INVESTMENT TALKS

European Fixed Income Outlook for 2017

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Do you think we are at a turning point or regime shift for Fixed Income in 2017?
Yes, we think so. We think that fiscal policy will play a much more important role going forward. We think that Central Banks are realising that negative interest rates or a very flat yield curves are not necessarily good for the whole economy. So we expect fiscal policy to support monetary policy going forward. We also expect the uptrend in globalisation that we have seen over the last decades to remain flat or even experience some downside. This is not only a consequence of the recent Trump victory, but a trend that started with Tsipras' victory in Greece, and continued with Brexit. The political events that we will have in Europe over the next few months are clearly something to watch.

Do you expect the ECB to start tapering in 2017?
As I said, the ECB is coming to a conclusion that actually a very flat yield curve and negative deposit rates are not good for the banking system. The banking system is very important in Europe in order to have an efficient transmission mechanism from Central Banks into the real economy. So we think that the ECB will try to modify its monetary policy in order to make it more favourable for the banking sector and also to tackle the scarcity issue. At the moment, after the recent pick up in yield, there's no scarcity issue in Government Bonds until September 2017, but we expect this issue to reappear again. So, we do believe that the ECB will need to taper in 2017.

What sectors of the European Fixed Income market look attractive heading into 2017?
We think that inflation-linked bonds will outperform nominal bonds over the next few months, in sympathy with what we also expect for the U.S. However, we are not sure that this is a trend which will continue in Europe for the whole year. UK breakeven inflation also looks interesting. Overall, we are favourable on the asset class globally for the whole year.

What is your outlook on European Investment Grade Credit for 2017?
We think that European Investment Grade spreads are fairly priced. If we are right and there is a risk of potential tapering from the ECB and increased volatility, this might be slightly negative for the asset class. At the same time, we see pockets of value for instance in the financial sector – a steeper yield curve is good for the financial sector. We also like subordinated bonds. So the difference compared to previous years is that you need to be more selective in the asset class, you need to buy the right names in the right sector with the right timing.

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