Portfolio Manager Perspectives
BlueBay Investment Grade Debt Update

February 2, 2018

The Greatest Stock Market Rally Ever

With Trump championing the stock market and geopolitical risk waning, we wonder if bullish price action will reassert itself in February

Global bond yields have continued to push higher over the course of the past week, with robust economic data leading to further upward revisions with respect to the projected trajectory of US rates over the months ahead. Anecdotally, it appears that the mood at Davos last week was particularly bullish and there seems to be a prevailing sense that the global economy is experiencing booming conditions at the start of 2018 with momentum continuing to build. A slightly more hawkish tone from this week's Federal Open Market Committee (FOMC) meeting also played into this theme and although this was Janet Yellen's last meeting, we expect continuity at the Federal Reserve under Jerome Powell. As things stand, there seems scope for some upward revision to the dot plot communicated at the March FOMC, bringing projections closer to our view of four hikes in 2018 and a further three in 2019.

Risk assets saw some consolidation into the end of the month, with a combination of profit taking after a positive month of returns coinciding with portfolio rebalancing flows and short-term fears that Trump could announce a more hostile tone on trade at Davos or the State of the Union Address. In the event, Trump has seemed to take a more conciliatory tone of late. The risk of NAFTA termination appears to have receded in the near-term, in part due to fears that this will favour the AMLO populists going into the upcoming Mexican elections. However, from a broader perspective we find it increasingly interesting to note how closely Trump is aligning himself as the Daddy of the Greatest Stock Market Rally ever, with his recent interview with Piers Morgan insightful, in the context of how many times he referred to stocks posting a record number of record highs under his tenure. From this point of view, we think it makes sense for Trump to do little and let financial markets run to the upside and consequently, it strikes us that geopolitical risk continues to wane for the time being.

With economic data seemingly pretty stable and predictable and with month-end effects now behind us, we therefore wonder if bullish price action may start to reassert itself in February in the absence of much to dent confidence. It is possible that risk assets are becoming more sensitive to the rise in government yields, though absent a more decisively hawkish tone from central banks, volatility remains low and with greed becoming more entrenched as the dominant psychology driving markets, we feel the upside momentum may start to build once more, in the absence of a driver to the downside.

We see scope for further credit compression in the eurozone, thanks to the MEGA Trump phenomenon (that is "Make Europe Great Again!"). Within the periphery, Spain continues to converge towards the semi-core and Italian spreads are being dragged tighter as investors increasingly realise that there is no realistic path towards an 'Italexit' anytime soon, notwithstanding the upcoming election. We continue to see the most value in Greece in the context of a compression trade and we believe that upcoming issuance may serve as a catalyst for further spread narrowing. Corporate credit spreads appear to offer more limited scope for tighter spreads at an index level. However, we continue to favour subordinated bank debt and other issuers set to benefit from a more generic compression theme.

Looking ahead, following payrolls later today, early February has a quiet feel to it. Consequently, unless higher rates start to destabilise risk assets, we wouldn't rule out a continuation of the trends seen during January as we head towards Chinese New Year celebrations. In that context, the Year of the Rooster may end on a Booster, though one wonders what that may end up inferring for the Year of the Dog to follow...

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