NATIXIS ASSET MANAGEMENT

FIXED INCOME STRATEGY *WEEKLY*

WEEKLY ANALYSIS 18 APRIL /// #13-2016

Document intended for professional clients

Stability in bond markets

Key Points

- **Treasury yields hover about 1.75%, Bunds near 0.15%**
- **Neutral stance on Bunds, long bias on T-notes**
- **Keep overexposure on peripheral sovereigns and credit**

Bond yields have been without a trend around 1.75% on 10y treasuries even as US data come in below expectations and some weakness in oil prices after OPEC and non-OPEC members failed to reach an agreement on output in Doha. The German Bund is trading about 0.15%. In turn 10s30s spreads in the US flattened somewhat whereas French bond syndications (20y and 50y deals) have weighed on long-dated euro yields. There have been little changes in sovereign spreads. Portuguese spreads have nevertheless dipped under the 300bp mark. In credit markets, spreads are stable about 130bps over German Bunds. Financial subordinated debt have benefitted from the announcement of a new fund aimed at supporting troubled Italian banks. Spreads in the materials sector also tightened last week. The rebound in equities sent synthetic credit spreads lower. CDX HY spreads narrowed by 18bps even as Fitch said US defaults totaled $14bn in April.

In turn, optimism regarding a swift impeachment procedure against President Dilma Rousseff has buoyed emerging markets. The rally was broad-based across the asset class (392bps vs. USTs) which keeps attracting investment flows.

China: growth 'whatever it takes'

According to Central Banks (ECB, Fed), downside risks to economic growth are mainly traceable to international developments. Hard landing in China entails one of these risks. Chinese authorities however seem to have engineered stabilization in activity. Chinese growth at 6.7%yoy in 1Q16 was about in line with expectations. That being said, a surge in credit is behind the apparent pickup in activity spurring speculation in housing markets to dangerous levels. The total of new financing reached 2384bn CNY in March. Hence, the sustainability of the growth recovery is highly questionable given skyrocketing public-sector investment and premium housing prices. Growth in retail sales is moderate at 10.5%yoy and the expected shift towards a greater consumption share in GDP is still way off. Some positive signs include better export numbers in keeping with encouraging data out of the US and Germany as regards the state of World trade. Private capital outflows moderated to around $50bn last month. Furthermore, the currency has stabilized.

US growth likely to improve through 2Q16

In the US, growth in the first quarter should be the low point for this year. GDP likely expanded less than 1%qoqa between January and March. Industrial output fell 2.3%qoqa in 1Q16. Manufacturing production adjusted with some delay to a slowdown in consumer spending on durables which is evident on lower auto sales. Inventories have fallen for a third consecutive quarter. Furthermore, persistent weakness in commodity prices has caused a sharp decline in extraction of natural resources. Natural gas output fell 12% from a year ago in March. Having said that, surveys and anecdotal evidence reported in the Fed's beige book depict an upturn in manufacturing. The inventory drawdown is ending and the outlook for investment spending now looks brighter. Service activity and job gains also remain quite steady. The risk of an abrupt ending to the current expansion that started in April 2009 lies in the buildup of debt especially in the non-financial corporate sector to levels now close to peaks seen in 2001 and 2007.

In the euro area, the ECB meeting should be a non-event. Mario Draghi expressed concerns about the possibility of a downward wage-price spiral developing across the monetary union. This - however dubious - argument will likely be the language used to convey a very dovish message to market participants on Thursday. Mario Draghi will also comment on the ECB lending survey to be released this week.

Sideways trading in bond markets

Since the start of this year, the four major bond markets have rallied in similar fashion. Ten-year yields on G4 bonds have fallen some 40-50bps year-to-date. Last week, markets ignored disappointing data out of the US (retail sales, CPI below consensus). The rise in stocks and the later gyrations in oil prices ahead of the Doha meeting (which failed to produce an agreement to freeze oil output) has kept US yields within a 1.70-1.80% range. Housing data and the PhilFed survey should remain well oriented but their impact on markets is likely to be limited. The yield curve has barely budged. The 2s10s spread is slightly above 100bps. Our flattener is still valid. The absence of significant reinvestment flows last week probably explains in part sideways trading in Treasuries. ETF flows have shown some selling pressure and continued investor interest for TIPS. The inflation carry will improve in months ahead despite a negative surprise on the March CPI. Also, a long TIPS strategy is a hedge against normalization in the term premium. The Fed's stance associated with heavy buying by the ECB and the BoJ keep Treasury yields in overvalued territory of say 30bps. However, the technical backdrop is still favorable to US 10y bond buyers as long as yields stay under 1.84%. We hold on to a long stance on T-note.

As per Bunds, yields reverted to 0.15% after a brief increase to 0.18%. Volatility is quite small. Syndications of long-term bonds have pushed yields higher beyond 10y maturities. The 10s30s spread is trading around 67bps. We still judge valuations in Bund markets to be unappealing. Fair value on 10y German bonds is 0.45% on our estimates. A scarcity premium on German securities maintains swap spreads at wide levels (40bp) despite the €4bn Bund sale scheduled on Wednesday. On Bund Jun16 future contracts, last week's price action could be an alert. The 164.40 resistance level could be hard to clear without a catalyst. We opt for a neutral duration stance. Continued pressure from BuBa purchases should however promote a flatter term structure in both 2s10s and 10s30s segments.

Consensus turns less favorable to non-core

Final investors prefer core bonds to peripheral sovereign securities. That being said, DSL 2047 issuance and syndications of long-dated OAT (20y and 50y securities) have resulted in upward pressure on long-term yields. The French debt agency issued €6bn of 20y OAT and €3bn of 50y bond respectively at historically low yield levels. Flows around 10y maturities have however been unaffected. The spread on 10y Oat is trading at 35bps ahead of April 25 large coupon and redemption flows. The trend for longer duration sold to markets will continue this week with long bond deals in Belgium (2035), Slovakia (2031) and Spain (2032, 2041). Our portfolio remains tilted towards peripheral markets despite poor spread performance year-to-date. The spread on Italian debt trades near 120bps, Spain's premiums hover about 135bps. The rally in Portugal may offer opportunities to lighten holdings ahead of DBRS' rating decision (April 29). Core country spreads are tight. We stay away from RFGB, RAGB and DSL. Neutrality is warranted in OAT markets.

Subordinated credit spreads narrow

Subordinated financial debt have benefitted from the announcement of a new fund to support ailing Italian banks. Atlante, with initial capital of €5bn, will be a backstop bid for equity and purchase junior tranches of ABS of NPLs. This plan will supplement the existing state guaranty scheme on senior ABS tranches. In this context, subordinated debt spreads have fallen. IG credit in aggregate is still about 130bps over Bunds. It is unlikely that Mario Draghi will unveil much detail about CSPP this week. Nevertheless, expected Central bank buying exacerbates downward pressure in primary markets.

Emerging debt markets have had a good week on expectations of a rapid political solution in Brazil and oil prices sticking about 40$. Currencies, local bonds markets and spreads have risen.

Main Market Indicators

Government Bonds	19-Apr-16	-1wk (bps)	-1m (bps)	Ytd (bps)
EUR Bunds 2y	-0.51 %	+1	-3	-16
EUR Bunds 10y	0.16 %	-1	-5	-47
EUR Bunds 30y	0.85 %	-2	-6	-64
EUR Bunds 2s10s	67 bps	-1	-2	-31
USD Treasuries 2y	0.76 %	+2	-8	-29
USD Treasuries 10y	1.78 %	+1	-9	-49
USD Treasuries 30y	2.59 %	-1	-8	-42
USD Treasuries 2s10s	103 bps	-1	-1	-20
GBP Gilt 10y	1.5 %	+6	+5	-46
JPY JGB 10y	-0.12 %	-2	-3	-39
€ Sovereign Spreads (10y)	**19-Apr-16**	**-1wk (bps)**	**-1m (bps)**	**Ytd (bps)**
France	34 bps	-2	0	-2
Belgium	39 bps	-2	-1	+5
Italy	122 bps	+1	+17	+26
Spain	136 bps	-2	+14	+22
Portugal	299 bps	-29	+28	+110
Inflation Break-evens (10y)	**19-Apr-16**	**-1wk (bps)**	**-1m (bps)**	**Ytd (bps)**
EUR OATi	99 bps	-2	+4	-10
USD TIPS	158 bps	+0	-4	+0
GBP Gilt Index-Linked	236 bps	-3	-2	0
Swap Spreads (10y)	**19-Apr-16**	**-1wk (bps)**	**-1m (bps)**	**Ytd (bps)**
EUR Swap Spread	39 bps	-2	+1	+2
USD Swap Spread	-15 bps	-1	+1	-7
EUR Credit Indices (BarCap)	**19-Apr-16**	**-1wk (bps)**	**-1m (bps)**	**Ytd (bps)**
EUR Corporate Credit OAS	130 bps	-1	-4	-4
EUR Financials OAS	147 bps	-1	+0	+17
EUR Agencies OAS	51 bps	-1	+0	+2
EUR Securitized - Covered OAS	54 bps	-1	-1	+3
EUR Pan-European High Yield OAS	438 bps	-21	-28	-20
Currencies	**19-Apr-16**	**-1wk (%)**	**-1m (%)**	**Ytd (%)**
EUR/USD	$1.133	-0.4	+0.73	+4.27
GBP/USD	$1.433	+0.58	-0.49	-2.77
USD/JPY	¥109.1	-0.31	+2.47	+10.17

Source: Bloomberg, Natixis Asset Management

Selected Market Views

Government Bonds	Market View
EUR Bunds 10y	=
EUR Bunds 2s10s	-1
EUR Bunds 10s30s	-1
USD Treasuries 10y	+1
USD Treasuries 2s10s	-1
USD Treasuries 10s30s	=
Cross-Currency Spreads	**Market View**
USD Treasuries - EUR Bunds (10y)	=
EUR Bunds - GBP Gilts (10y)	-1
€ Sovereign Spreads - All Maturities	**Market View**
France vs. German Bunds	=
Netherlands vs. German Bunds	-1
Belgium vs. German Bunds	-1
Spain vs. German Bunds	+1
Italy vs. German Bunds	+1
Other Bond Markets	**Market View**
EUR Index-Linked Bonds (Breakeven View)	= / +1
EUR Corporate Credit	+1
EUR Agencies (vs. Swap Curve)	+1
EUR Securitized - Covered (vs. Swap Curve)	=
EUR Pan-European High Yield	+1

Positions on a scale of "-2" to "+2", "=" stands for neutral
+1 is long (-1 is short) spread or duration or steepening view
Source: Natixis Asset Management

Writing

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