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6 February 2018
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Market overview
4Q highlights

The US dollar continued its slide

Global Financial conditions eased further

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

Growth synchronised and at multi-year highs

But geopolitics dominates headlines

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

Still little evidence of inflation
Market overview
A bullish year for asset returns

MSCI World Index Total Return; CL1 Oil futures; JPM Global Agg Index USD unhedged

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

US & European Corporate OAS

Bloomberg Barclays EuroAgg Corporate

US Agg Corporate Avg OAS

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

5-yr point has led the sell off

Front end has been on the move for more than a year

Source: Bloomberg | Chart range: 4 January 2016 – 31 January 2018
Macro backdrop
Growth to surprise on the upside

Euro area GDP

Euro area PMI composite (LHS, % Q/Q, 1Q lag)
GDP annualized (RHS)

Source: Thompson Reuters Datastream
Chart data: January 2001 – December 2017
Macro backdrop
Employment to improve further

Euro area employment

PMI composite employment (LHS, 1Q lag)

Employment % y/y (RHS)

Source: Thompson Reuters Datastream | Chart data:
February 1998 – 3Q18
Macro backdrop
Slight tightening in financial conditions

Euro area monetary conditions
Euro area PMI composite (LHS)    FMCI (RHS, 1m lag)

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

![Chart data: Monthly Fed, BoJ, ECB, and BoE asset purchases ($ bil)](chart)

Macro backdrop
With shifting supply dynamics

EMU issuance excluding ECB flow (EUR, bil)

G4 net issuance less QE (excluding re-investments) (USD, tril)

Sources: European Commission, Bloomberg, National Debt Management Offices, January 2018
Macro backdrop
Total issuance highest since 2015

Gross sovereign issuance NET of central bank purchases (including re-investments) (USD, bil)

Sources: European Commission, Bloomberg, National Debt Management Offices, January 2018
Bond market outlook
Burning questions for 2018

Will the ECB end QE?
Will the BoJ change its policy targets?
Will inflation finally emerge?
Who will buy additional supply?
Will the curve flattening theme continue?
Will the EU follow on a new virtuous path?
Will the melt up in risky assets continue?
**Bond market outlook**

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

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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
QE has been powerful at lowering yields

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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

EONIA forward curves (%)

Carry and roll

As of 26 January 2018 | Source: Bloomberg
Bond market outlook
Outlook for 2018

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

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

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

Tighter spreads as structure and cycle make further gains
Areas for discussion

Geopolitical risks still very important drivers

Melt up v Melt Down

Inflated assets or inflation

The unwinding of balance sheets

The return of Mr Bond?

China cycle risks

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