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# Bond Market Outlook ECB Bond Market Contact Group

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6 February 2018

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Manager

Wellington Management International Ltd

Neeta Madahar, Falling 1 (detail), 2005. Lightjet print mounted on aluminum, 48 x 48 inches (122 x 122 cm)

## Market overview

### 4Q highlights

The US dollar continued its slide

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Global Financial conditions eased further

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Even though both Bank of England and Fed hiked....

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Growth synchronised and at multi-year highs

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But geopolitics dominates headlines

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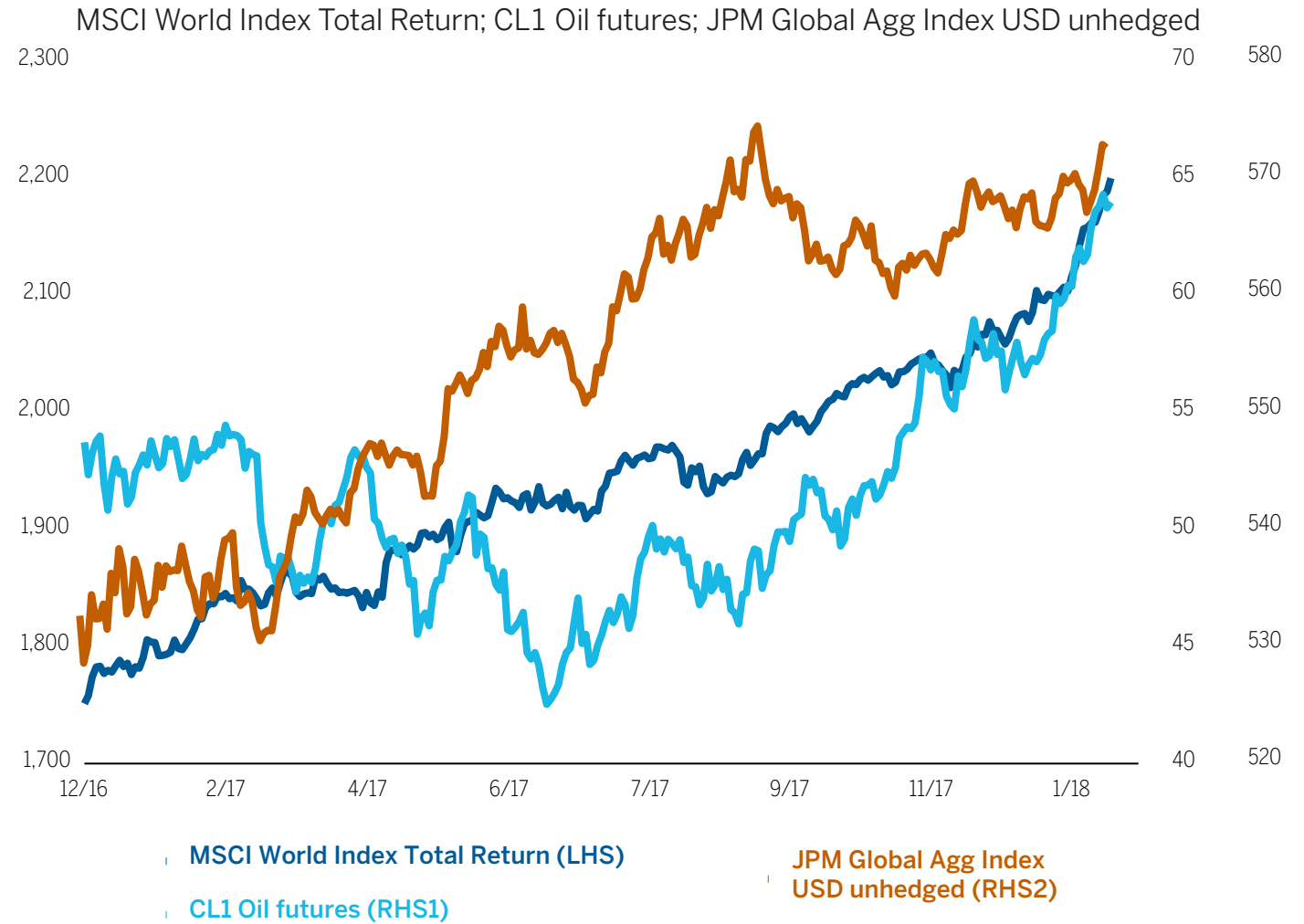
Continued curve flattening in the US gathered more attention....

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Still little evidence of inflation

## Market overview

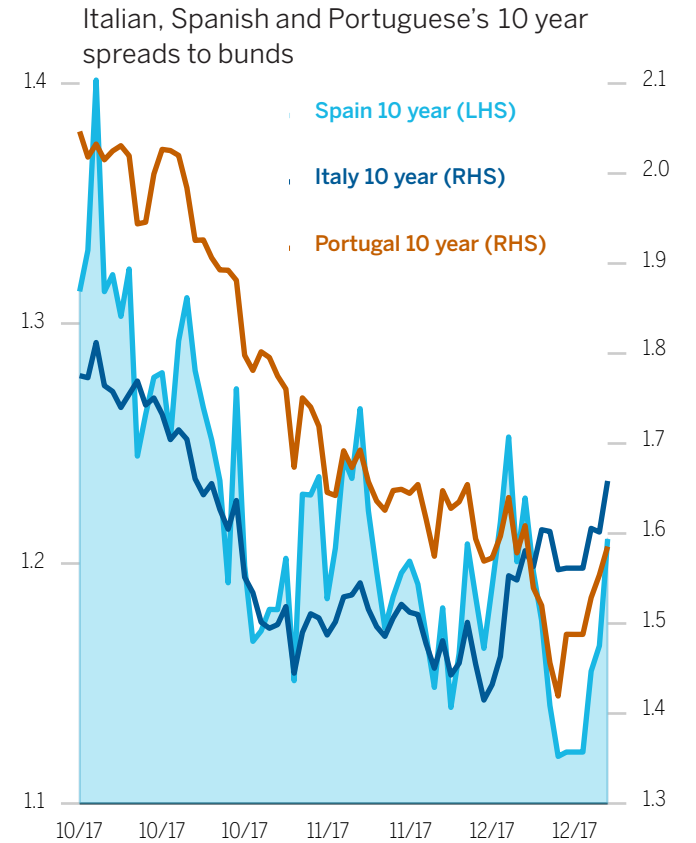
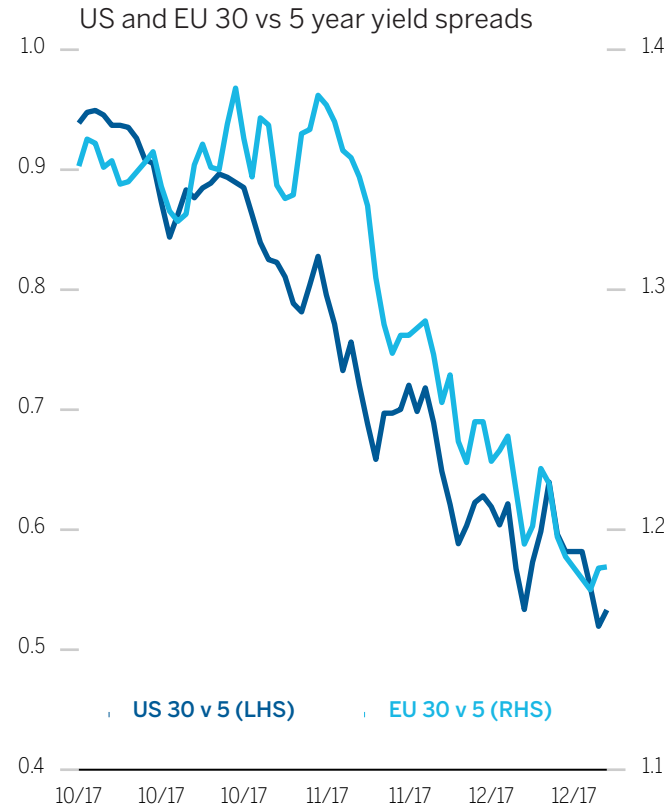
### A bullish year for asset returns



Source: Bloomberg | Chart data: 30 December 2016  
– 17 January 2018

## Market overview

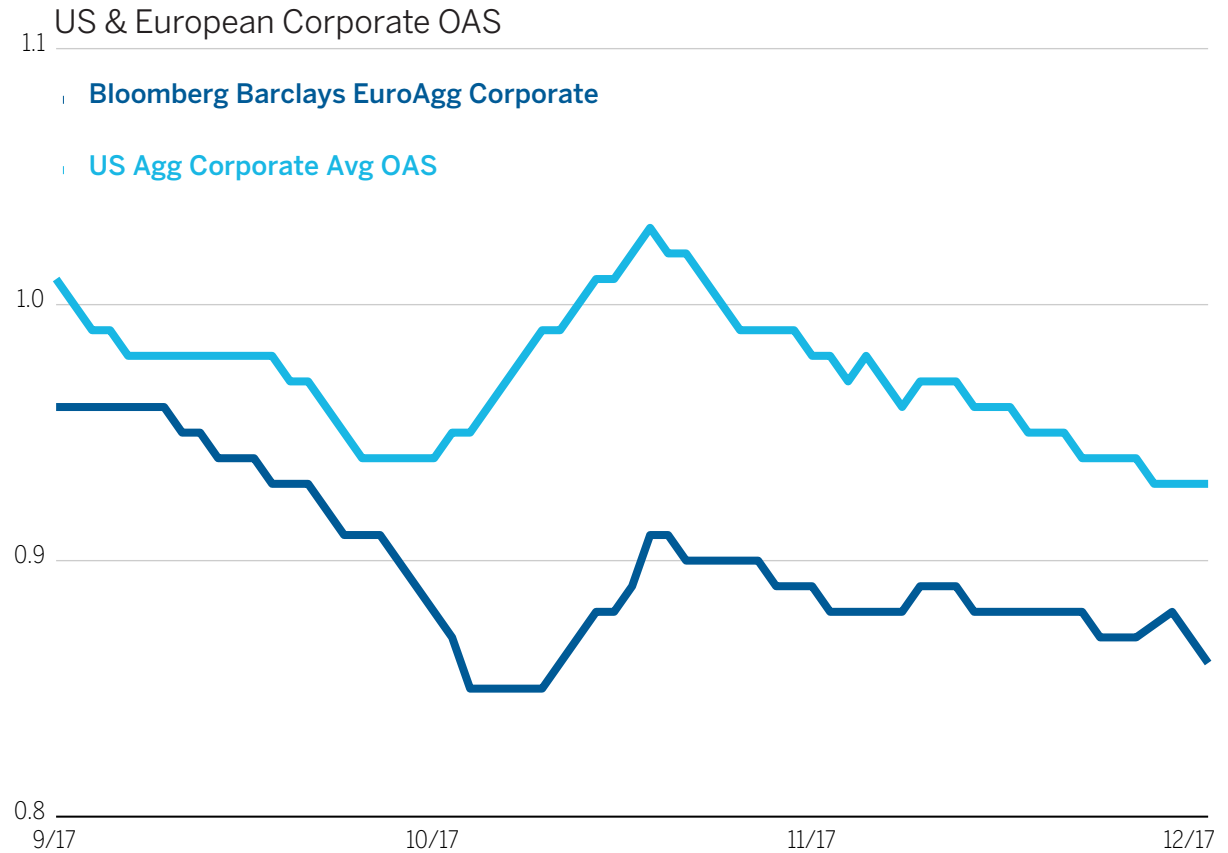
### Flatter curves and tighter spreads



Source: Bloomberg | Chart data: 2 October 2017 – 29 December 2017

## Market overview

### Tighter credit spreads

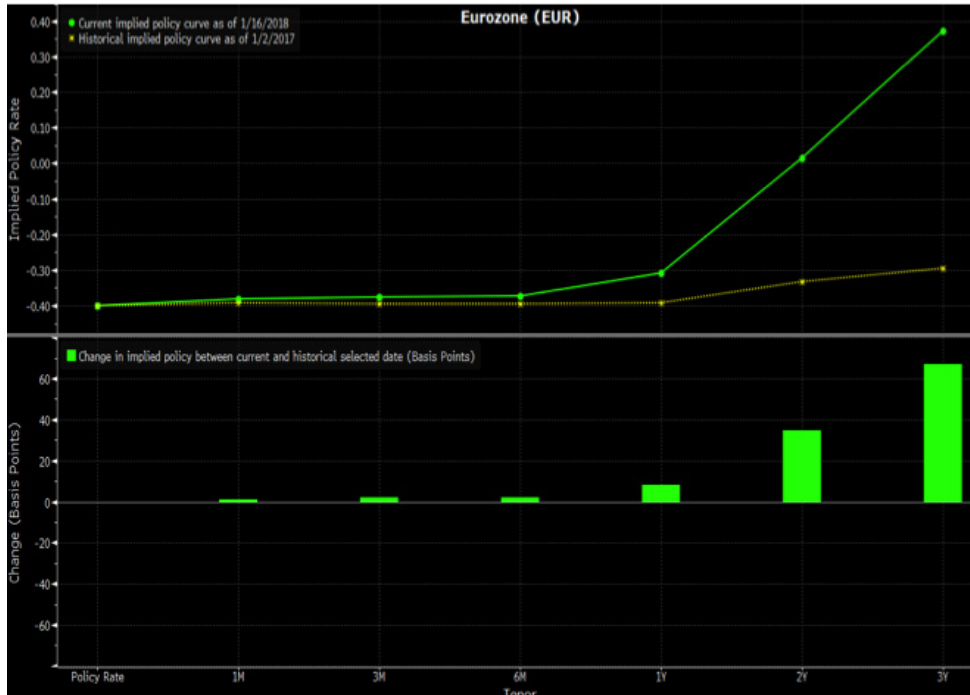


Source: Bloomberg | Chart data: 30 September 2017  
– 29 December 2017

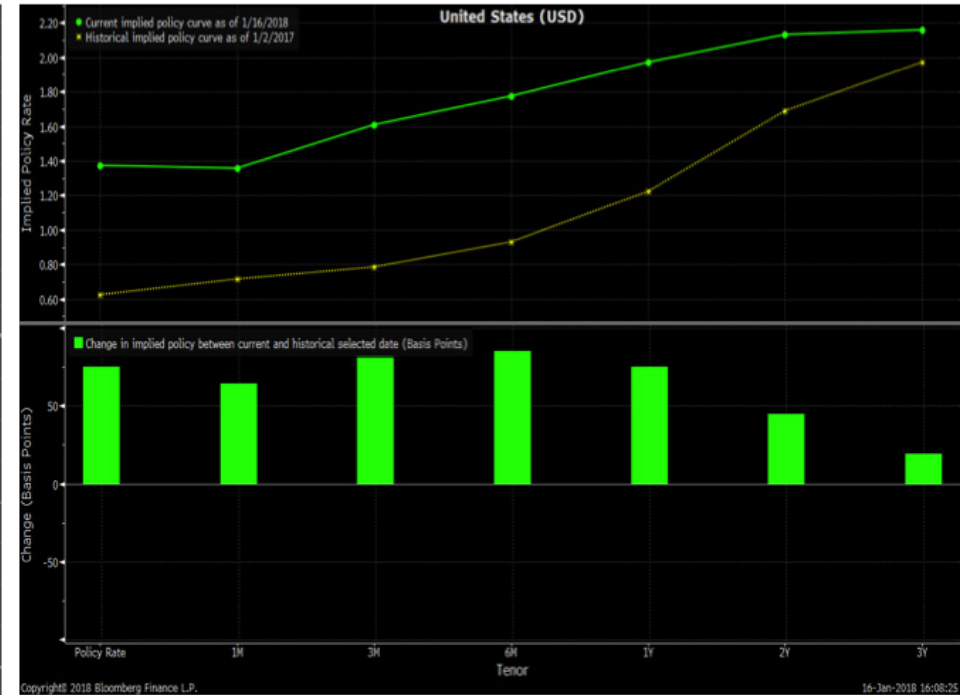
# Market overview

## Different continents, different stories

Steepening of Eurozone front-end curve



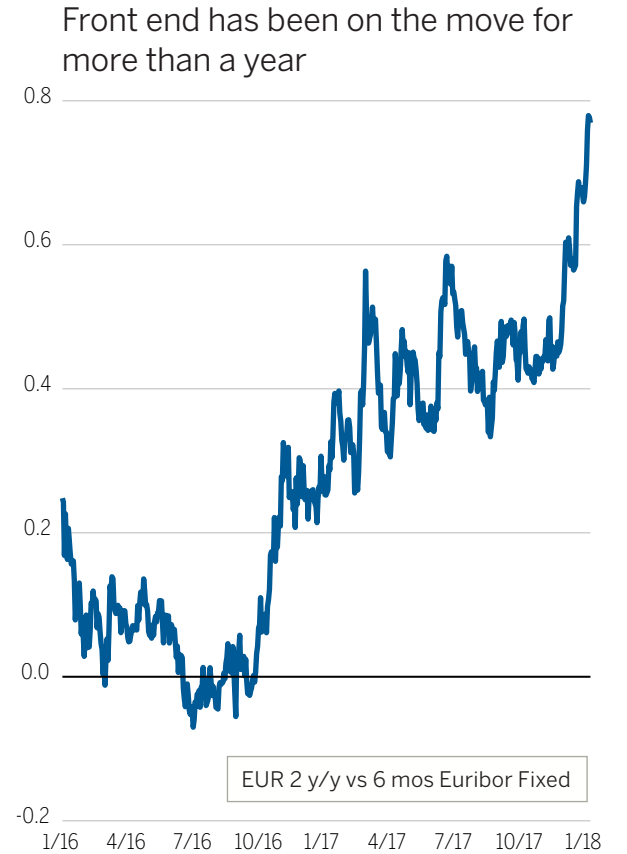
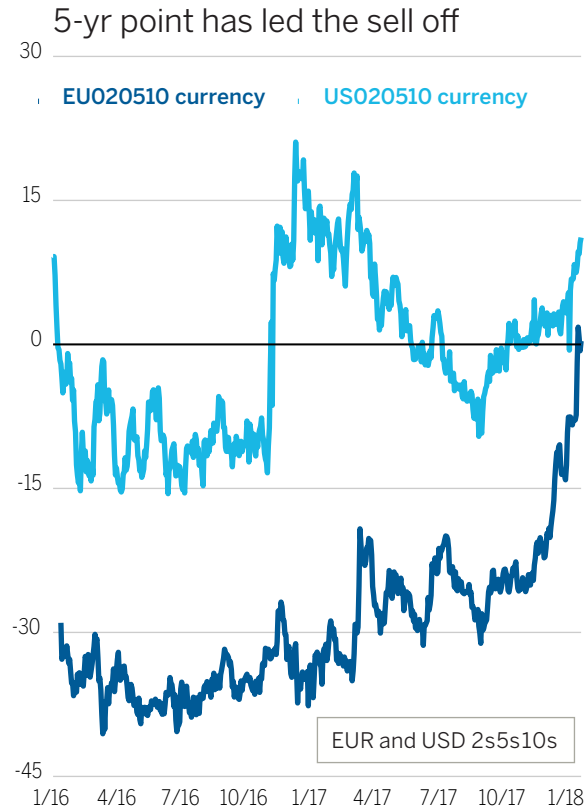
Flattening in the US



Source: Bloomberg as of 17 January 2018

## Market overview

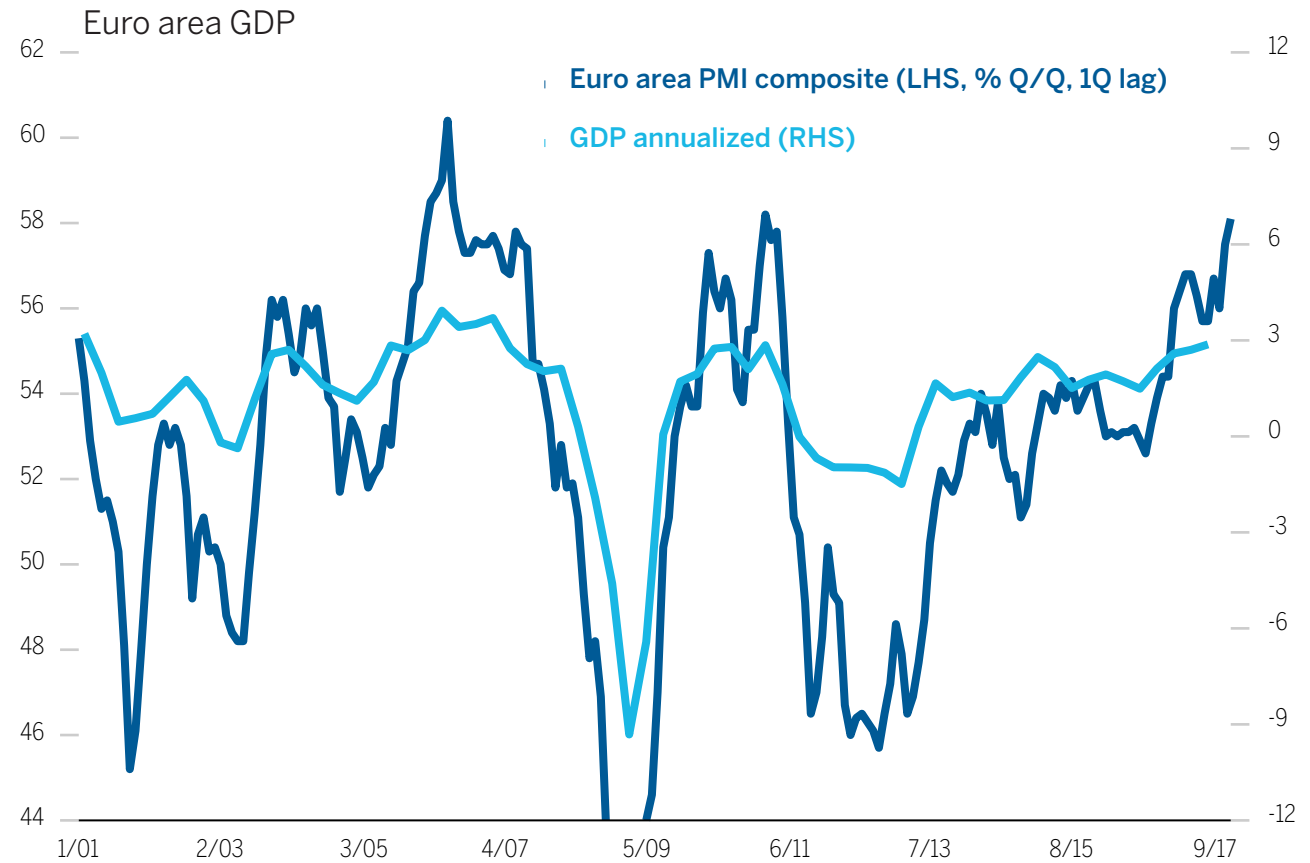
### Magnitude of recent sell-off



Source: Bloomberg | Chart range: 4 January 2016 – 31 January 2018

## Macro backdrop

Growth to surprise on the upside



Source: Thompson Reuters Datastream | Chart data:  
January 2001 – December 2017



## Macro backdrop

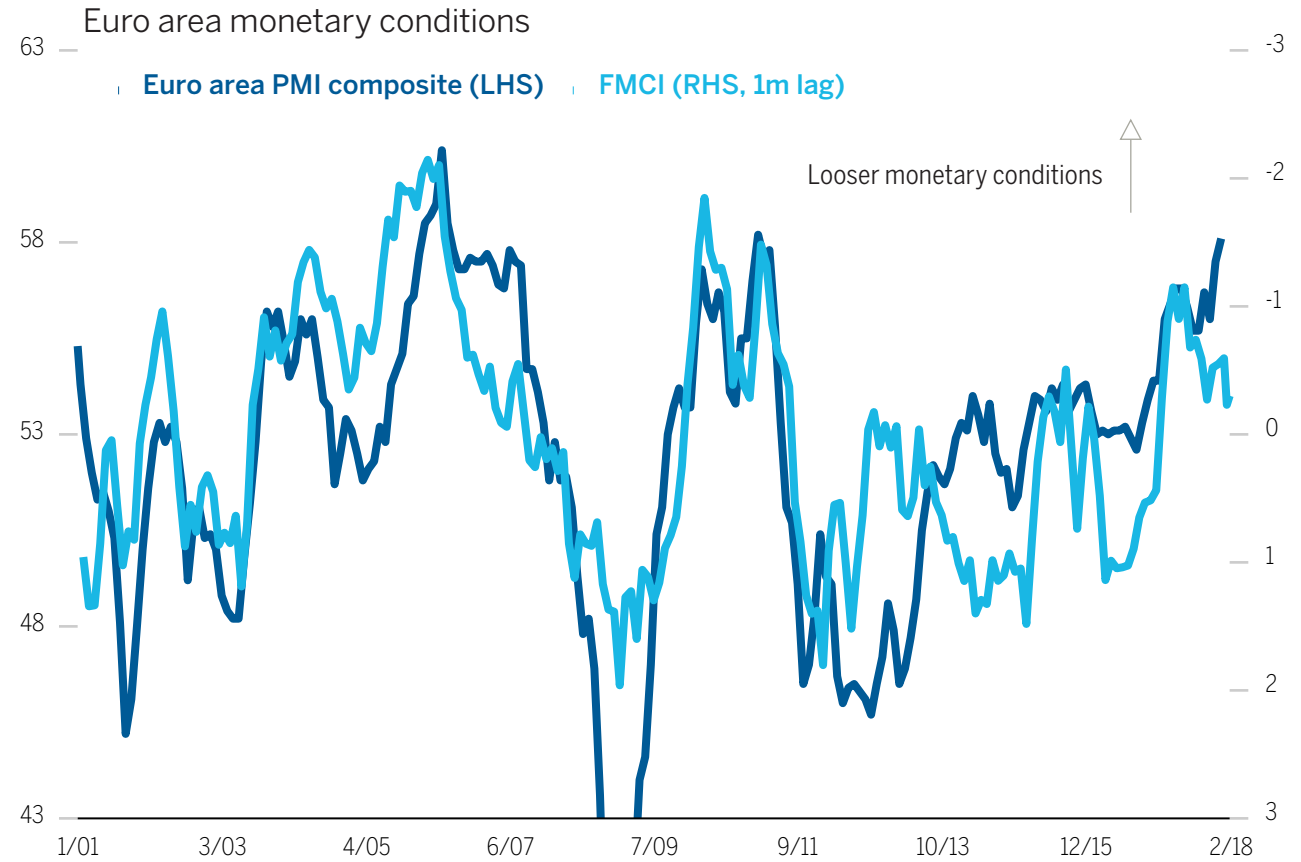
### Employment to improve further



Source: Thompson Reuters Datastream | Chart data:  
February 1998 – 3Q18

## Macro backdrop

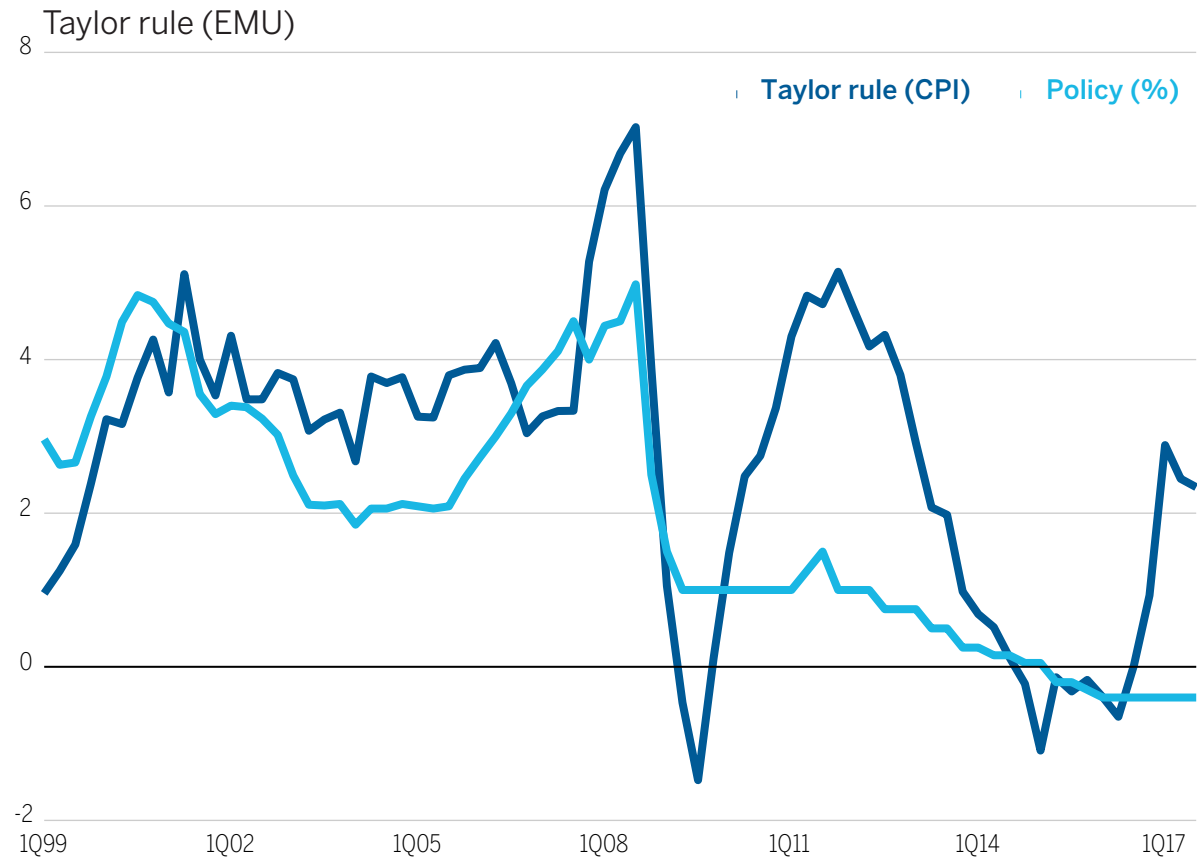
### Slight tightening in financial conditions



Source: Thompson Reuters Datastream | Chart data:  
January 2001 – February 2018

## Macro backdrop

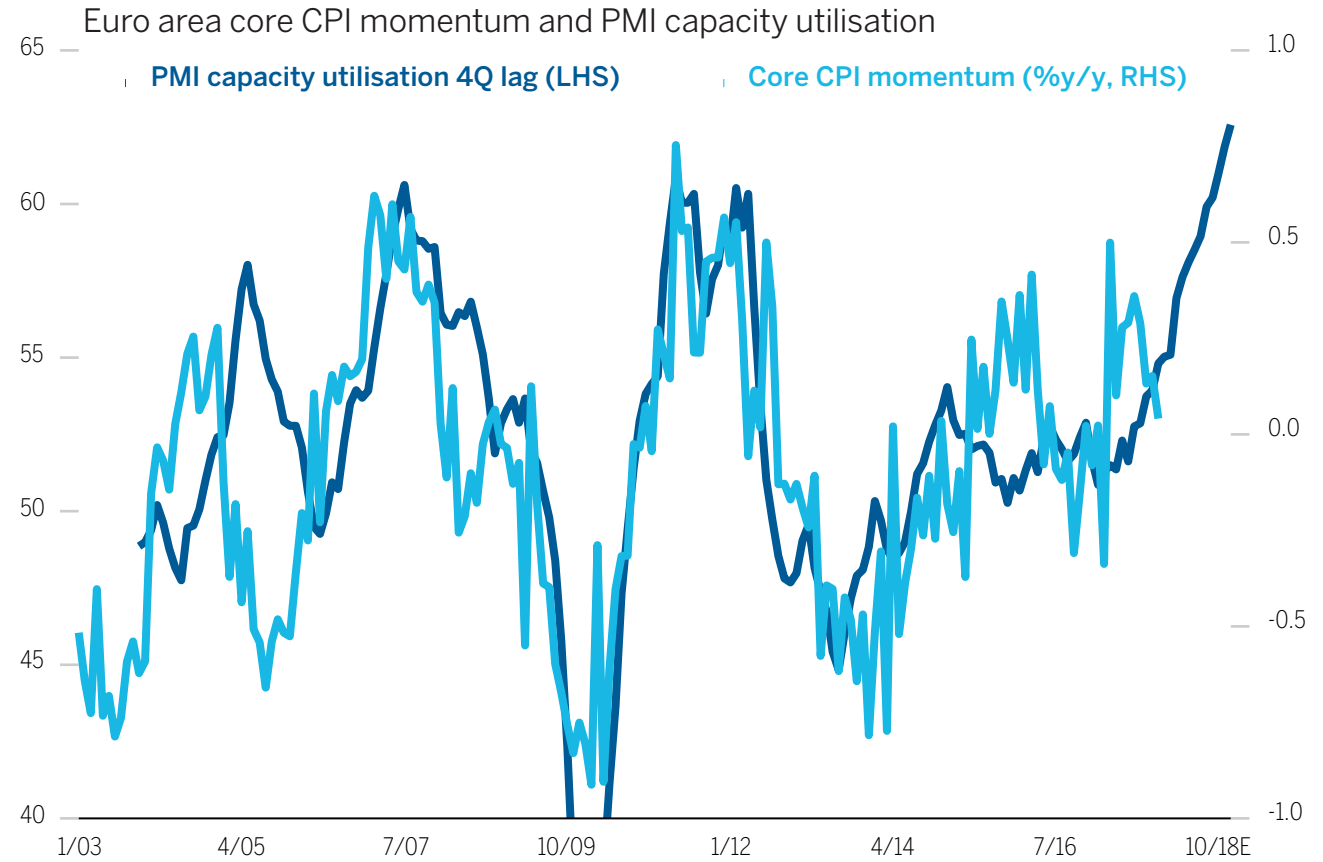
But monetary conditions are very easy



Source: Thompson Reuters Datastream | Chart data:  
1Q99 - 3Q17

## Macro backdrop

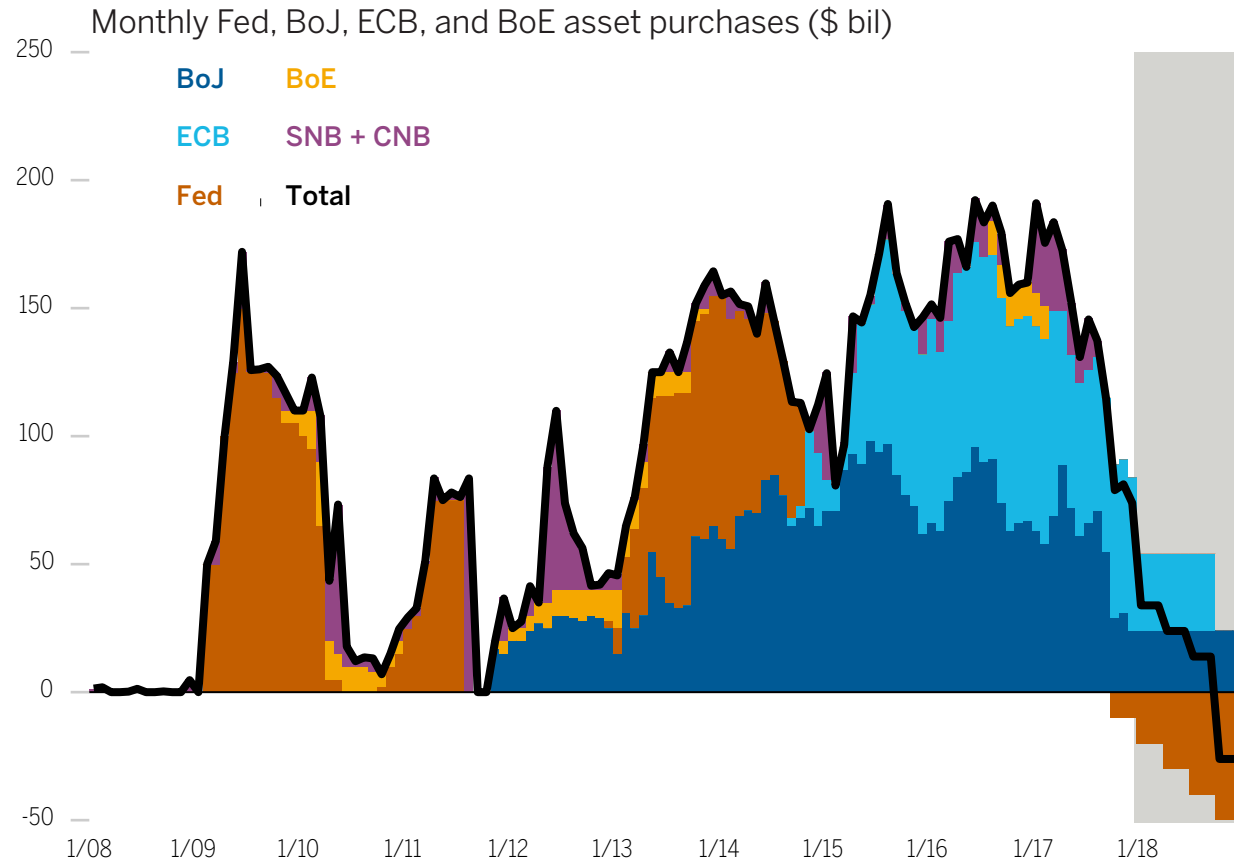
### Inflation expectations



Source: Thompson Reuters Datastream | Chart data:  
1 January 2003 – 3 December 2018

## Macro backdrop

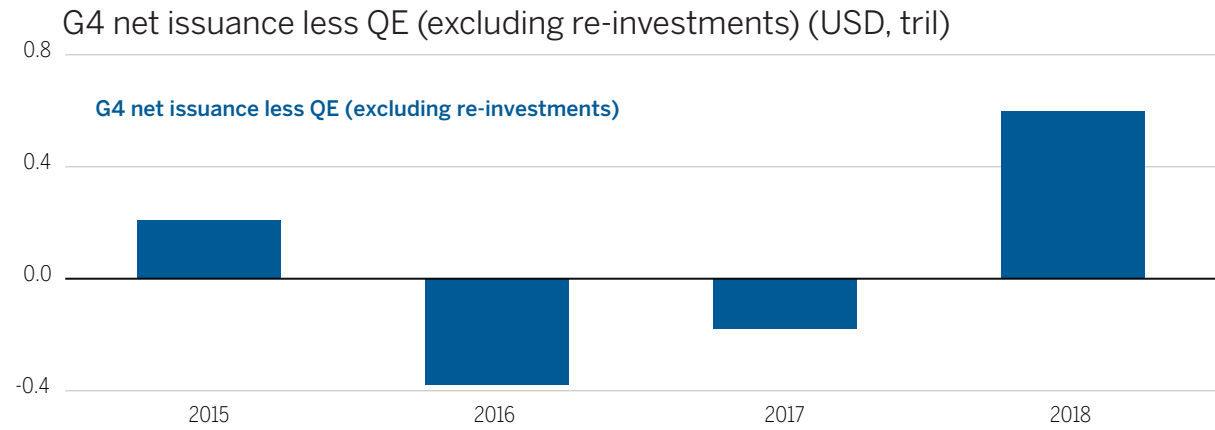
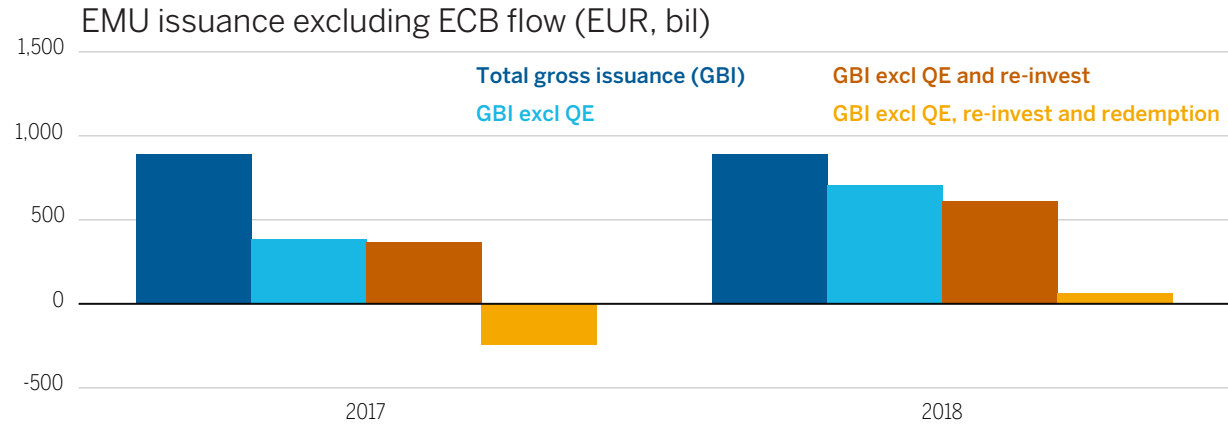
Major central banks are expected to reduce policy stimulus



Shaded data beyond January 2018 represent our estimates. Actual results may vary significantly from estimates. | Sources: Various national central banks, Wellington Management | Chart data: January 2008 – December 2018

## Macro backdrop

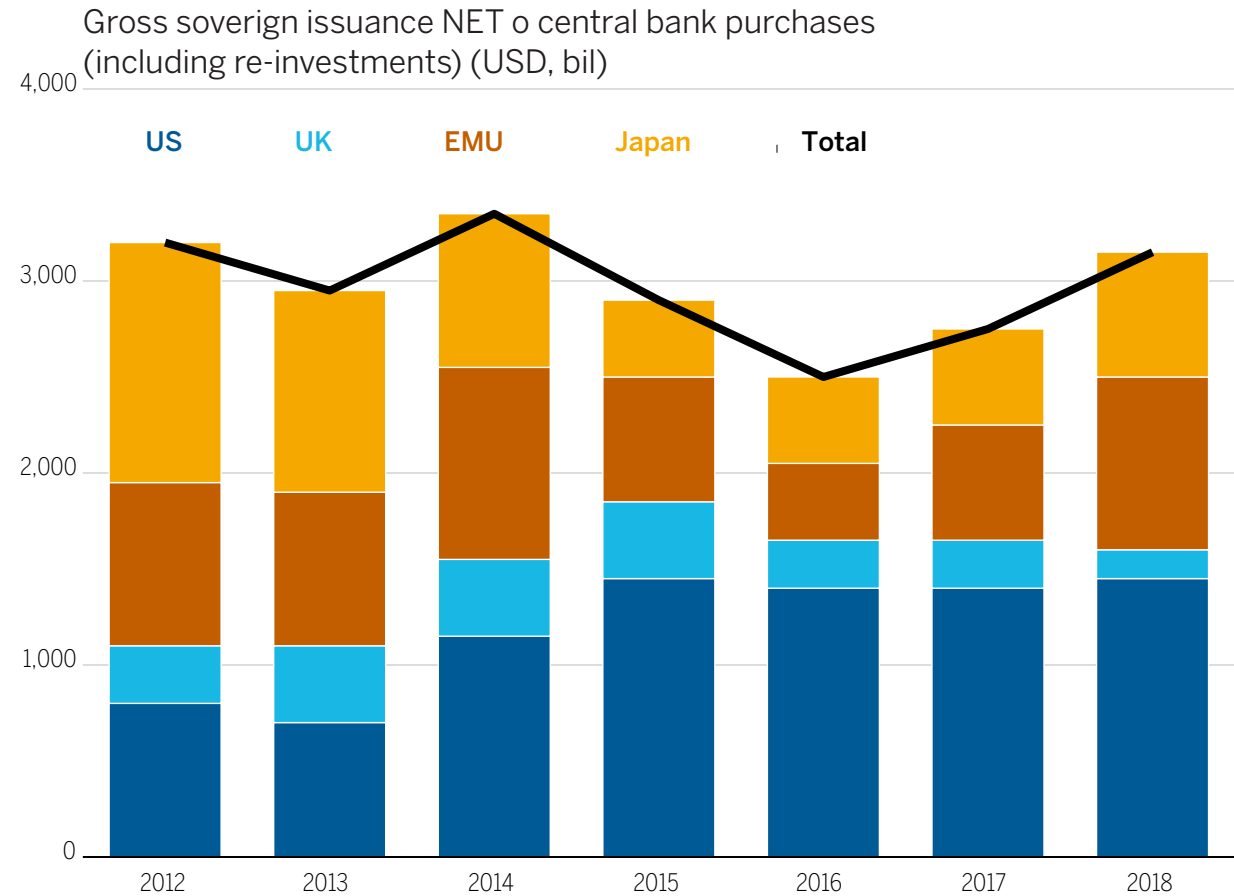
With shifting supply dynamics



Sources: European Commission, Bloomberg, National Debt Management Offices, January 2018

## Macro backdrop

Total issuance highest since 2015



Sources: European Commission, Bloomberg, National Debt Management Offices, January 2018

## **Bond market outlook**

### Burning questions for 2018

Will the ECB end QE?

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Will the BoJ change its policy targets?

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Will inflation finally emerge?

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Who will buy additional supply?

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Will the curve flattening theme continue?

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Will the EU follow on a new virtuous path?

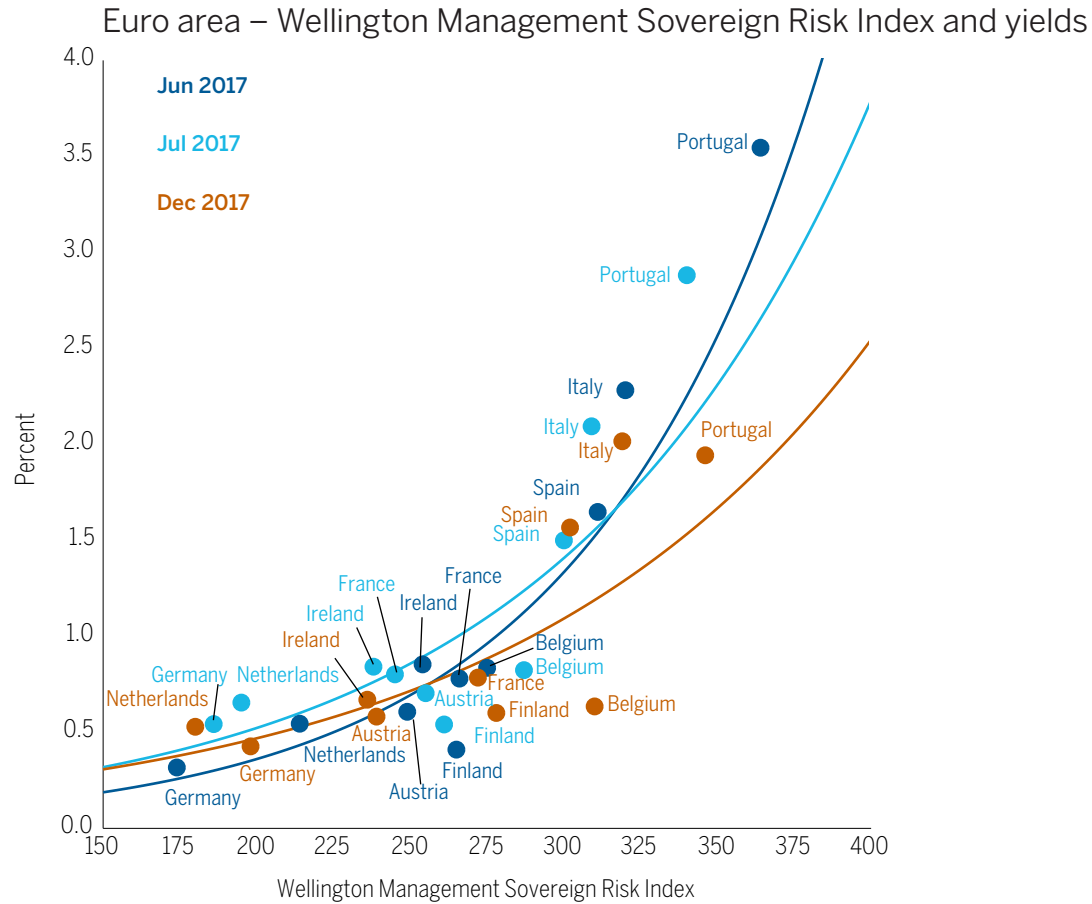
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Will the melt up in risky assets continue?



## Bond market outlook

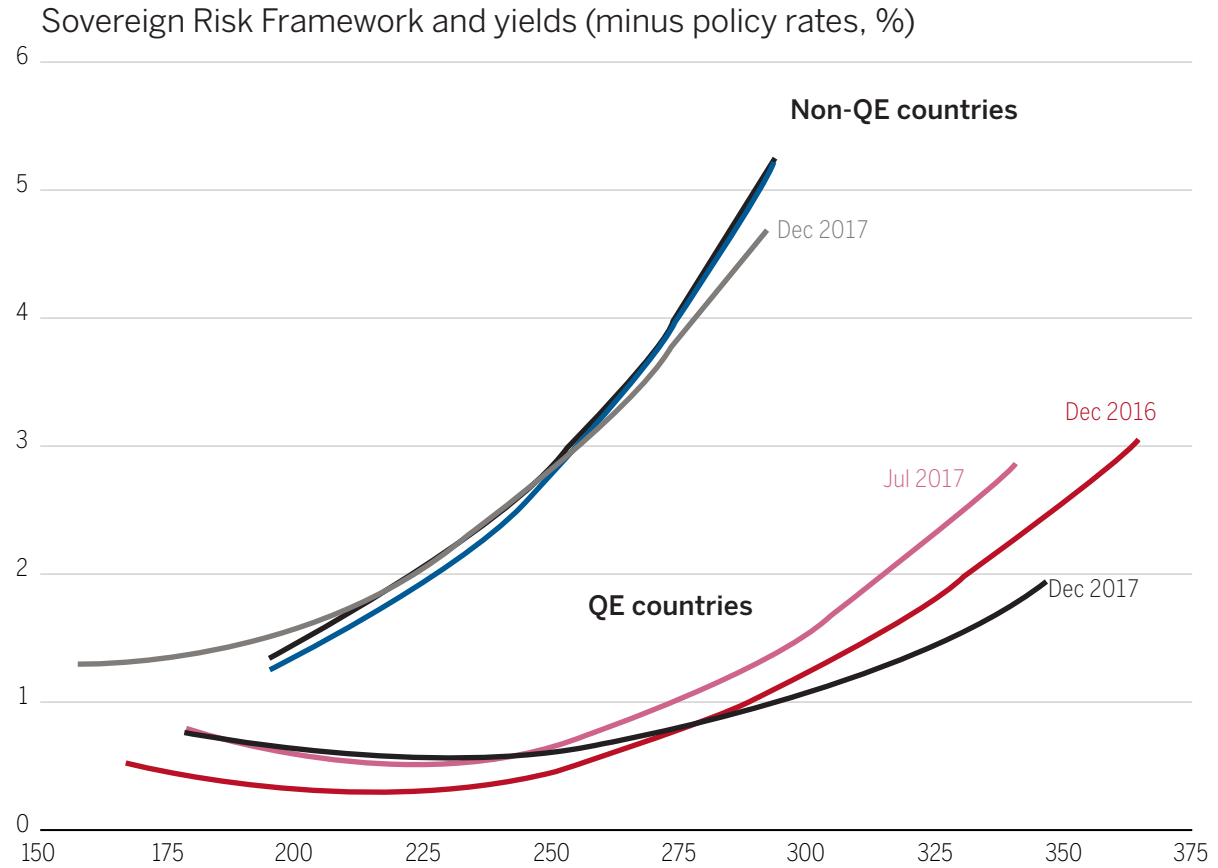
QE has been powerful at lowering yields and risk premium for sovereigns



The output data presented are internal ratings based on the Wellington Management's proprietary Sovereign Risk Framework. | For illustrative purposes only. Not representative of an actual investment. | Source: Wellington Management, January 2018

## Bond market outlook

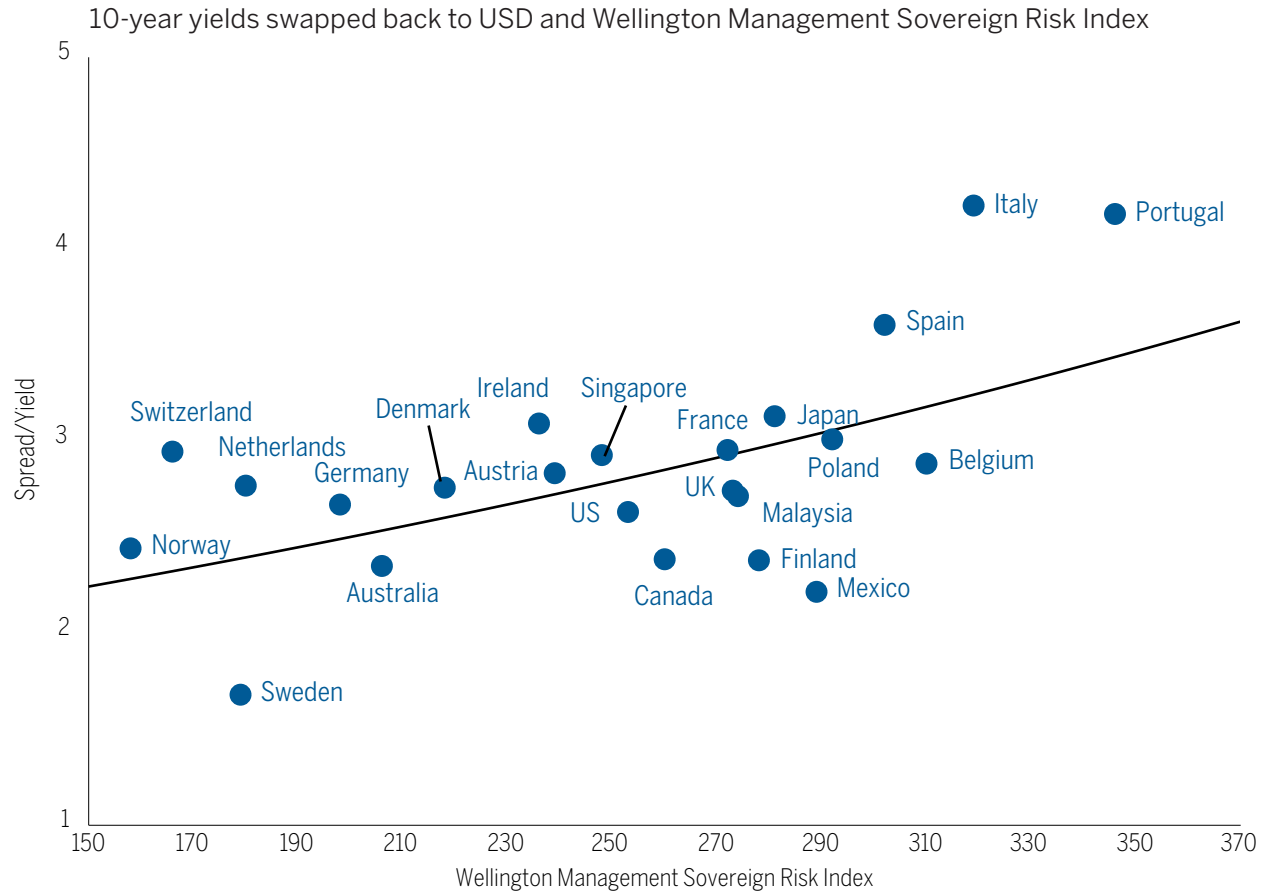
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## Bond market outlook

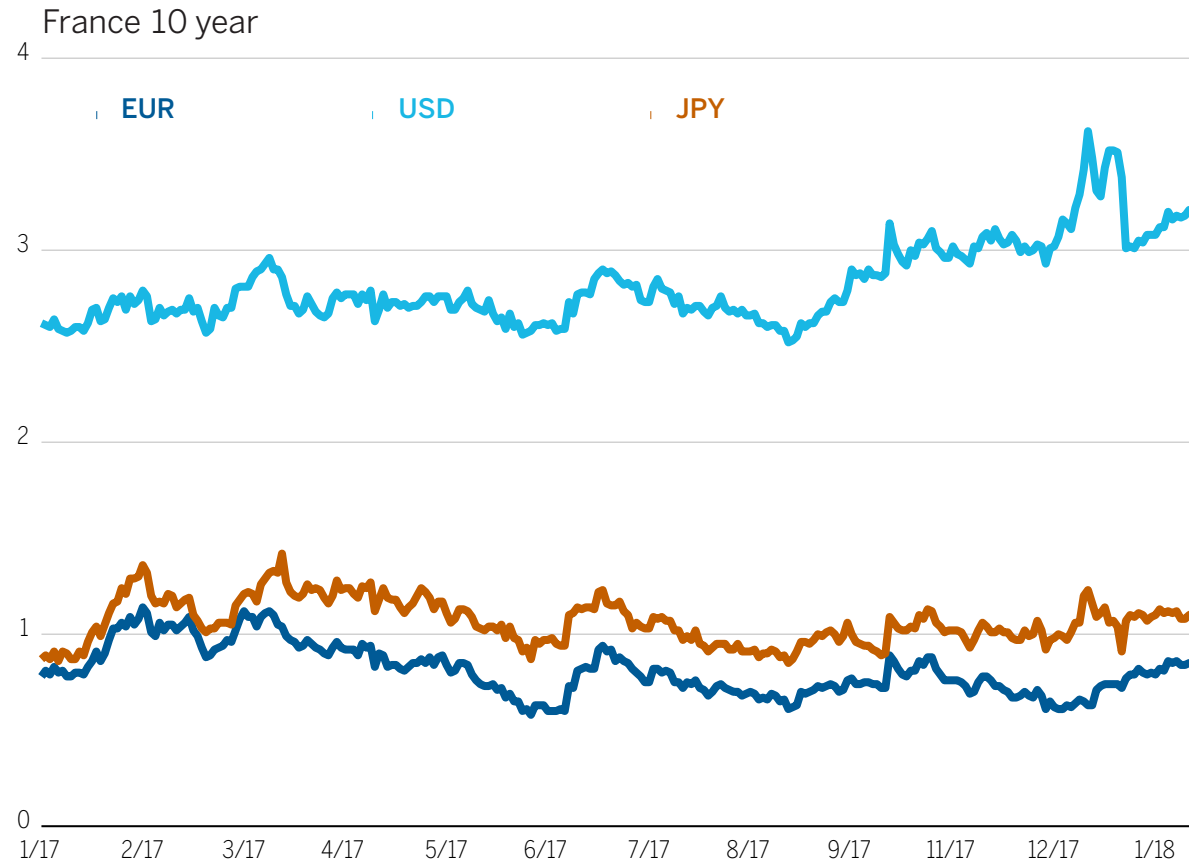
Nevertheless there is value in some



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## Bond market outlook

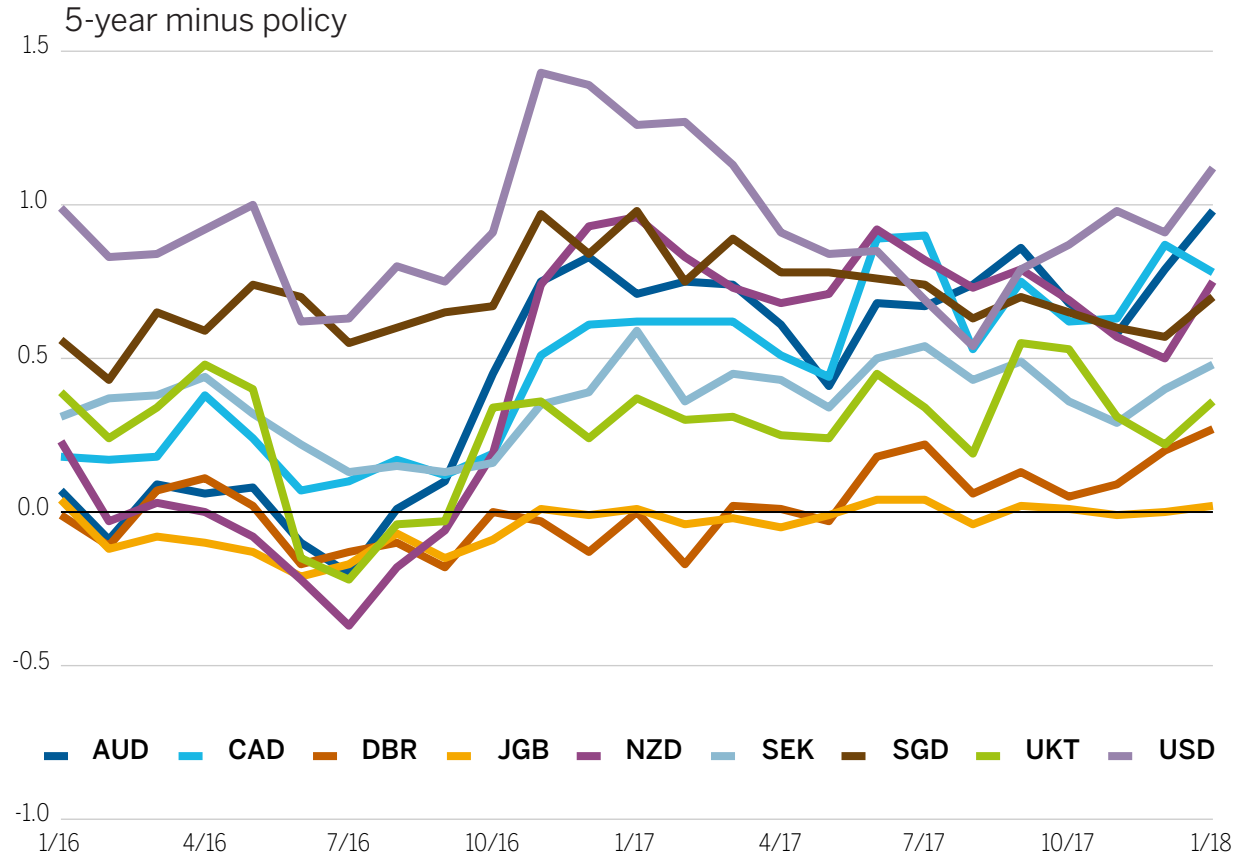
### European Fixed Income still attractive



Source: Bloomberg | Chart data: 3 January 2017 – 19 January 2018

## Bond market outlook

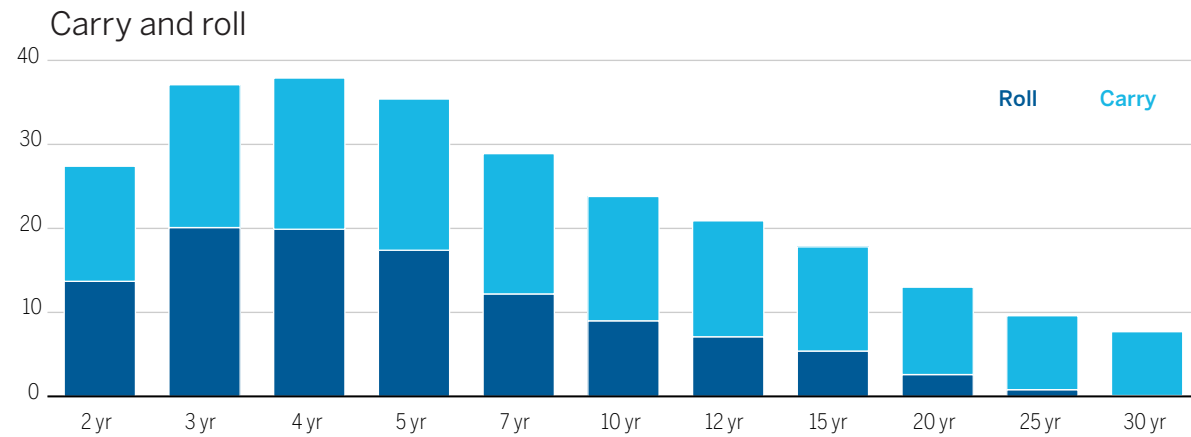
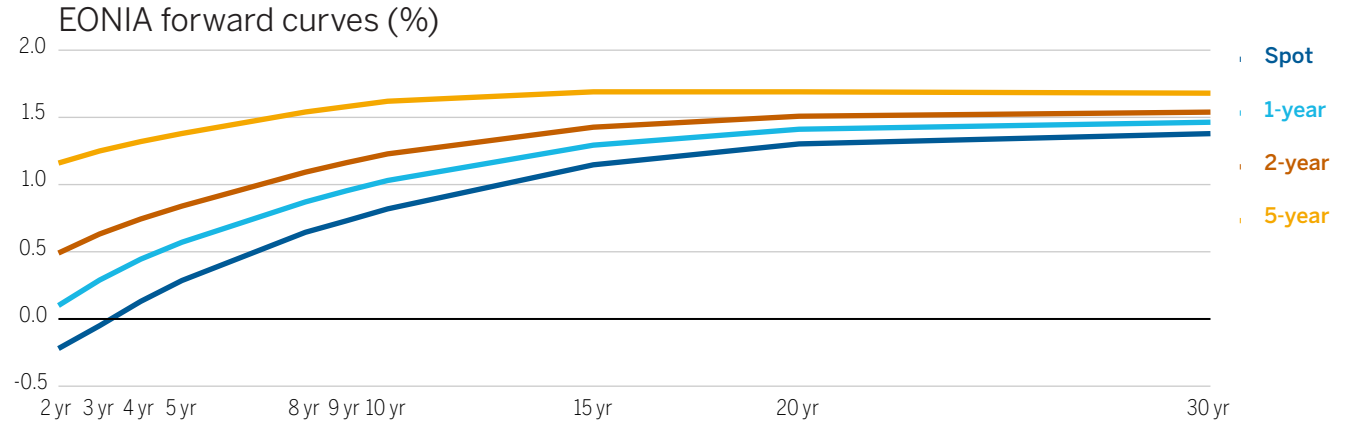
Less value however if policy is normalising



Source: Bloomberg | Chart data: 29 January 2016 – 31 January 2018

## Bond market outlook

Forwards markets already pricing some normalisation



## **Bond market outlook**

### Outlook for 2018

Higher yields but difficult to consistently beat forwards given carry & roll

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Flatter curves across the EUR universe; 10-30 year especially

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Front end can reprice further. 5s and 10s rich relative to 30s

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Tighter spreads as structure and cycle make further gains

## Areas for discussion

Geopolitical risks still very important drivers

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Melt up v Melt Down

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Inflated assets or inflation

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The unwinding of balance sheets

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The return of Mr Bond?

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China cycle risks

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What will they look like? Fed, ECB, BOJ staff changes 2018-2019



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