INVESTMENT TALKS

U.S. Fixed Income Outlook for 2017

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How does the outcome of the U.S. elections affect your economic outlook for 2017?
Despite the ongoing controversy over the President-elect, I believe when you get through some to rhetoric and look at the programme as proposed, it is going to be pretty stimulative if it gets enacted in large measure. For example, there is a programme of large tax cuts - both corporate and personal income tax cuts. Loosening the regulatory noose is also on the agenda – I believe those two things combined will be fairly stimulative. Alternatively, depending on how far Mr. Trump goes on the trade protectionism, that could offset some of those positives. I believe the programme overall will be quite stimulative to the U.S. economy, which has already begun to pick-up a little growth towards the latter part of 2016.

What do you expect from the Federal Reserve next year?
I think the Federal Reserve is going to be facing a situation of modifying their slow pace. 2015 & 2016 saw one interest rate hike each - I believe the second interest rate hike will be in December 2016.
Considering the fact that we are nearly at full employment, the inflation data (while not very high yet) is definitely turning up very near to the Federal Reserve's goals – if you look at personal consumption and expenditures - core CPI is already over 2%. With the fiscal stimulus on top of the situation where we are with full employment and prices turned up, I think the Federal Reserve is going to be faced with faster hikes come 2017.

We see corporate debt outperforming U.S. treasuries and sovereign debt in 2017, although the sort of absolute returns we saw in 2016 will be hard to repeat.

What is your view of the USD vs the Euro?
We have recently seen the dollar make new highs over the last part of 2016. I believe it is going to continue for a while. I believe that relative growth rates in the U.S. are going to pick-up compared to the rest of the world. I believe that relative real rates will also pick up faster in the U.S., relative to the major developed countries, like the Euro region and Japan, where I think monetary policy is likely to remain very accommodative. Therefore, the dollar is going to continue this cyclical upswing, I believe.

What is your view on the credit market?
The credit markets are interest rate sensitive. I think the sort of absolute returns we saw in 2016 will be hard to repeat. High Yield is up mid-double digits so far this year and credit in general has done very well. I do believe, though, in the environment we are expecting (with faster growth, better corporate earnings, and still modest interest rate hikes from the Central Bank in the U.S. and very few, if any, overseas) that corporate credit will continue to be pretty good. Earnings are likely to go up in this environment - we have already seen corporate earnings turn up - and with the fiscal stimulus on our doorstep, I think defaults are going to be very low next year and therefore corporate debt will probably outperform U.S. Treasuries and Sovereign debt.

Where will the 10 year Treasury stand at the end of next year?
That's a good question and you can come at it several ways. Frankly, I think, inflation is already running at 2% in the U.S. GDP has been running at nearly 2%, so nominal GDP has been running at 3.5% probably likely to be over 4% next year. Historically, that has been a pretty good indicator of where 10 year yields ought to be. Even if you take a more pessimistic view of slower global growth, a real rate of 1% on a 2% inflation rate (and

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rising) still gives you 3% so with rates still in the low twos, I think we have a little more wood to chop on the 10 year Treasury yield.

What parts of the fixed income market offer the most compelling value?

Going forward into 2017, I think we are not likely to see the sort of aggressive capital gains we saw in 2016 given the benign interest rate environment we had. Therefore, given my prospects for positive corporate earnings, better credit conditions in terms of corporate earnings, I believe that still sticking with corporate credit is a good idea, but given the more difficult interest rate environment I really like bank loans going into 2017. They have very short duration, as they are tied to short term interest rates like LIBOR and given the steep rise in LIBOR in 2016 due to regulatory shifts in U.S. money market arena, I believe this looks like a very good opportunity to seek some decent income and try to preserve capital at the same time, even if interest rates rise.