Credit Outlook:

All bubbles burst

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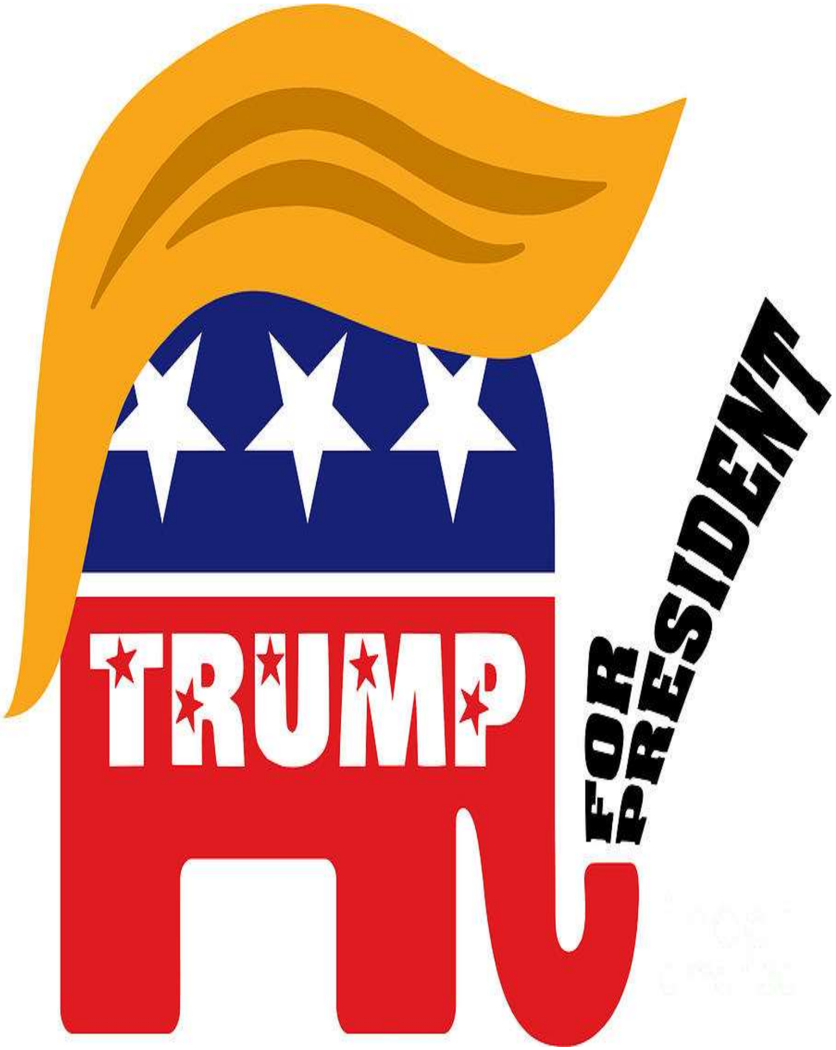
Trump:

the elephant in the room

Trump

The Republican elephant in the room



Source: Fine Art America, imgur by zayzaya, About.com

Trump

What does it all mean?

We still don’t have a good sense about what his policies will be but at this stage they are most likely to include:

I. Higher Spending
   a. Military
   b. Construction

II. Lower corporate tax rates and loss of interest deductibility

III. Reduced regulations – cutting red tape
   a. Financials
   b. Pharmaceuticals

IV. Reduced globalisation/trade – *"Make America Great Again" "America First"*

Trump

Potential consequences

I. Greater fiscal spending – making fiscal policy more important

II. Danger of higher inflation

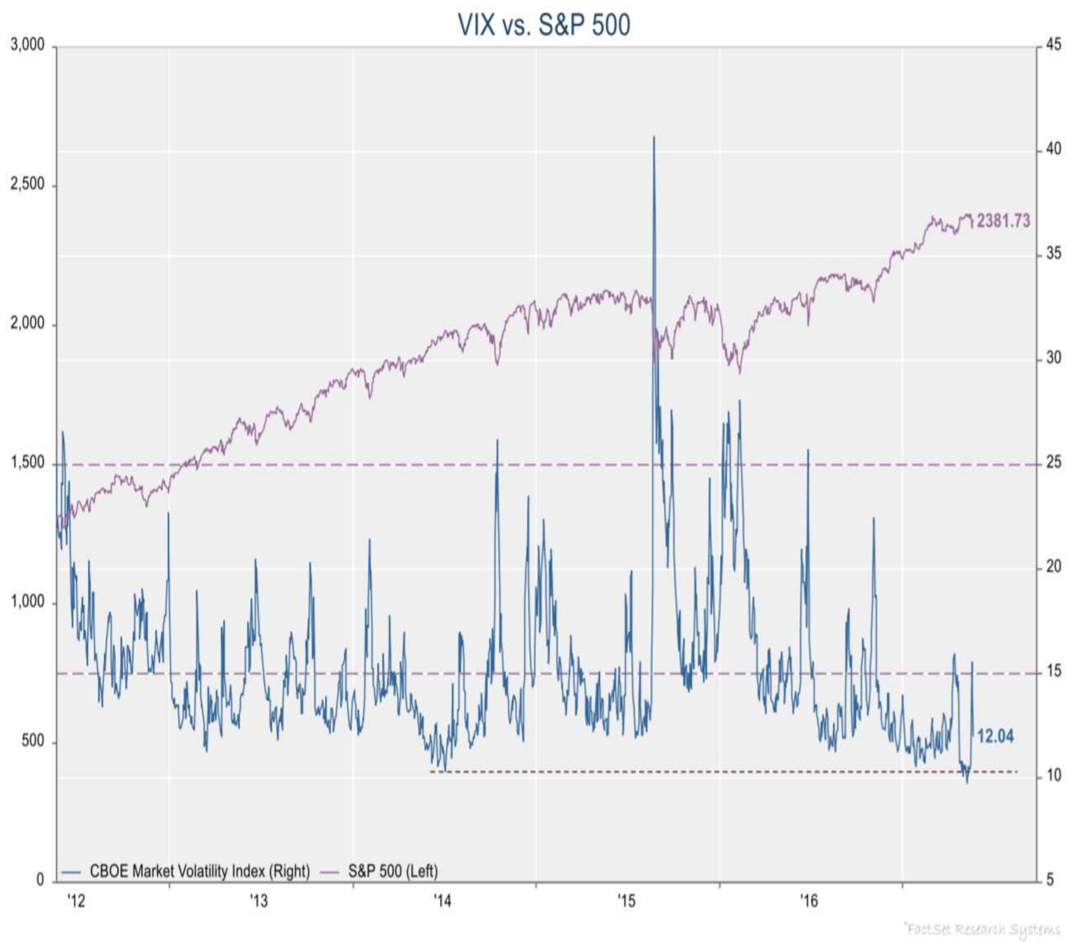
III. Fear of higher interest rates

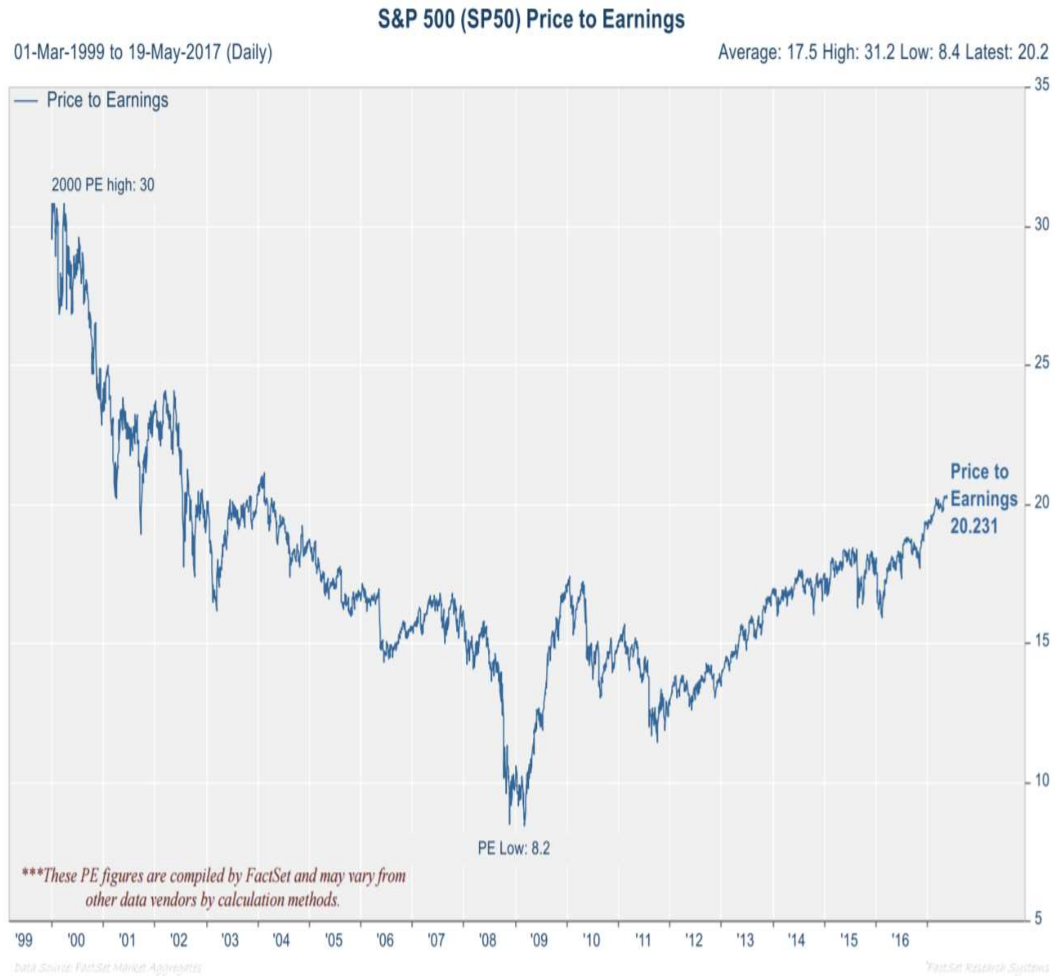
IV. Tinkering at the Federal Reserve – potentially reducing the impact of monetary policy and increased uncertainty surrounding Janet Yellen's position as Chair

Market reaction

Market reaction

How have equity markets reacted?

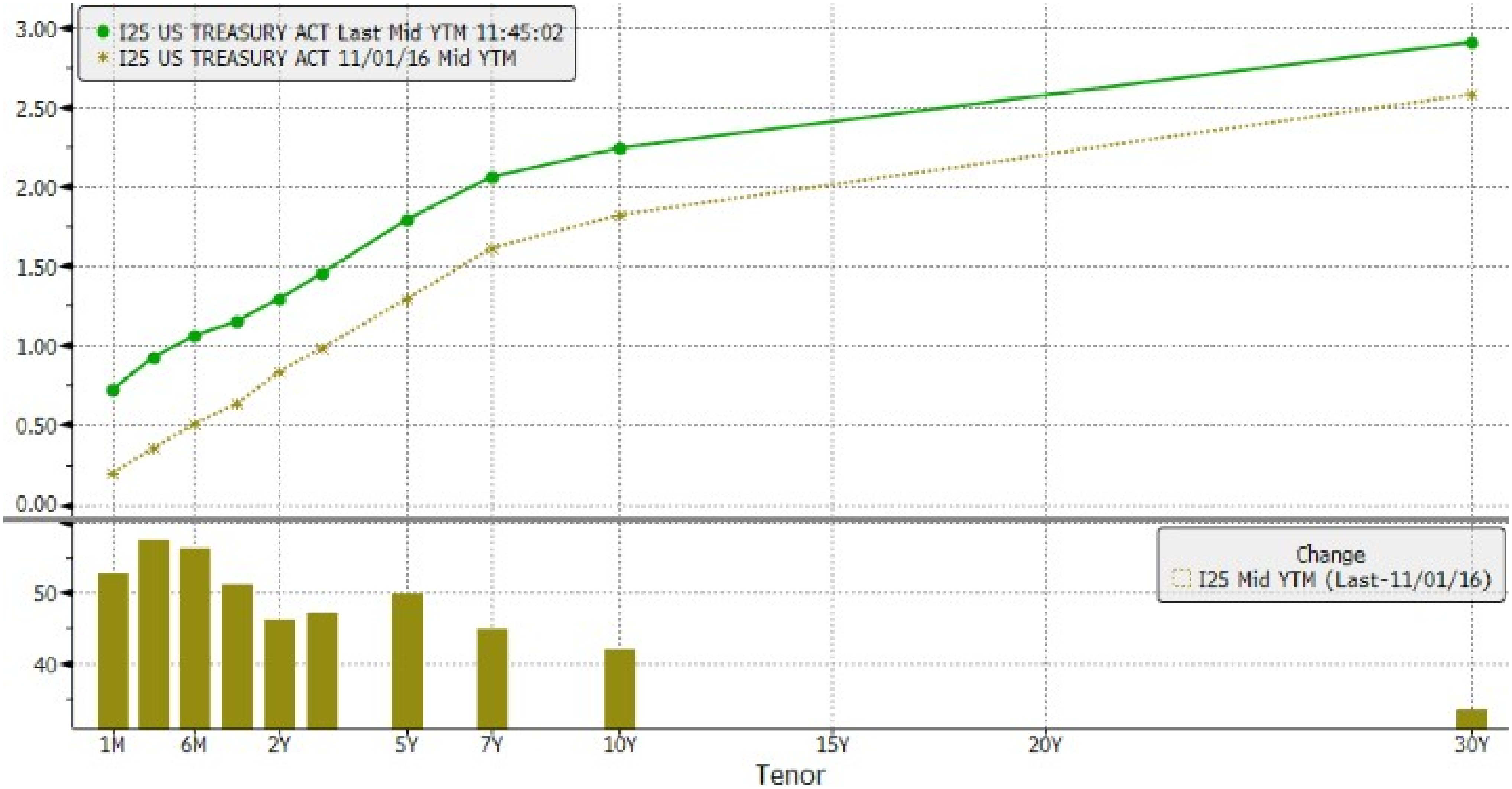




Source: Raymond James

Market reaction

How has the US government bond market reacted?



Source: Bloomberg

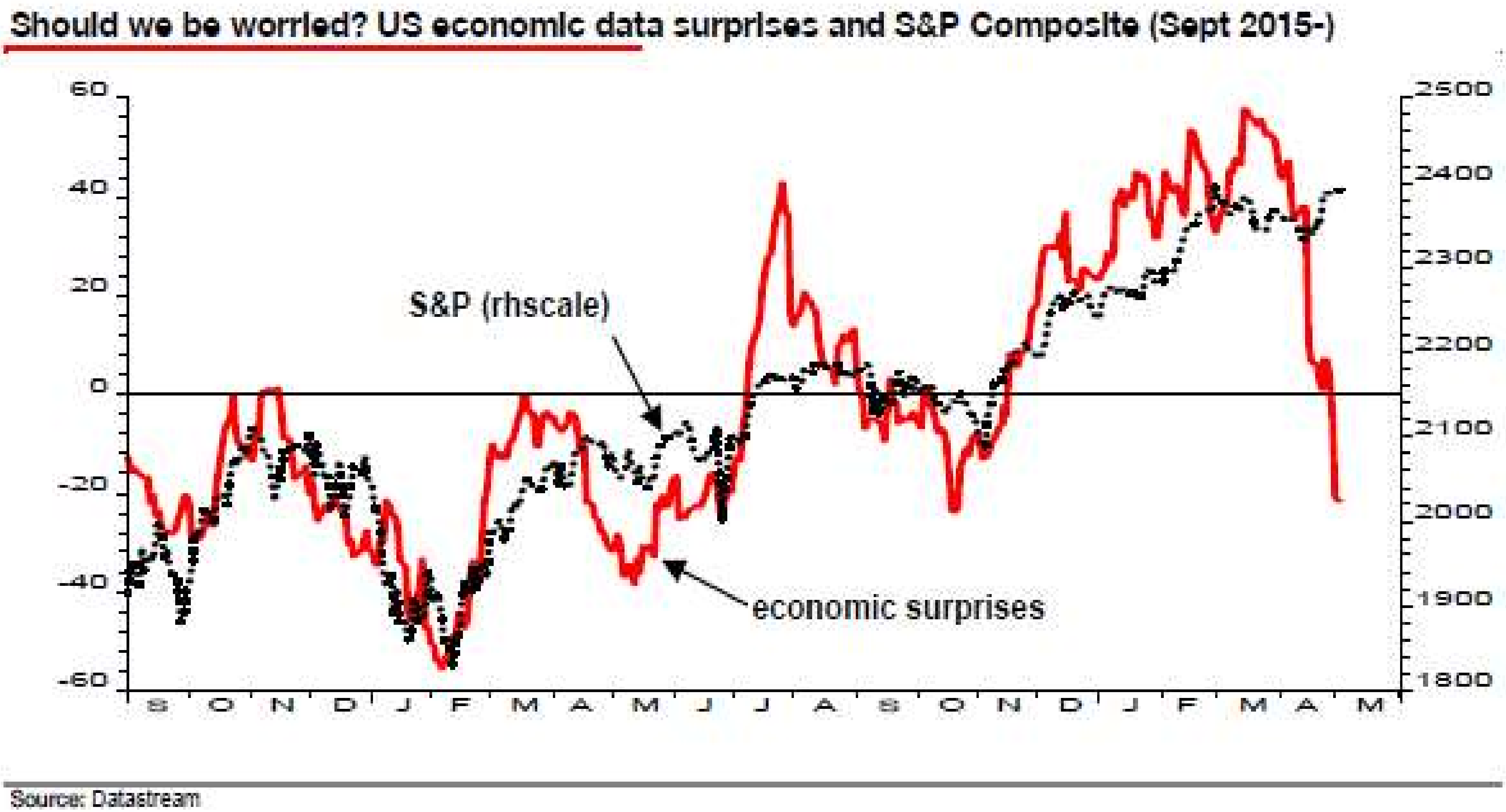
Market reaction

How have the global credit markets reacted?

Source: Bloomberg

Market reaction

How have markets reacted and should we be worried?



Source: Societe Generale

Market reaction

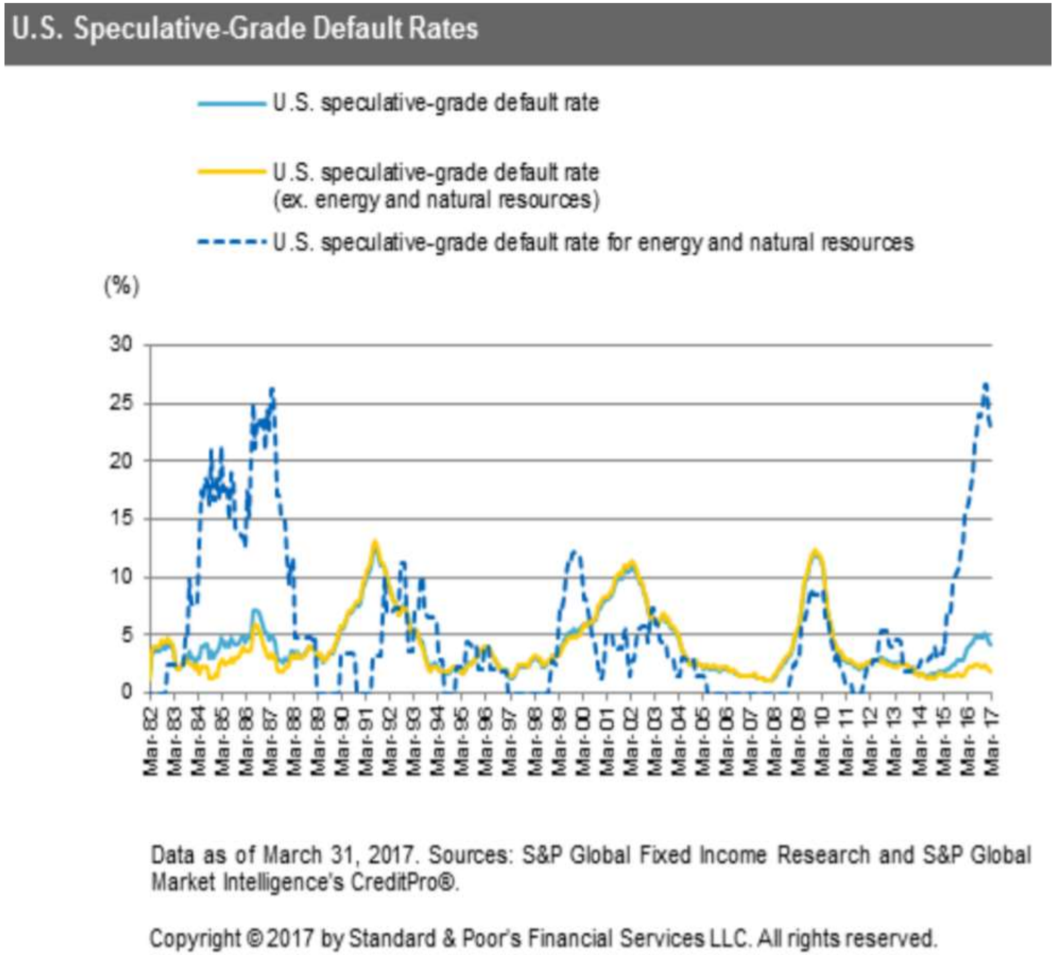
Is this the right response?

- We are unconvinced that US fiscal spending will have much impact on growth
- We don't expect any rapid and/or a major untick in US inflation
- In our opinion, the Fed will still have to move incredibly slowly with any hikes
- Given we are late in the US economic cycle, we question how much of a boost fiscal spending can give
- We still believe in the lower-for-longer thesis – interest rates (short-end), growth, inflation and returns
- Having said that, we expect to see further steepening of government yield curves as investors continue to position for the EXPECTED inflation threat
- These fears will eventually be unfounded – remember Quantitative Easing and the inflation that must follow

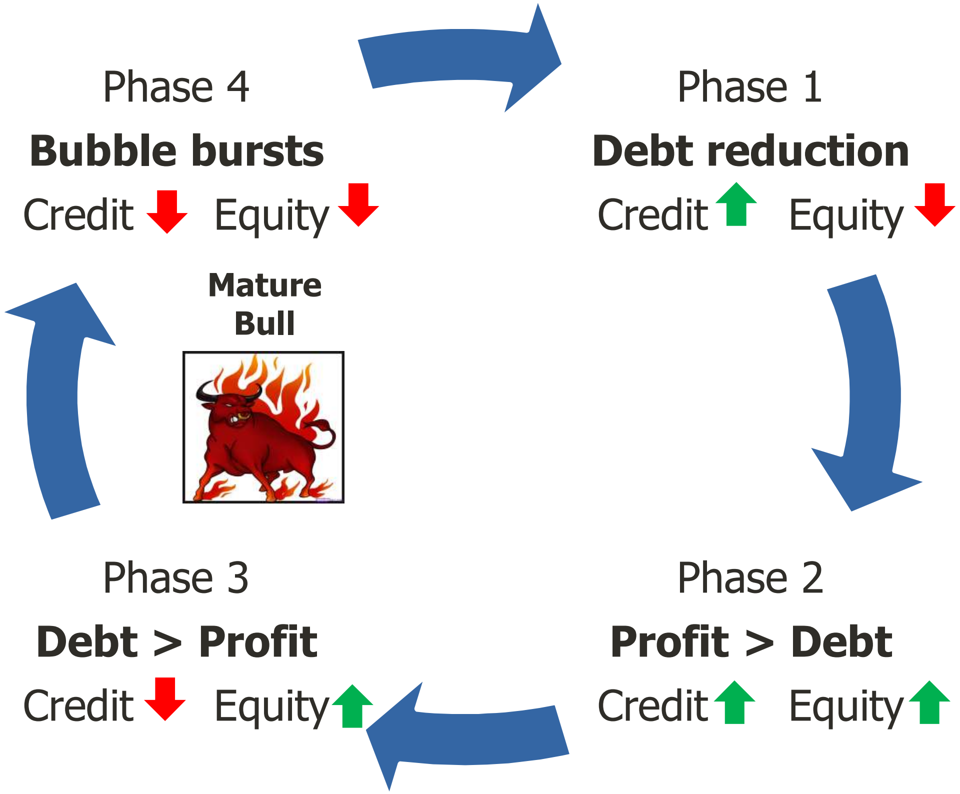
Credit cycle

Credit cycle: Mature bull

Where are we in the normal credit cycle? Mature Bull…



Source: S&P and Citigroup



Australia – 2017 outlook

Relatively unexciting outlook

2017 Australian Corporate Outlook

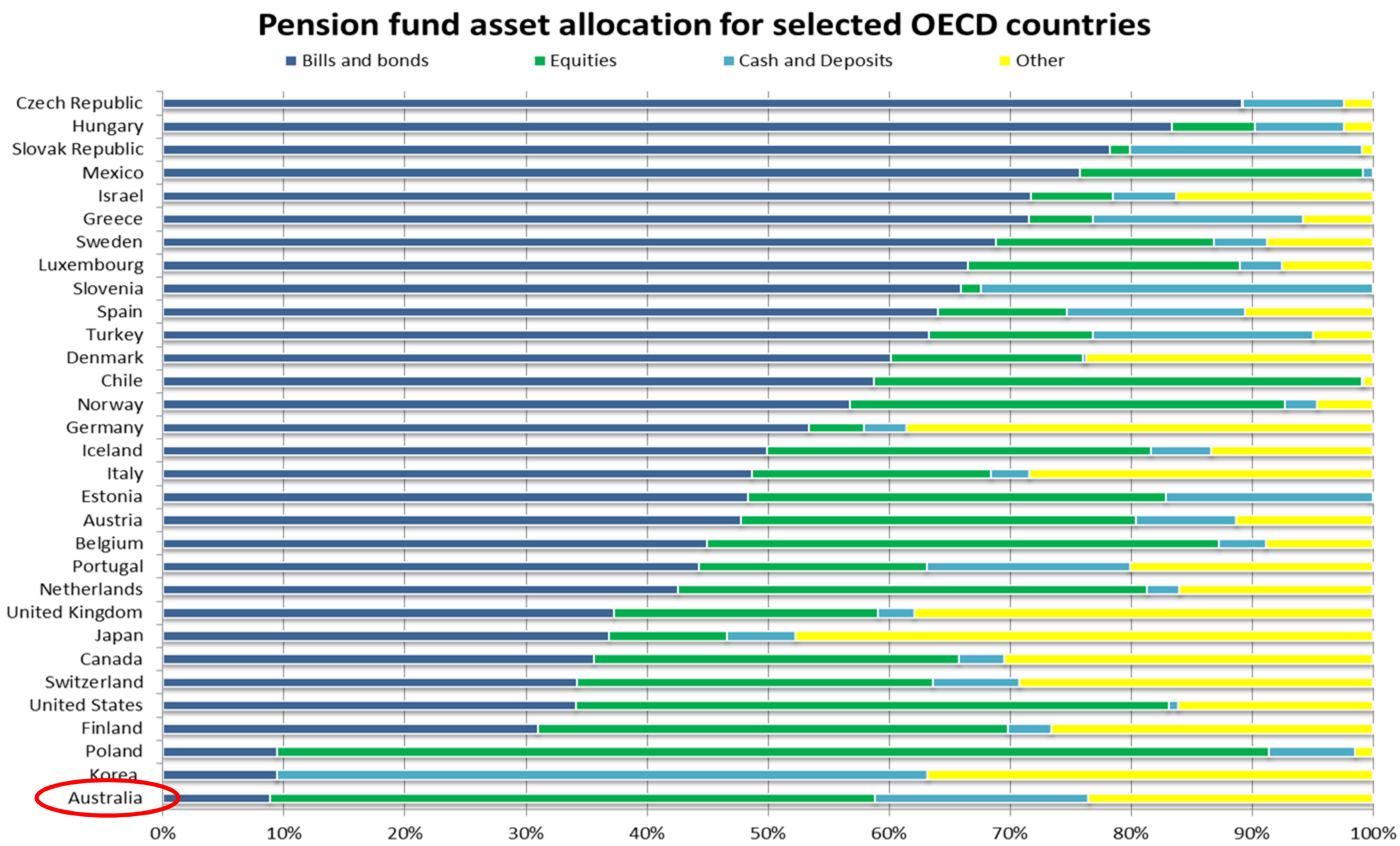
Outlook Key: NEGATIVE | STABLE | POSITIVE

STABLE	STABLE	STABLE	STABLE	STABLE
Metals & Mining	**Retail & Consumer**	**A-REITs**	**Building & Construction**	**Airlines**
» Prices improving for some commodities and are unlikely to return to low levels seen in early 2016 » Continued cost cuts and lower capex/dividends support improvements to credit metrics » Debt pay-down and asset sales likely to continue as companies adjust balance sheets to lower earnings environment » Strong liquidity continues to be a focus.	» Clear winners and losers in food retail » Increased focus on price is increasing competition and price deflation » Quality of retail execution is a key driver of relative market share moves	» Operating income will increase moderately (circa 2.5%) with broadly steady vacancy rates and fixed rent increases » Office rentals to benefit from good demand in Sydney and Melbourne. Retail rentals to benefit from high occupancy and solid discretionary spending » Good liquidity and staggered debt maturity profiles support ratings	» Earnings broadly flat as Industry transitions from resources-related spending » Residential construction activity to be close to peak levels » Road and rail infrastructure spending in 2017 will help mitigate lower resources sector investment	» Earnings and credit metrics should be broadly stable » Cost savings, low fuel prices and debt reduction to continue » Competitive but rational domestic environment and capacity management » Arrival of offshore airlines into the Australian international aviation market increases competition

Source: Moody's

All bubbles burst

All bubbles burst – are you protected?



Source: OECD 2016

Conclusion

Corporate bonds still offer attractive risk-adjusted returns

- Financial markets continue to operating in unprecedented and unconventional times
- Fiscal policy will play an increasing role but Central Banks will remain key participants
- We still believe in the lower-for-longer thesis – interest rates (short-end), growth, inflation and returns
- Investors need to accept volatility and be prepared for the equity bubble to burst
- Australians are typically over exposed to equities and that corporate bonds should play an important and growing part within investment portfolios
- Global credit fundamentals are slightly deteriorating and technicals remain volatile
- Given the late nature of the credit cycle, we believe that the rest of 2017 and 2018 will be characterised by marginally wider credit spreads
- As such, we recommend a more defensive or cautiously positioned portfolio by migrating to more highly-rated and shorter-dated corporate bonds
- For investors searching for even more yield, we recommend moving into shorter-dated, lower-rated corporate bonds rather than longer-dated but more highly-rated bonds

Any questions

Source: Political Outcast

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