Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Investment Grade Debt Update

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Goldilocks Period

Risky assets break new highs as volatility in the eurozone pauses for breath.

Attention refocused on data and monetary policy this week, with Janet Yellen delivering the semiannual Humphrey Hawkins testimony to Congress and Retail Sales/CPI releases coming out of the US. Data and rhetoric continue to validate our core thematic views, and rate expectations have moved higher over the week. Janet Yellen's tone was modestly hawkish rhetoric, but not overly so. She put a March hike back in play but was fairly balanced. Perhaps the most significant new information was her assertion that the Federal Reserve does not intend to use the balance sheet as a tool to tighten policy, emphasising that the short term interest rate was the primary tool for adjusting monetary policy. January inflation numbers were firmer than expected with headline CPI rising to 2.5% from 2.1% in December. Retail sales were also to the stronger side and other data points remain unambiguously robust. Rates in the US have moved modestly higher but we remain in the fairly narrow range that has been in play since the beginning of the year.

In Europe, the European Central Bank minutes caused some excitement with the mention that implementation of the QE program might require "limited and temporary deviations from the capital key". Peripheral sovereigns have performed well on the news, and generally, even before the release of the minutes, we have observed a pause in volatility in the European space. France has consolidated, perhaps more a result of there being little fresh momentum from Le Pen's election campaign than anything else. In our view, the balance of risk remains skewed towards a further escalation in fears over the outcome of the election in May. There has been no concrete change in the ongoing standoff between Greece, the IMF and the EU Institutions. What we would comment on, however, is that the mood music from EU policy makers at the core of this dispute is much more positive. We continue to expect a muddle through fudge in the coming weeks.

Perhaps the most noteworthy price action over the week has been the strong performance of risky assets. Equity markets are going up, and there is general spread compression in credit, both in sovereign and non-sovereign asset classes. The market is experiencing a goldilocks period as docile core rates, a well behaved US dollar and supportive global macroeconomic data are creating an environment that is very constructive for risk in general.

So far, 2017 has been about adjusting to the reality of the Donald Trump Presidency. His frenetic style of governance and stream of conscious tweeting is keeping policy makers and investors around the world on their toes, and has been hugely entertaining/encouraging/horrifying depending on your political bias. Cutting through all the noise, we would observe that the global growth outlook is looking more constructive and more evenly balanced than we (and the market) thought at the back end of 2016. This is significant because the more synchronised the global economy is, the less likely there is to be a significant and disruptive move in currency markets. It will also give risky assets greater capacity to withstand the inevitable tightening in monetary policy that we anticipate in the US.

Overall, there is little in the way of change to our core thematic positioning. We remain patient, and confident, that our bearish view on the front end of the US curve will pay dividends. Similarly, in the UK, we remain confident that 2017 will witness a big move higher in inflation that will force a more hawkish stance from the Bank of England. In Europe, the re-pricing of sovereign credit risk has paused for breath, but attention is firmly focussed on the potential for either Marine Le Pen or Benoit Hamon (an extreme left candidate) to win the French Presidential election in May. Either candidate would be a disaster for French credit. For now, we are happy enough to be along for the goldilocks ride, but remain vigilant and mindful that there are multiple sources of risk that could upset the applecart.

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