
Euro aggregate	-8.97	-3.42	-2.85	1.55	7.2
US aggregate	-9.43	-3.79	-1.54	3.47	6.7
Global convertible bonds	-10.77	-5.38	2.45	-1.35	2.3
Global emerging-market corporate bonds	-10.99	-2.06	0.91	6.06	4.6
Global inflation-linked bonds	-11.09	-6.10	2.69	-0.89	11.3
Asian high yield	-11.10	-1.00	-11.05	12.26	3.0
Global aggregate	-11.51	-5.48	-4.71	2.60	7.3
US fixed-rate preferred securities	-12.24	-5.48	2.24	5.57	5.6
US investment grade	-12.59	-5.47	-1.04	4.29	7.9
Global government bonds AAA-AA	-13.66	-6.84	-7.52	1.83	8.2
Global emerging-market sovereign bonds	-15.37	-5.59	-1.80	7.43	7.1
Global green bonds	-15.45	-7.61	-7.85	2.42	7.9

Sources: Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors. Index returns in USD (unhedged) except for euro indices. Yield-to-worst adjusts down the yield-to-maturity for corporate bonds which can be "called away" (redeemed optionally at predetermined times before their maturity date). Effective duration also takes into account the effect of these "call options". Past performance does not predict future returns. See the disclosure at the end of the document for the underlying index proxies.

Disclosures

The ICE US Dollar Index is a geometrically averaged calculation of six currencies weighted against the USD: EUR, JPY, GBP, CAD, SEK, CHF. The ICE BofA MOVE Index tracks the movement in US Treasury yield volatility implied by current prices of one-month over-the-counter options on 2-year, 5-year, 10-year and 30-year Treasury securities. US aggregate (represented by the Bloomberg US Aggregate Bond Index): The Bloomberg US Aggregate Bond Index tracks the investment-grade, USD-denominated, fixed-rate taxable bond market. The index includes treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency); US investment grade (Bloomberg US Corporate Bond Index): The Bloomberg US Corporate Bond Index tracks the investment-grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US issuers; US High Yield (ICE BofA US High Yield Index): The ICE BofA US High Yield Index tracks USD-denominated below investment-grade corporate debt publicly issued in the US domestic market; US floating-rate notes (Bloomberg US Floating Rate Notes Index): The Bloomberg US Floating Rate Notes Index tracks USD-denominated, investment-grade, floating-rate notes across corporate and government-related sectors; US fixed-rate preferred securities (ICE BofA Fixed Rate Preferred Securities Index): The ICE BofA Fixed Rate Preferred Securities Index tracks fixed-rate, USD-denominated, investment-grade exchange-traded preferred securities (\$25 par) with outstanding market values of at least USD100 million issued in the US domestic market; Euro aggregate (Bloomberg Euro Aggregate Bond Index): The Bloomberg Euro Aggregate Bond Index tracks the investment-grade, EUR-denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues; Euro investment grade (ICE BofA Euro Corporate Index): the ICE BofA Euro Corporate Index tracks EUR-denominated investment-grade corporate debt publicly issued in the euro domestic or eurobond markets; Euro high yield (ICE BofA Euro High Yield Index): The ICE BofA Euro High Yield Index tracks EUR-denominated below investment-grade corporate debt publicly issued in the euro domestic or eurobond markets; Euro floating-rate notes (Bloomberg Euro Floating Rate Notes Index): The Bloomberg Euro Floating Rate Notes Index tracks EUR-denominated, investment-grade floating-rate notes across corporate and government-related sectors; Asian investment grade (JP Morgan Asia Credit Index – Investment Grade): The JP Morgan Asia Credit Index – Investment Grade tracks fixed-rate, USD-denominated investment-grade bonds issued by Asia sovereigns, quasi-sovereigns, banks and corporates; Asian high yield (JP Morgan Asia Credit Index – Non-Investment Grade): The JP Morgan Asia Credit Index – Non-Investment Grade tracks fixed-rate, USD-denominated below investment-grade bonds issued by Asia sovereigns, quasi-sovereigns, banks and corporates; China government & policy bank bonds (Bloomberg China Treasury and Policy Bank 1-10 Year Index): The Bloomberg China Treasury and Policy Bank 1-10 Year Index tracks CNY-denominated bonds issued by the Ministry of Finance of the People's Republic of China (PRC), and debt issued by Chinese policy banks (PRC government agencies which are not guaranteed by the government), that are listed on the China Interbank Bond Market (CIBM); Global emerging market sovereign debt (JP Morgan Emerging Market Bond Index (EMBI) Global Diversified): The JP Morgan EMBI Global Diversified Index tracks liquid, USD-denominated emerging market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities; Global government bonds AAA-AA (Bloomberg Global Government AAA-AA Capped Index): The Bloomberg Global Government AAA-AA Capped Index tracks local currency bonds with a minimum AA rating issued by governments of developed countries worldwide; Global inflation-linked bonds (Bloomberg Global Inflation-Linked Index): The Bloomberg Global Inflation-Linked Index tracks investment-grade, government inflation-linked debt from 12 different developed market countries; Global green bonds (Bloomberg MSCI Global Green Bond Index): The Bloomberg MSCI Global Green Bond Index tracks the global market for fixed income securities issued to fund projects with direct environmental benefits. An independent research driven methodology is used to evaluate index-eligible green bonds to ensure they adhere to established Green Bond Principles and to classify bonds by their environmental use of proceeds; Global convertible bonds (ICE BofA Global 300 Convertibles Index): The ICE BofA Global 300 Convertibles Index includes 300 convertible securities and is considered generally representative of the global convertible market; Global emerging market corporate debt (JP Morgan Corporate Emerging Market Bond Index (CEMBI) Broad Diversified): The JP Morgan CEMBI Broad Diversified Index tracks the performance of USD-denominated bonds issued by emerging market corporate entities; Global aggregate (Bloomberg Global Aggregate Bond Index): The Bloomberg Global Aggregate Bond Index tracks the performance of the global investment-grade, fixed-rate bond markets and includes government, government-related and corporate bonds, asset-backed, mortgage-backed and commercial mortgage-backed securities from both developed and emerging markets issuers; Euro inflation-linked bonds (Bloomberg Euro Government Inflation-Linked Bond All Maturities Index): The Bloomberg Euro Government Inflation-Linked Bond All Maturities Index tracks the performance of EUR-denominated investment-grade inflation-linked bonds issued by governments of the euroarea across the whole yield curve.

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