

Where Next for Global Fixed Income?

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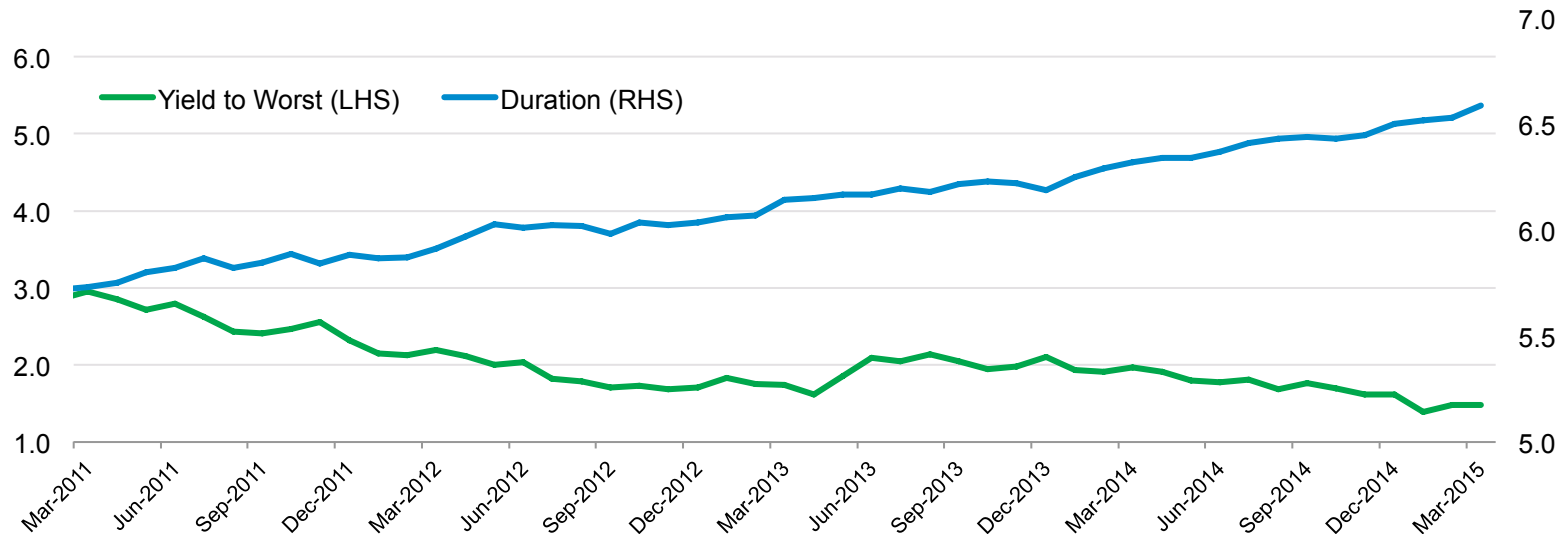
1st May 2015

Where next for global fixed income?

- ▶ **The world is in an exceptionally low yield environment**
- ▶ **Global monetary policy looks set to truly diverge**
- ▶ **Normalisation of US interest rates is unlikely to be smooth for financial markets**
- ▶ **Risks and opportunities – emerging markets**
- ▶ **How do we approach this new world?**

Yields have fallen to record low levels

Global Aggregate Index yield and duration



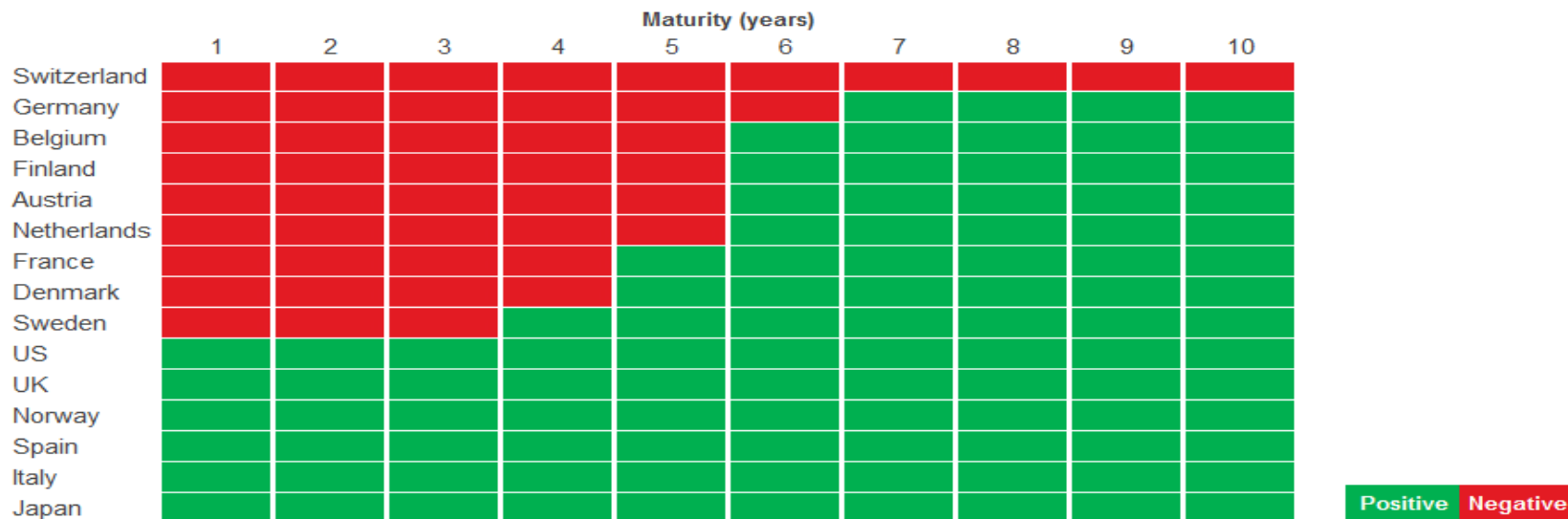
Zero return 'breakeven' increase in yield = 22bps

Source: Barclays Live, BlackRock, Thomson Reuters

Yields have fallen to record low levels

Disappearing yields

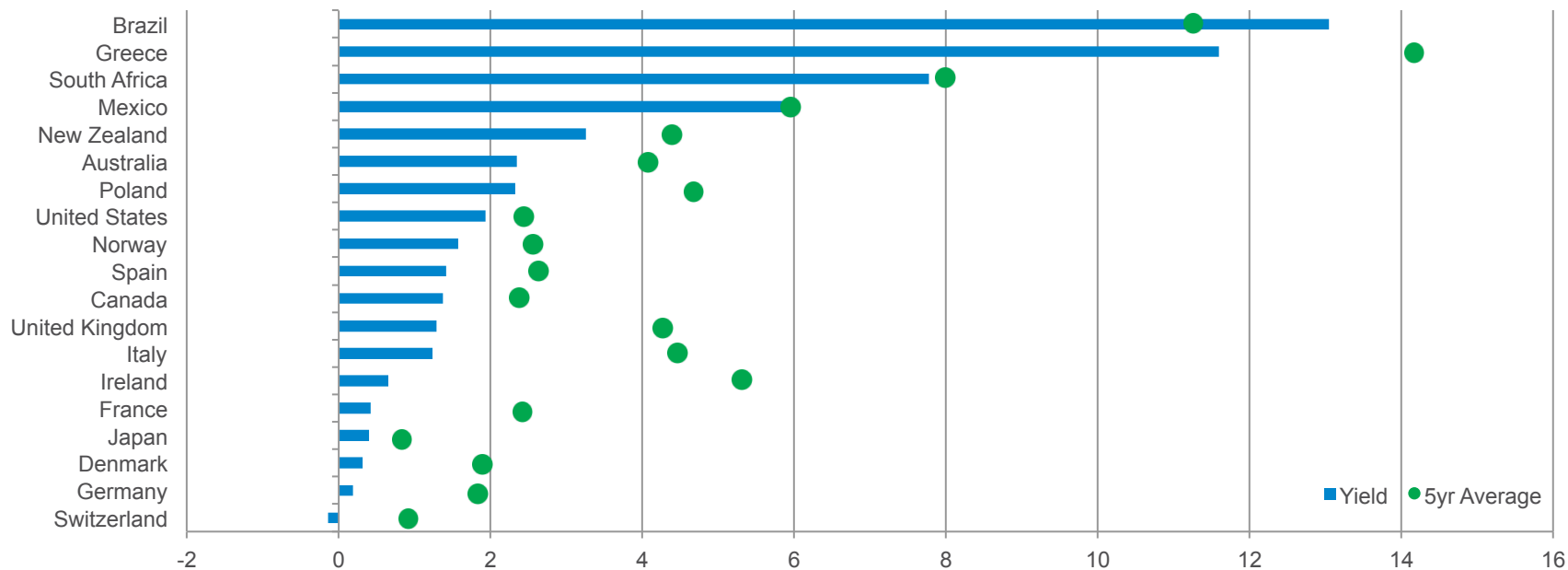
Negative Yields in Government Bond Markets



Source: Barclays Live, BlackRock, Thomson Reuters . March 2015

Generating yield in fixed income without sacrificing principal protection is increasingly challenging

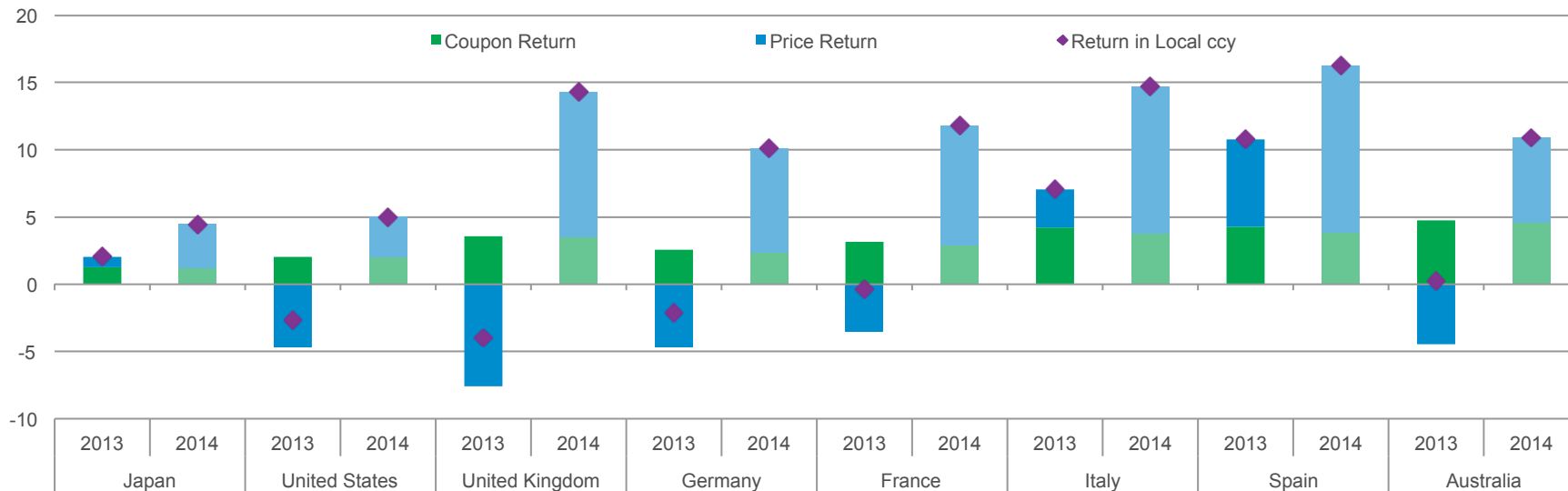
Global 10-year government bond current yields vs 5yr average



Source: Thomson Reuters and Bloomberg as of 07 April 2015

Generating yield in fixed income without sacrificing principal protection is increasingly challenging

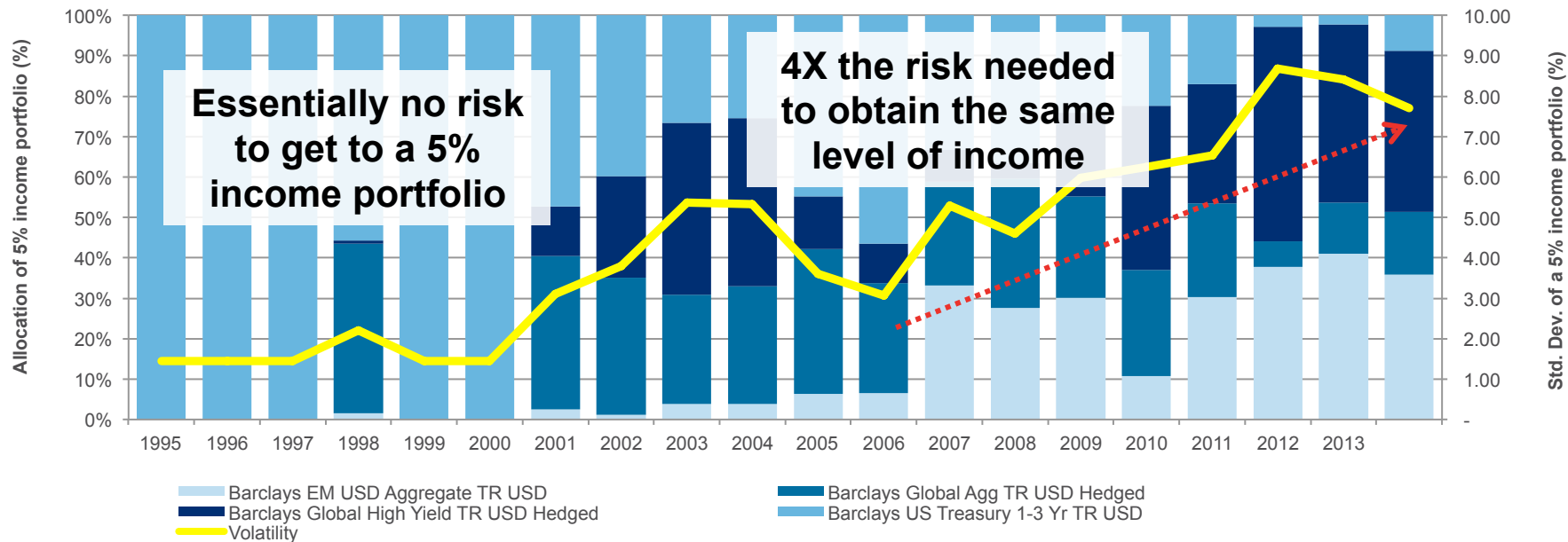
Global Treasury bond market performance (%)



Source: Barclays

Reaching for yield has its risks

The standard deviation of a 5% income portfolio has multiplied more than 4 times



Source: Morningstar, Inc and Barclays Capital. as of 31 December 2014. Risk represented by average standard deviation from 1995 – 2014 calculated using monthly returns. Yield represented by Yield to Worst

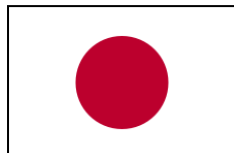
Growth and inflation are causing central bank monetary policies to diverge

Easing



Euro area

ECB commenced QE programme this year



Japan

BoJ is a pioneer of QE: Size and Scale

Next step interest rate rise?



US

Fed expected to raise interest rates

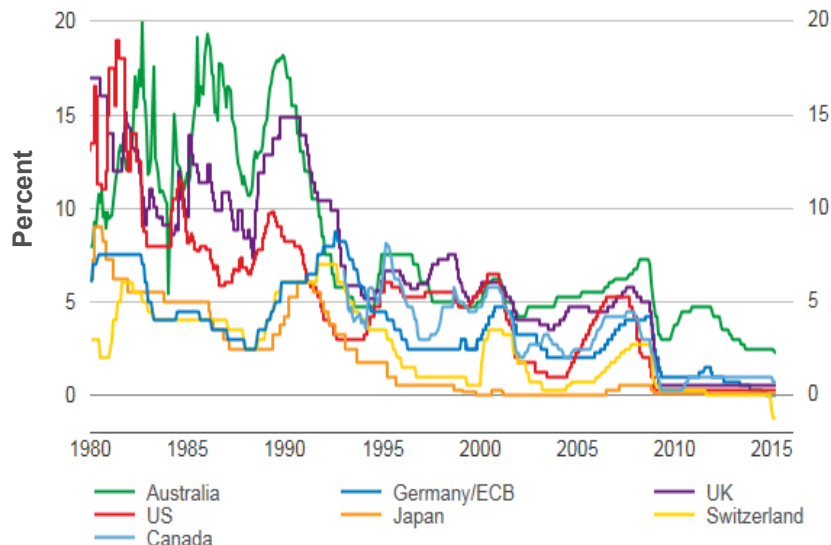


UK

BoE expected to raise rates after the Fed

Historical central bank policy rates

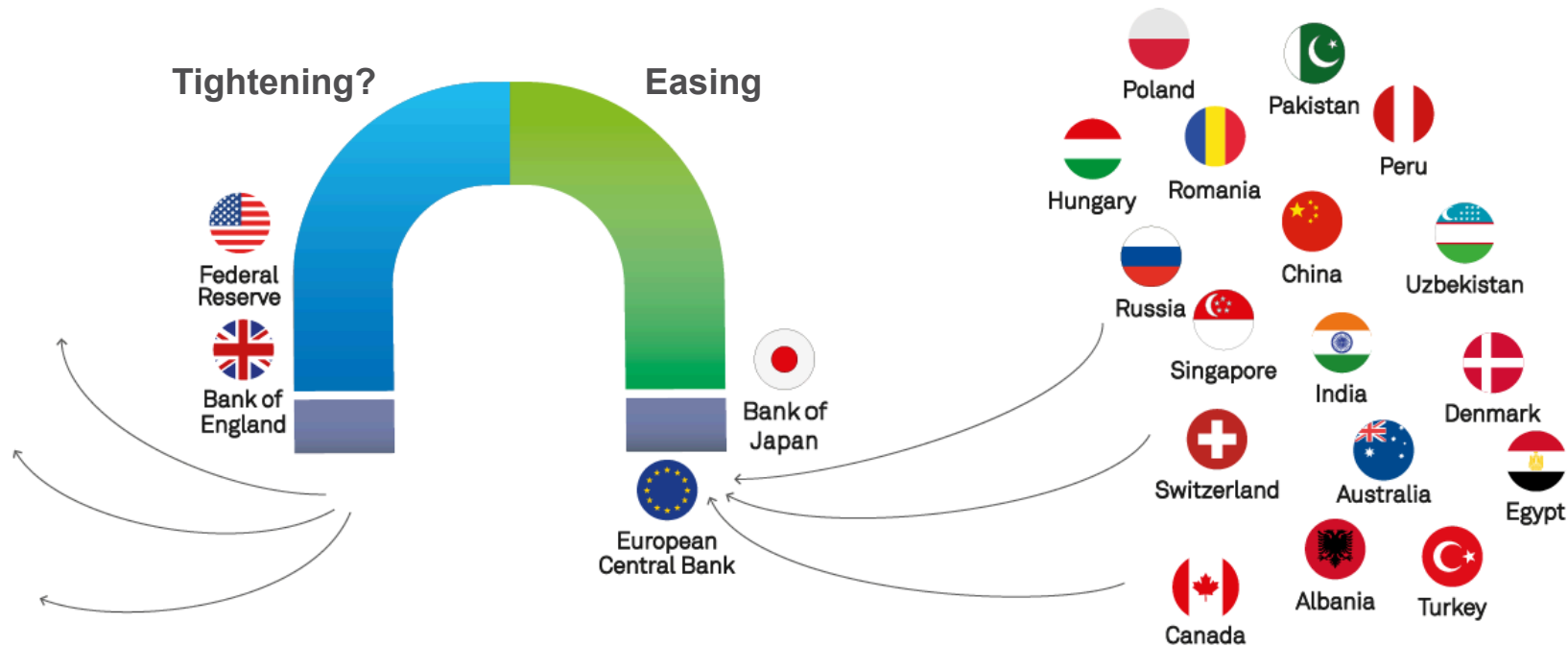
Central Bank Interests Rates



Source: Thomson Reuters Datastream, BlackRock Investment Institute 26/03/2015

But so far this year most central bank action has been on the easing side

Magnetic pull of easing

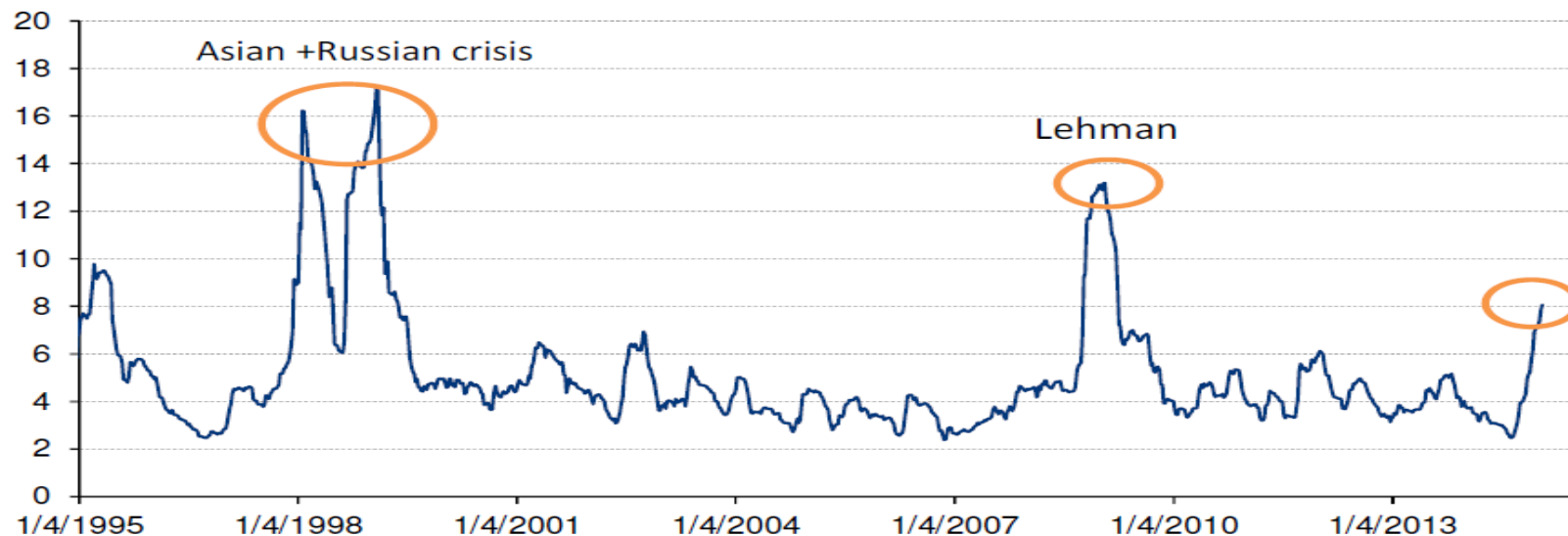


Source: BlackRock, March 2015. Note: for illustrative purposes only

Volatility has already increased – we can expect a bumpy ride to rate normalisation

Global FX Volatility

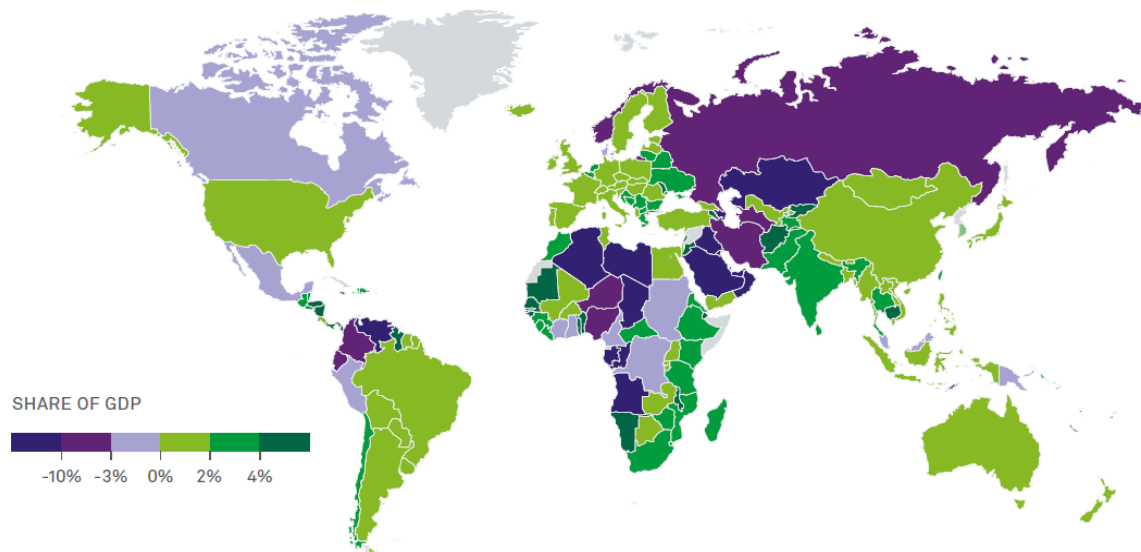
GDP weighted range-based FX volatility measure for 20 largest economies
(difference between maximum and minimum in 26-week rolling window)



Source: BofA Merrill Lynch Global Research, March 2015

Lower oil prices create risks and opportunities within emerging markets

Oil spill-over: revenue impact of \$50 oil price fall, 2015



- ▶ Lower energy prices benefit many EMs due to improved trade balances, reduced government subsidies and lower inflation
- ▶ India for example should be a key winner
- ▶ Emerging oil exporters, on the other hand, have seen a sharp deterioration in their export and fiscal receipts
- ▶ These include Venezuela, Russia, Ecuador, and Kazakhstan

Sources: BlackRock Investment Institute, EIA and IMF, January 2015. Notes: the map shows estimated revenues gained or lost from a \$50 fall in the price of oil as a share of GDP. The impact is calculated by taking each country's 2013 net imports of oil, multiplying this by \$50 and then translating the total into a share of 2014 GDP.

For fixed income, this leads us to some principles for a new approach

Deliver consistent, high risk-adjusted returns in all environments

Be Flexible

Remove benchmark constraints

Retain the general risk profile of conservative fixed income investments

Be Diversified

Seek out best opportunities globally
Seek a low correlation to traditional fixed income indices

Retain “Tail-risk” hedge characteristics

Mitigate Losses

Aim to hedge tail-risk and control volatility
to deliver attractive risk-adjusted returns

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