Manulife Investment Management

The global fixed-income landscape now is built for active investors

So we're about halfway through 2024, and we're right about the point in time where coming into the year, we've had a more favorable view for interest-rate risk, with an expectation that global inflation pressures would continue to decelerate and that central banks, after being in a period of tightening of policy, having a period then of, of a wait and see to see how things progress right about this point in time, you'd start to see, central banks be able to start reducing policy rates. And that's exactly what we're seeing so far. You've had rate cuts from a couple of developed markets, central banks, including the Bank of Canada and the ECB. And we believe within the next 3 to 6 months, a lot of the additional developed markets, central banks, will be able to join those in cutting rates, which includes the U.S. Fed. This is a landscape where you'll see global yields continue a downward trend. But we're cognizant of the fact that they're not going to go in a straight line. You'll have some check back. So, we think about this as a broader downtrend for global yields. But you'll have some volatility within that downtrend. And so, we pair that favorable view for interest-rate risk with being active in managing portfolio duration. We also continue to look for opportunities and think this could be a good way to embrace from a contribution to duration perspective, some of the divergence in policy.

Yes, a lot of the developed markets, central banks will be cutting rates or have already started, but you're going to get some divergence from the perspective of how quickly, the overall pace and the ultimate number of rate cuts that they, end up doing. So, there's some opportunity to think about interest-rate risk from that perspective as well.

In the fixed-income landscape right now, it's certainly much more favorable from the perspective of income generation. There's income available on offer across a lot of different areas, within the fixed-income landscape, whether that is across different sectors or geographies. So certainly, a much more favorable environment for getting income in your fixed income. Now, particularly versus in past years when you had, cash rates from central banks at zero, you had a lot of negative yielding Fixed-income instruments out there. So now certainly much more favorable from that perspective.

Now, that said, I think you do still want to be thoughtful about where you're getting that yield from. From our perspective, we would think about things like riskier segments of the corporate credit space, particularly things like U.S. high yield there's can still be some great opportunities, we think, within that area. But at this point of the cycle and also given valuations, we think it warrants being a little bit more thoughtful, not just thinking about yield at the overall level, but where you're getting that yield from, from an issuer perspective, security selection sector credit quality. If you look at the high-yield index on average and aggregate right now, the Bank of America Merrill Lynch Index spreads to our perspective. Feel like they're a little bit rich right now trading on average around 300 over the last 20 years or so that has averaged instead closer to 500. From a percentile perspective, over the last 20 years or so, where yields are or spreads are right now, you're about the 10th percentile, meaning about 90% of the time over that 20-year period, spreads have been wider. So, there's still certainly there's some good yields to be found out there. But we think it, is warranted to be a little bit more thoughtful and take an active approach, in terms of where we're getting that yield.

So, the idea of the potential for the U.S. dollar to lose its status as the global reserve currency is a topic that has come up over time for many, many years. Most recently, it's been in the context of what people refer to as de-dollarization, which has been driven by a trend where certain governments have wanted to participate in global trade in their own currencies. So, excluding the U.S. dollar from that perspective, yes, that is happening, but we don't see that as a near-term threat to the U.S. dollar status as a reserve currency. And we think about this in a couple of different ways. These types of trends, if they do happen, they take a very long time to play out. If we think about, for example, the composition of central bank reserves, which the IMF tracks through their composition of official foreign exchange reserves, so-called COFER data. If you go back about 20 years, the U.S. dollar was a little bit over 70% of the total weight of those reserves more recently. Now it's come down to a little bit below 60%. So yes, it has reduced steadily over time. But if you look at the next largest within that balance, it's the euro at only 20%. So, the star still has a fairly healthy lead there. And where have those reserves gone. Well, it's been spread across a lot of different currencies. Some of that's been the dollar block. Things like the Australian dollar, the New Zealand dollar, the Canadian dollar, some Asian currencies, the Korean won, the Singapore dollar. And yes, the Chinese renminbi has been a part of that. And when people think about the potential for the U.S. dollar to lose its status, that's often where they think is the Chinese renminbi. That's gone up from about zero to only about two and a half to 3%. So still a big difference between the U.S. and China. There also, from a daily liquidity perspective of there's a tri annual survey of daily liquidity volume in the foreign exchange market over the last 20 years. In U.S. dollar aggregate terms, that market has grown from about a little over $1 trillion, traded daily, of total currency volume to a little bit over seven and a half. Now, the U.S. dollar as a portion of that because you have to recall every currency trade. There are two currencies involved. The U.S. dollar as a percentage of that total volume is gone from about 90% down to about 88%. So yes, there's been a slight reduction, but the U.S. dollar is still by far and away, the largest component of daily FX volume. So, in terms of managing currency risk, these changes haven't really impacted, what we're doing. And when you look at the history of currency reserves, yes, they can change. They have changed over time, but it's usually measured in generations and not in years.

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