23 November 2018

Rates and Credit

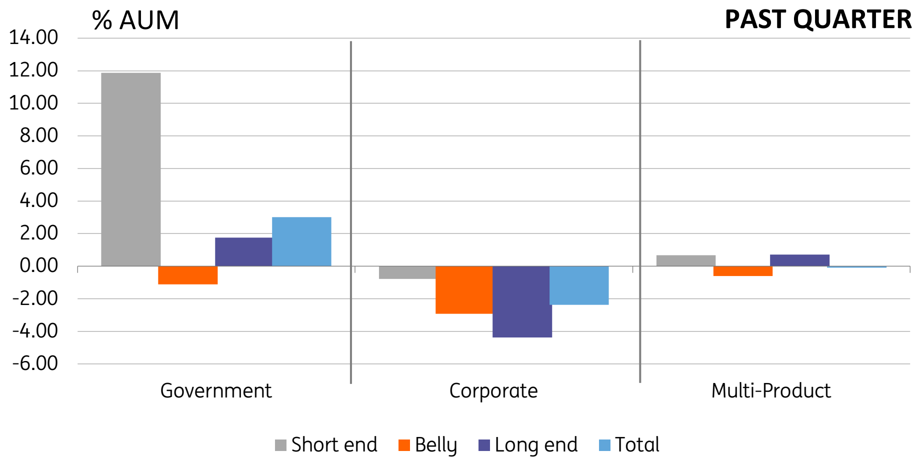
Note: The weekly data in this report reference the week ended Wednesday 21nd Nov 2018

Global debt flows

Duration/risk asset flight to front end bonds

Core markets are re-setting duration shorts on a significant flight into front end government bonds, but this also reflects flight from risk assets. The remarkable liquidation in inflation funds continues, pulling nominal rates off their highs. High yield is on an end-of-cycle-type alert mode on default elevation risks, while long end corporates are seeing ongoing outflows. Emerging markets continue to struggle flow-wise, but are eyeing a topping out in rates and the dollar in 2019.

Graph of the week: Pronounced inflow to front end government bonds and an outflow from long end corporates



Source: EPFR Global, ING estimates

Six things learnt from latest flows data

1. The implied preference from core flows is to favour elevated front end government bond exposure, overlayed with a barbell structure in government space, and a liquidation of long end risk in corporates (in past quarter).

2. Inflation linked funds remain friendless, indicative of a net re-pricing down in inflation breakevens, contrasting with a net re-pricing up in real rates, leaving nominal rates at a cross-over point, with no clear impulse.

3. It's not been a pretty year for emerging markets, but it's not been all about flows. Rather flows have been symptomatic of a combination of some isolated idiosyncratic risks plus a wider firm dollar/higher core rates environment.

4. Things have stabilised somewhat of late, with allocations to the likes of Turkey now off the lows (although the lows were the lowest ever) and the markets are eyeing a likely topping in the US rates and the dollar in 2019.

5. Global high yield returns are running negative, at -3.3% YTD (in USD), but this is better than seen in emerging markets for example (between -4% to -5% YTD), and even Treasuries are off by 3% YTD.

6. An issue looking into 2019 is the risk for a rise in US delinquencies as the Fed finally tops out. Typically such a scenario correlates with higher default risk in high yield. This is a concern, but not an inevitable outcome at this juncture.

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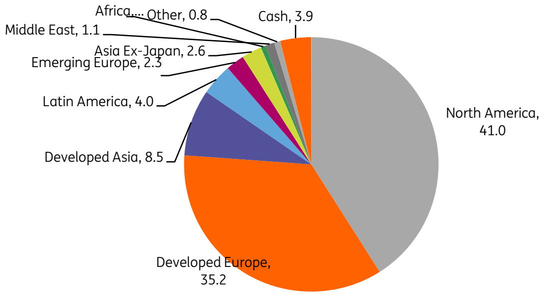
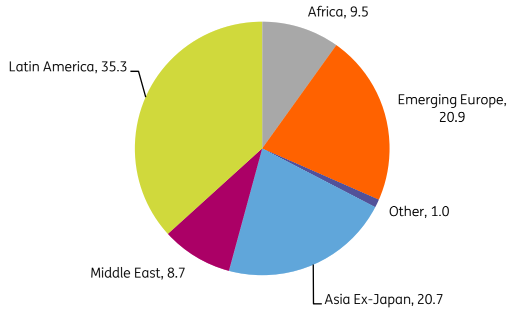
Global Manager (average) Allocations by Region

Fig 1 Global allocations one month ago (%)



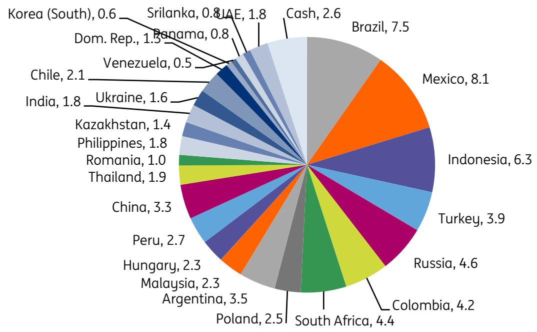
Source: EPFR Global, ING estimates

Fig 2 EM allocations one month ago (%)



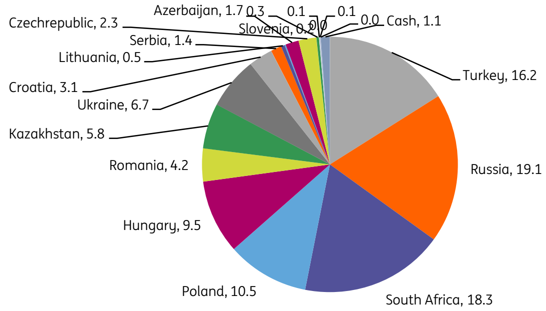
Source: EPFR Global, ING estimates

Fig 3 EM detailed allocations one month ago (%)



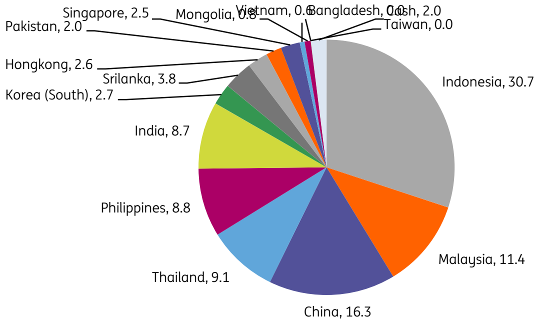
Source: EPFR Global, ING estimates

Fig 4 EMEA allocations one month ago (%)



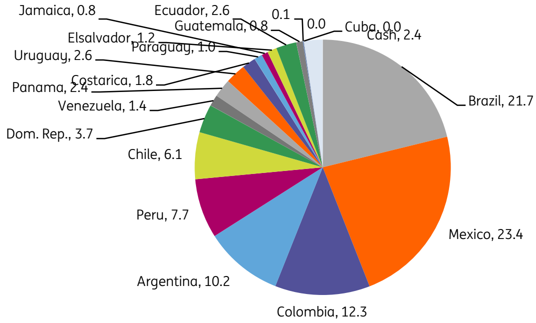
Source: EPFR Global, ING estimates

Fig 5 Asia EM allocations one month ago (%)



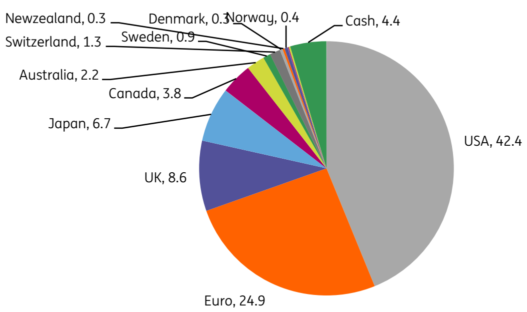
Source: EPFR Global, ING estimates

Fig 6 Latam allocations one month ago (%)



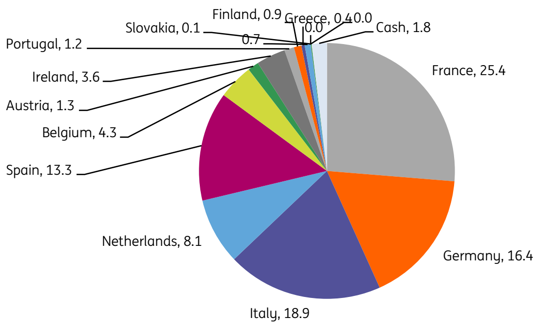
Source: EPFR Global, ING estimates

Fig 7 Developed allocations one month ago (%)



Source: EPFR Global, ING estimates

Fig 8 Eurozone allocations one month ago (%)



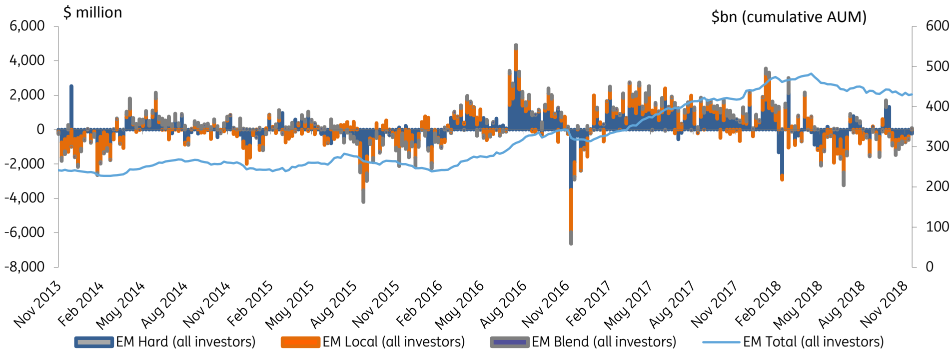
Source: EPFR Global, ING estimates

Emerging markets

Emerging Markets – Summary themes

- Outflows have dominated in recent months. Most of these have been from blend funds and local currency funds; in the past quarter blend funds have shed 3.2% of assets under management (AUM) and local currency funds 1.2% of AUM, while the fall in hard currency funds AUM has been moderate, just 0.2% of AUM.
- The bulk of the downsizing has been from retail, and have been in-discriminate with respect to EM product. Overall retail has shed 4.6% of AUM in the past quarter, with hard, local and blend funds all down by at least a 4% handle.
- In contrast, professional accounts have been net buyers of emerging markets debt in the past quarter, especially in hard currency, with AUM there up 1.7%. There has also been some moderate inflows to local currency funds, with AUM there up 0.4%; not a big inflow, and at least not an outflow.
- Net net, despite moderate inflows in the past week, outflows have dominated in the past quarter(s). This plus negative returns has seen cumulative AUM under stress, as encapsulated in the graph below (blue line).

Fig 9 Feature Chart: The light blue line shows flows including returns and has clearly been stressed lower in recent months



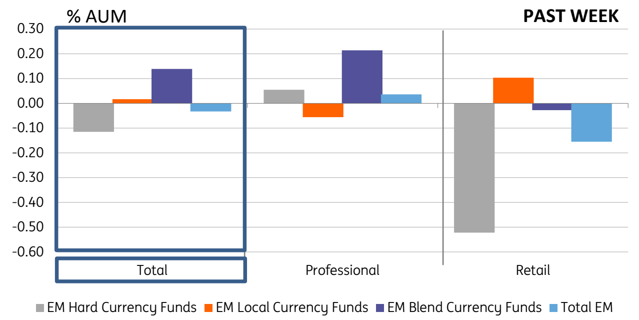
Source: EPFR Global, ING estimates

- It is clear from the allocations in recent months that the severe angst that had stricken the likes of Turkey and Argentina has eased, manifesting in increased allocations. Turkish allocations for GEM accounts hit an historical low in August, but have recovered since; still well below average though.
- Most emerging markets saw outflows in the past month, although Colombia and China managed some inflows. At the other end of the spectrum, Brazil, Thailand and Israel saw outflows in excess of the average in the past month. Beyond that, the regional spectrum was broadly balanced by global geography.

BOTTOM LINE: It's not been a pretty year for emerging markets, with hard currency returns running at c.-5% and local currency at -4.4% (both in USD). It's not been all about flows. Rather flows have been symptomatic of a combination of some isolated idiosyncratic risks plus a bigger picture firm dollar/higher core rates environment. In fact outflows from emerging markets are running at a mere 0.4% in the past year; it's just that outflows have dominated on aggregate since 2Q. Things have stabilised somewhat of late, with allocations to the likes of Turkey now off the lows (although the lows were the lowest ever) and markets are eyeing a likely topping in US rates and the dollar in 2019. A soft landing from the cumulative US rate hike process would help emerging markets re-engineer some inflows as a theme for 2019.

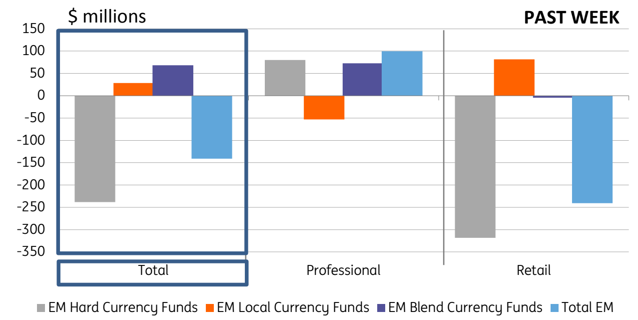
Emerging Markets Net Fund Flows

Fig 10 Emerging Markets - Change in the past week (%)



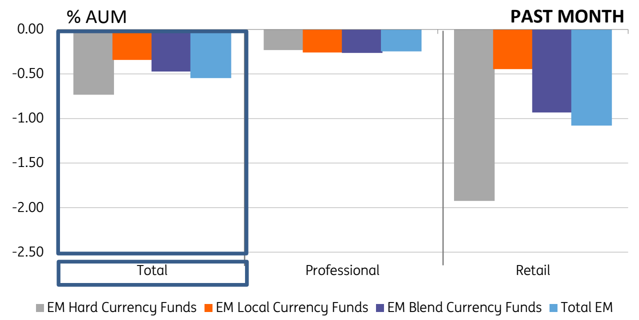
Source: EPFR Global, ING estimates

Fig 11 Emerging Markets - Change in past week (US$m)



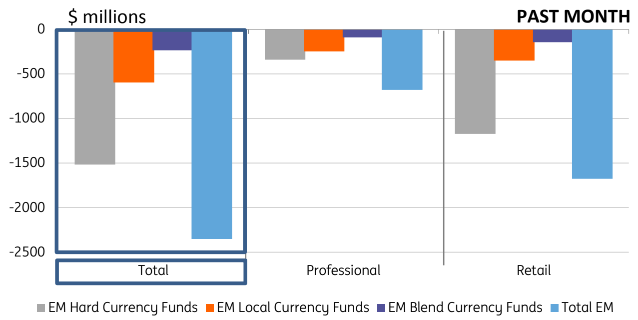
Source: EPFR Global, ING estimates

Fig 12 Emerging Markets - Change in the past month (%)



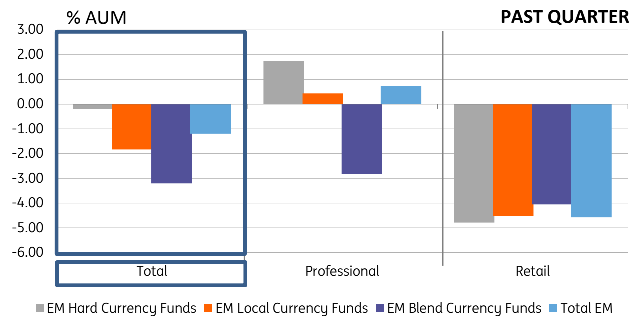
Source: EPFR Global, ING estimates

Fig 13 Emerging Markets - Change in past month (US$m)



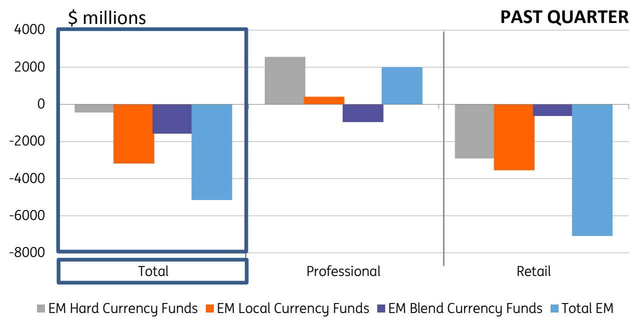
Source: EPFR Global, ING estimates

Fig 14 Emerging Markets - Change in past quarter (%)



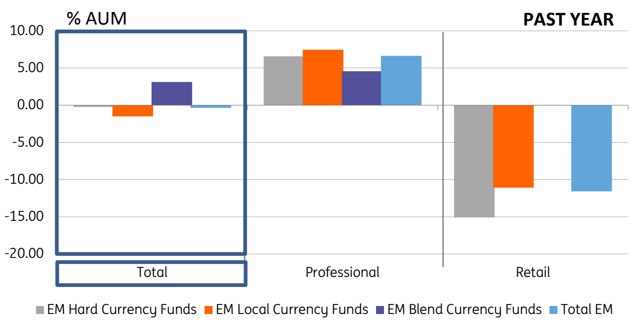
Source: EPFR Global, ING estimates

Fig 15 EM - Change in past quarter (US$m)



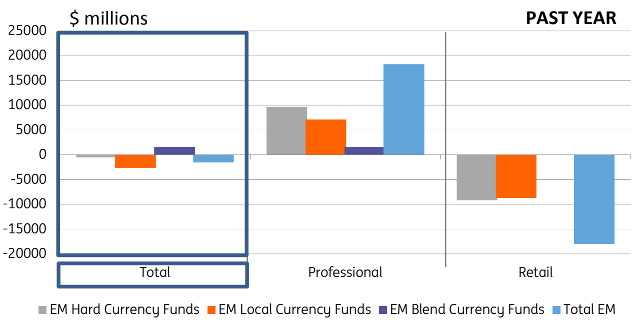
Source: EPFR Global, ING estimates

Fig 16 Emerging Markets - Change in the past year (%)



Source: EPFR Global, ING estimates

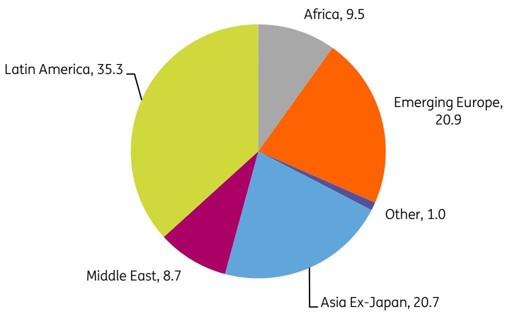
Fig 17 Emerging Markets - Change in past year (US$m)



Source: EPFR Global, ING estimates

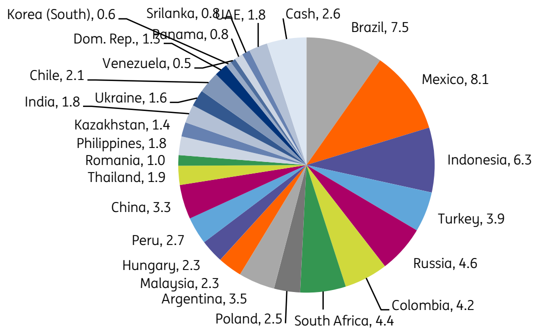
Global EM Manager Asset Allocations

Fig 18 GEM allocations one month ago (%)



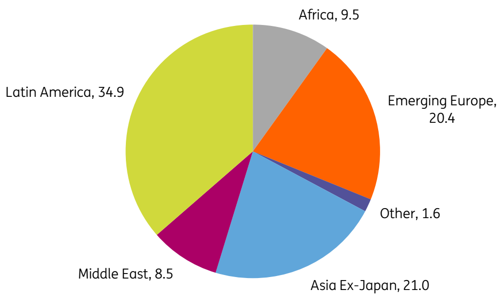
Source: EPFR Global, ING estimates

Fig 19 GEM detailed allocations one month ago (%)



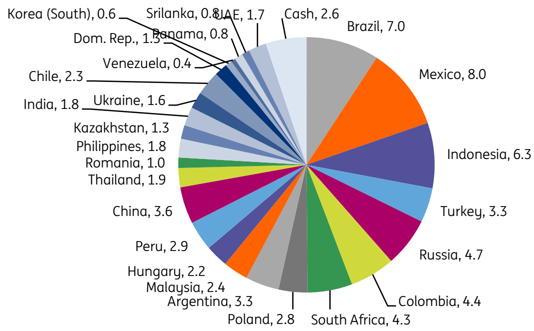
Source: EPFR Global, ING estimates

Fig 20 GEM allocations two months ago (%)



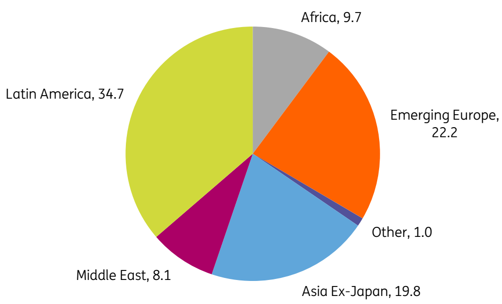
Source: EPFR Global, ING estimates

Fig 21 GEM detailed allocations two months ago (%)



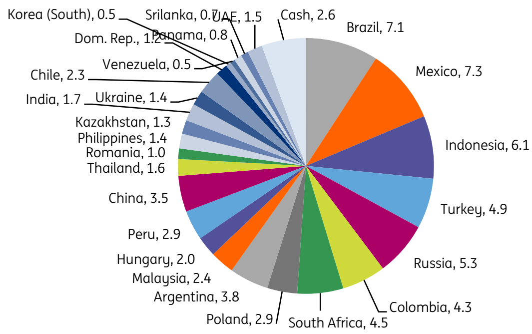
Source: EPFR Global, ING estimates

Fig 22 GEM allocations one quarter ago (%)



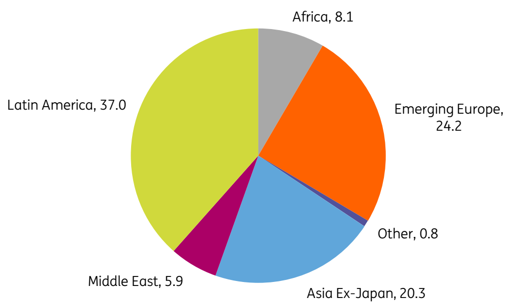
Source: EPFR Global, ING estimates

Fig 23 GEM detailed allocations one quarter ago (%)



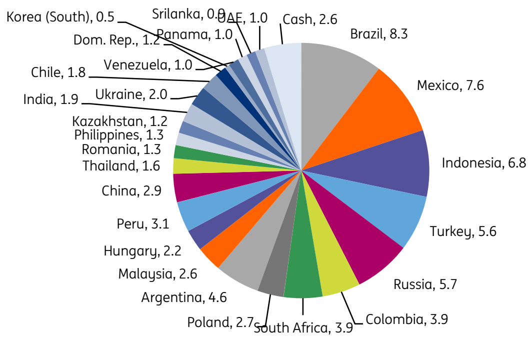
Source: EPFR Global, ING estimates

Fig 24 GEM allocations one year ago (%)



Source: EPFR Global, ING estimates

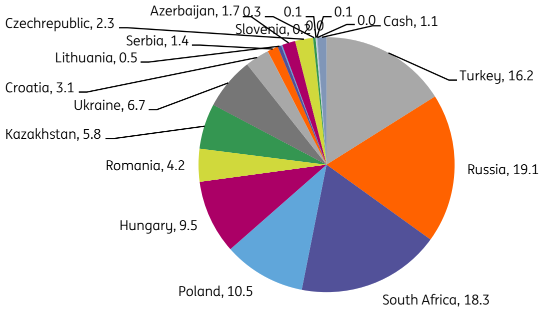
Fig 25 GEM detailed allocations one year ago (%)



Source: EPFR Global, ING estimates

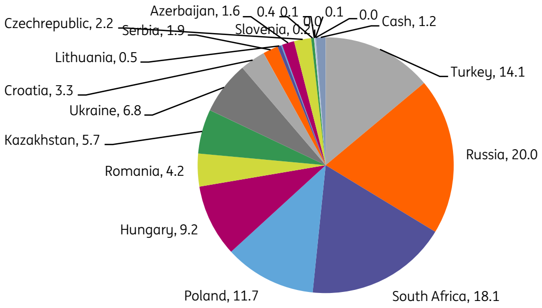
Regional EM Manager Asset Allocation

Fig 26 EMEA allocations one month ago (%)



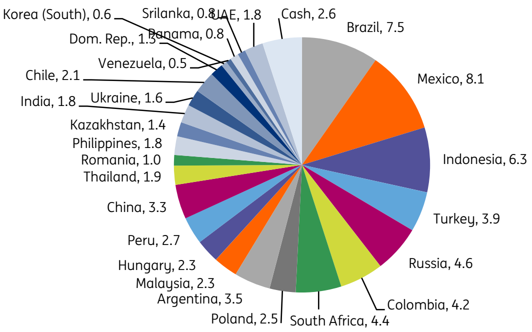
Source: EPFR Global, ING estimates

Fig 27 EMEA allocations two months ago (%)



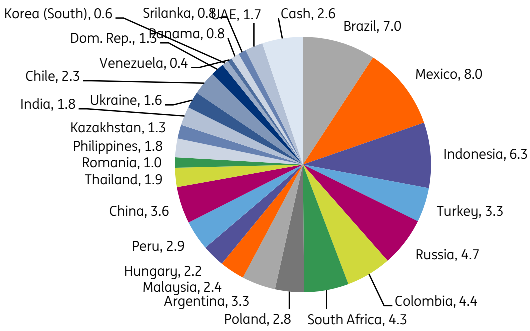
Source: EPFR Global, ING estimates

Fig 28 Asia allocations one month ago (%)



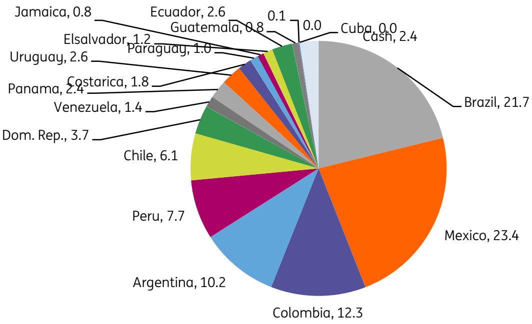
Source: EPFR Global, ING estimates

Fig 29 Asia allocations two months ago (%)



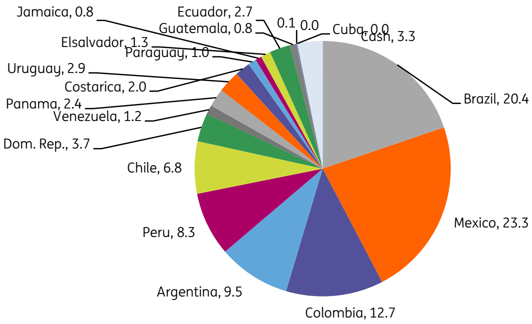
Source: EPFR Global, ING estimates

Fig 30 Latam allocations one month ago (%)



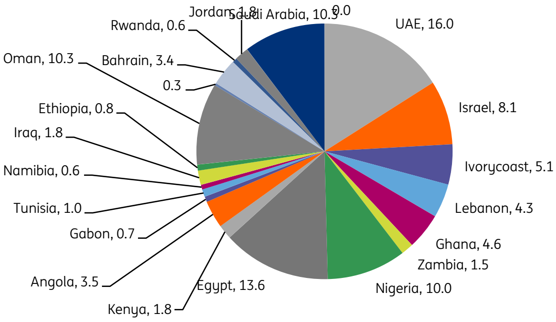
Source: EPFR Global, ING estimates

Fig 31 Latam allocations two months ago (%)



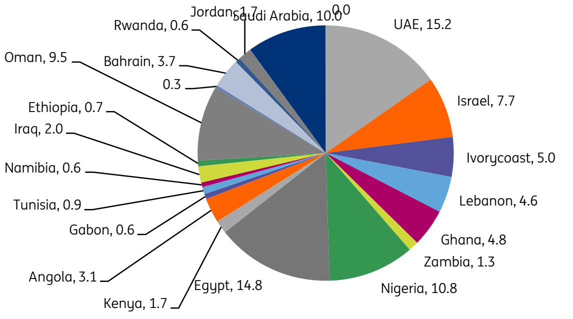
Source: EPFR Global, ING estimates

Fig 32 Africa & ME allocations one month ago (%)



Source: EPFR Global, ING estimates

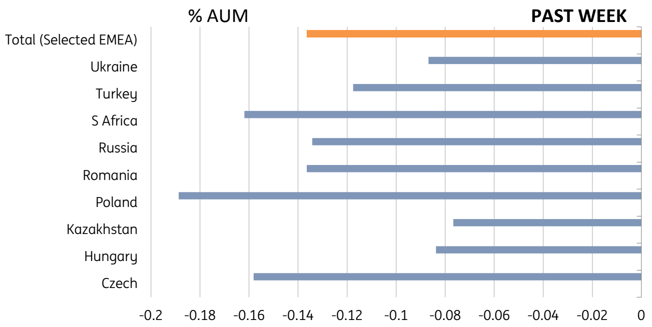
Fig 33 Africa & ME allocations two months ago (%)



Source: EPFR Global, ING estimates

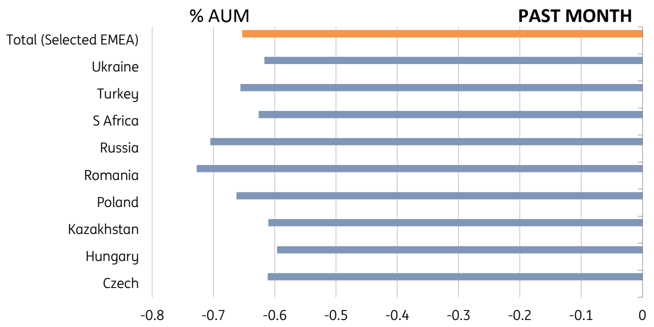
Selected EMEA and Latam Country Flows

Fig 34 EMEA – Change in the past week (%)



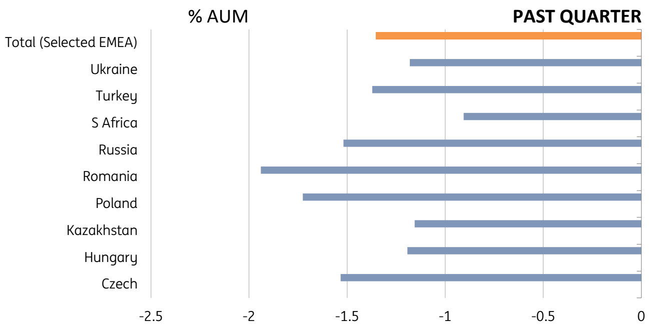
Source: EPFR Global, ING estimates

Fig 35 EMEA – Change in the past month (%)



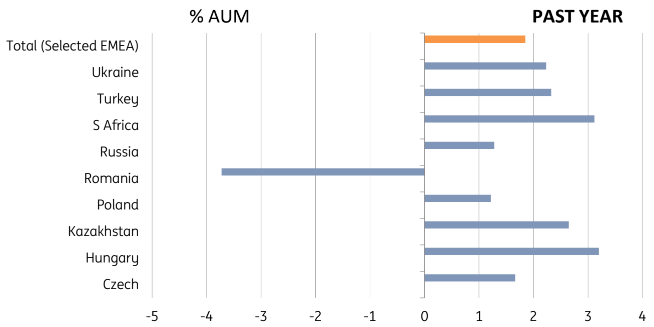
Source: EPFR Global, ING estimates

Fig 36 EMEA – Change in the past quarter (%)



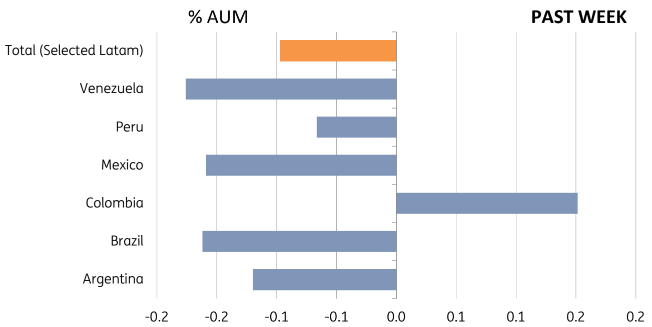
Source: EPFR Global, ING estimates

Fig 37 EMEA – Change in the past year (%)



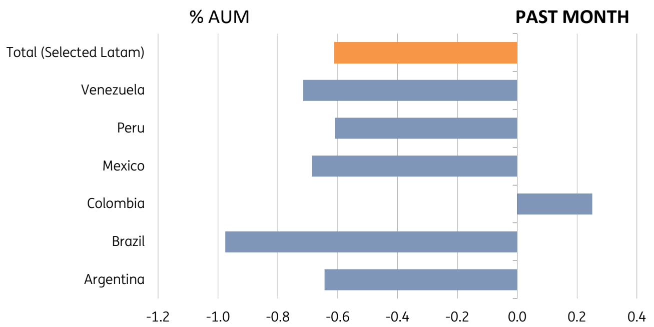
Source: EPFR Global, ING estimates

Fig 38 Latam – Change in the past week (%)



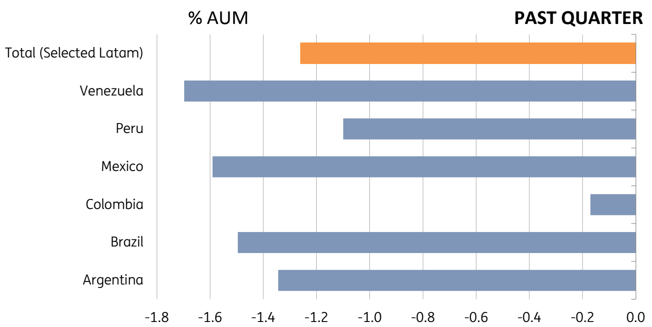
Source: EPFR Global, ING estimates

Fig 39 Latam – Change in the past month (%)



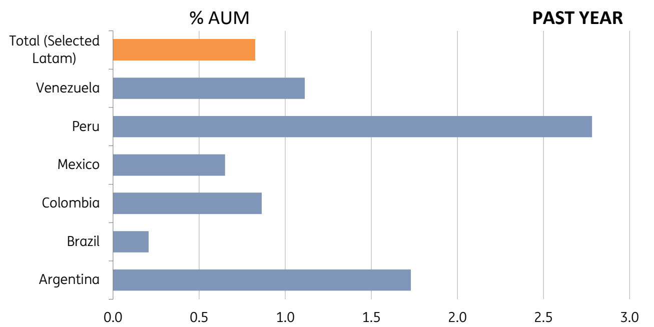
Source: EPFR Global, ING estimates

Fig 40 Latam – Change in the past quarter (%)



Source: EPFR Global, ING estimates

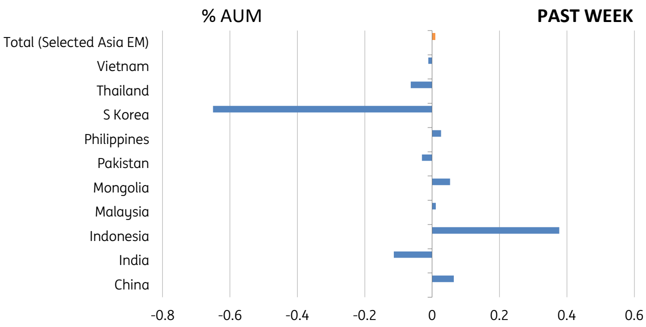
Fig 41 Latam – Change in the past year (%)



Source: EPFR Global, ING estimates

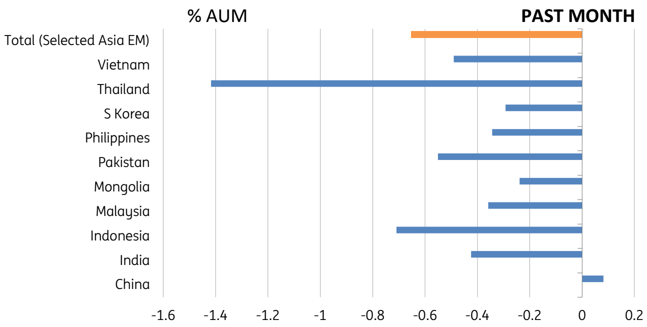
Selected Asia and ME/Africa Country Flows

Fig 42 Asia – Change in the past week (%)



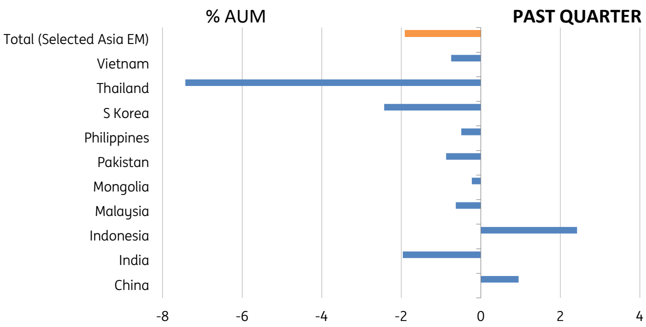
Source: EPFR Global, ING estimates

Fig 43 Asia – Change in the past month (%)



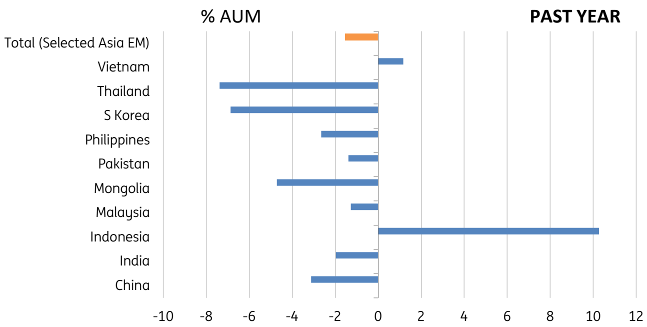
Source: EPFR Global, ING estimates

Fig 44 Asia – Change in the past quarter (%)



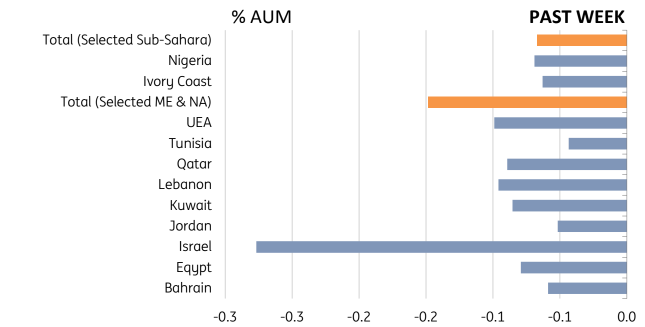
Source: EPFR Global, ING estimates

Fig 45 Asia – Change in the past year (%)



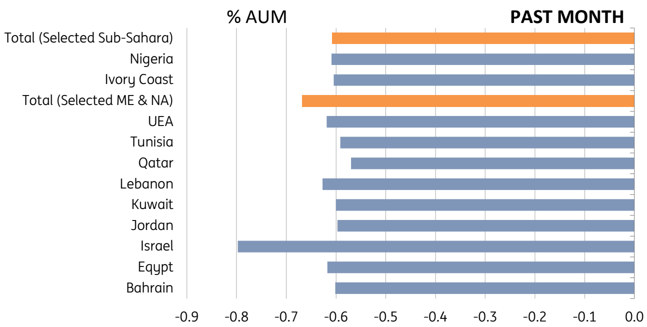
Source: EPFR Global, ING estimates

Fig 46 Middle East & Africa – In the past week (%)



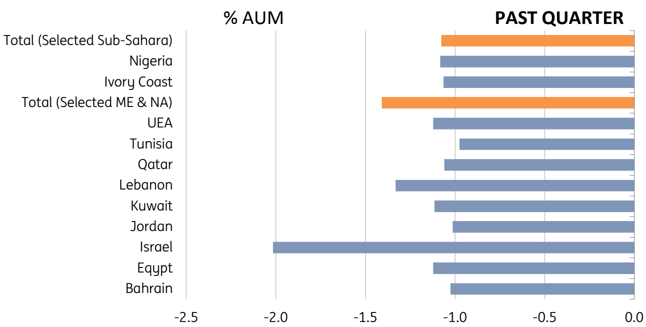
Source: EPFR Global, ING estimates

Fig 47 Middle East & Africa – In the past month (%)



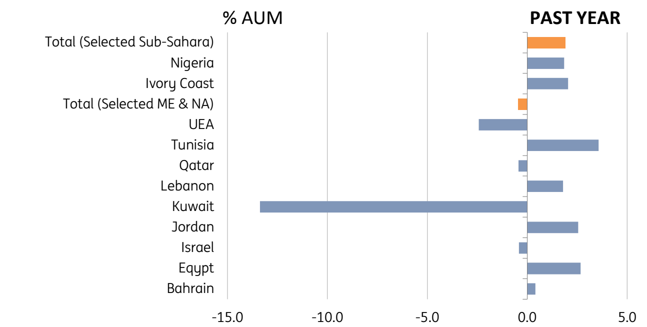
Source: EPFR Global, ING estimates

Fig 48 Middle East & Africa – In the past quarter (%)



Source: EPFR Global, ING estimates

Fig 49 Middle East & Africa – In the past year (%)



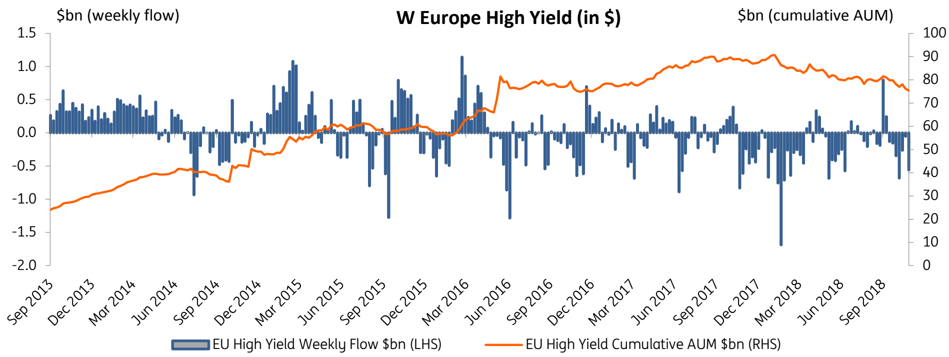
Source: EPFR Global, ING estimates

High Yield

High Yield – Summary themes

- Outflows from high yield funds have re-accelerated in recent weeks, capping off a year of significant net outflows. Assets under management (AUM) in the past quarter are down 3.2%, of which half has occurred in the past month; and half of that has happened in the past week (outflow of 0.8% of AUM).
- The chart below highlights W European high yield. The blue bars illustrate the weekly flows, and illustrate a dominant outflow process. This has been the dominant driver underpinning the fall in cumulative AUM seen for 2018 (orange line), as opposed to total returns which have not been outsized negative, far from it.

Fig 50 Feature Chart: Orange line is AUM changes incl. returns. Blue bars are flows

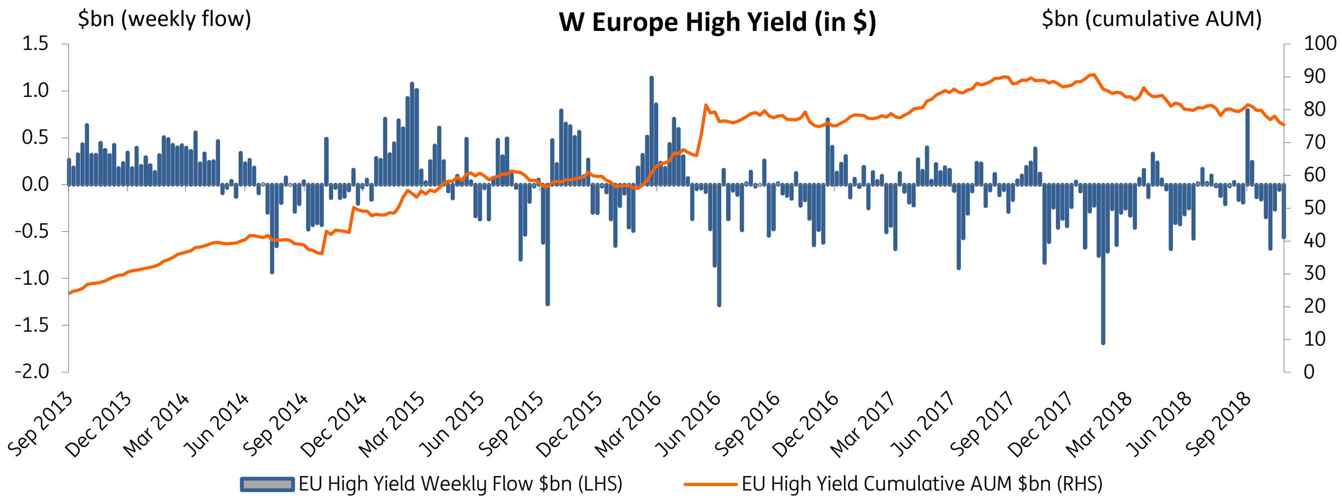


Source: EPFR Global, ING estimates

- W Europe has seen higher relative outflows in the past month, but the US saw the more severe of the relative outflows in the past quarter (3.8% fall for US AUM versus a 2.0% fall for W Europe AUM). The geographic distinction between the US and W European high yield has been more balanced in more recent weeks.

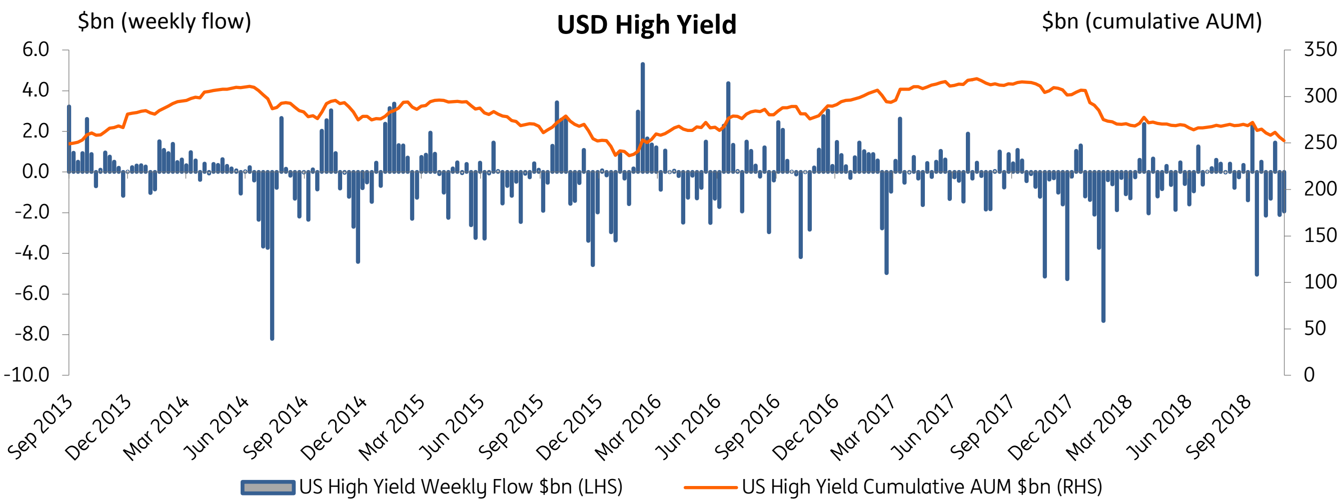
BOTTOM LINE: Global high yield returns are running negative, at -3.3% YTD (in USD), but this is better than seen in emerging markets for example (between -4% to -5% YTD), and even Treasuries are off by 3% YTD. Negative total returns have accelerated in recent week though, having held up quite well through previous quarters. An issue looking into 2019 is the risk for a rise in delinquencies generally across the US economy as the Fed finally tops out with rate hikes. Typically such a scenario correlates with higher default risk in high yield. This is a concern, partly centred on leverage, but not an inevitable outcome at this juncture.

Fig 51 Western Europe High Yield Weekly Flows



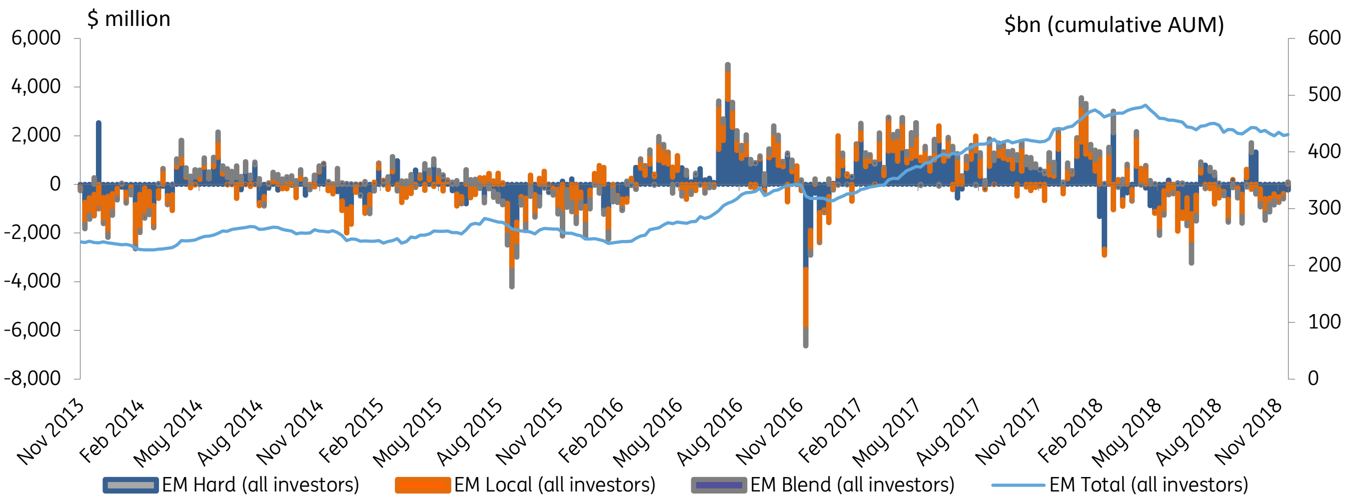
Source: EPFR Global, ING estimates

Fig 52 US High Yield Weekly Flows



Source: EPFR Global, ING estimates

Fig 53 Emerging Markets Weekly Flows – all currencies



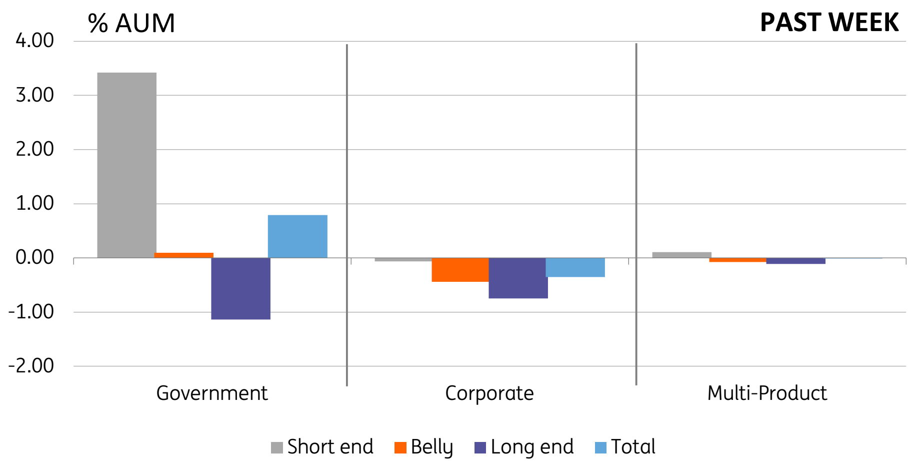
Source: EPFR Global, ING estimates

Developed Markets

Developed Markets – Summary themes

- Quite a pronounced inflow to short end government funds has been thematic in recent months; in fact in the past quarter there has been a near 12% rise in AUM here. This contrasts with a 1% contraction in belly funds and a near 2% expansion in long end funds. In any case, this is a net reduction in duration on average.
- This theme has intensified in the past week, with a 3.4% rise in front end government AUM contrasting with a 1.1% contraction in long end AUM (while the belly has been broadly neutral). This renewed duration short preference has come in the wake of falls in global rates in the face of risk asset angst.
- Despite this duration short preference, inflation funds continue to haemorrhage. Which is quite remarkable, as typically at this stage of the US macro and rates cycle inflation linked funds would typically prove a decent hedge as late cycle correlates with an elevation in both actual inflation prints, and the risk for higher inflation.
- This implied benign inflation risk discount is in turn a factor that contains ambition for nominal rates to rise too much (interconnected of course).

Fig 54 Feature Chart: The market is re-setting duration shorts

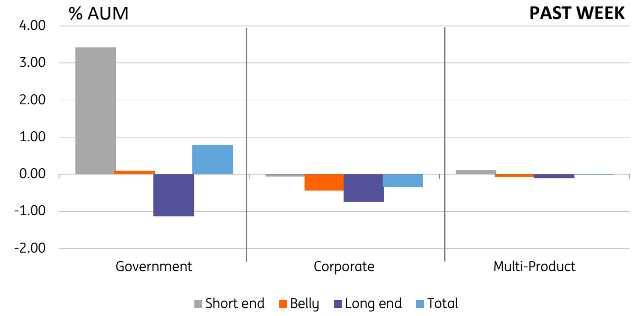


Source: EPFR Global, ING estimates

- Meanwhile, corporate funds continue to see outflows, and the trend in the past quarter has been for outflows to be concentrated in longer end funds. Specifically, AUM in long end corporate funds are down 4.4% in the past quarter, compared with a 2.9% fall in belly fund AUM and a 0.8% fall in front end corporate AUM.

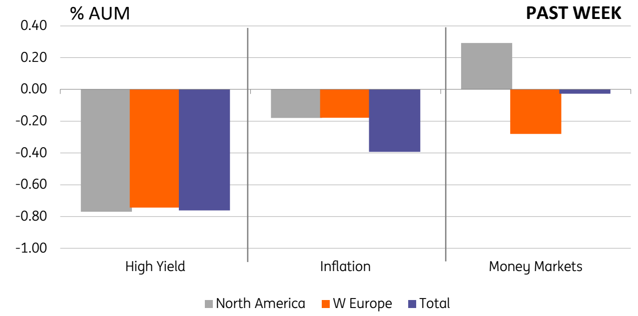
BOTTOM LINE: The implied preference derived from developed market flows is to favour maintaining corporate front end exposures alongside elevated front end government bond exposure, overlaid with a barbell structure in government space and a liquidation of long end risk in corporates (as a theme in the past quarter). And inflation linked funds remain friendless, indicative of a net re-pricing up in real rates a net re-pricing down in inflation breakevens, leaving nominal rates with no clear impulse.

Fig 55 Change in the past week (%)



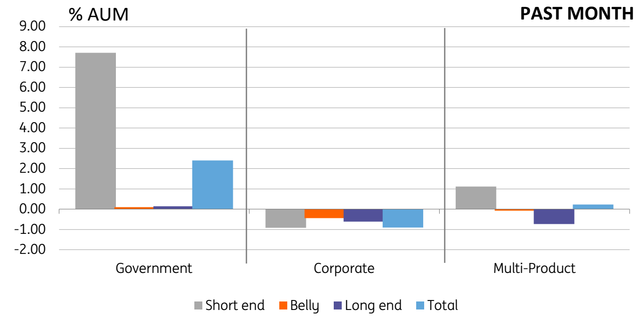
Source: EPFR Global, ING estimates

Fig 56 Change in the past week (%)



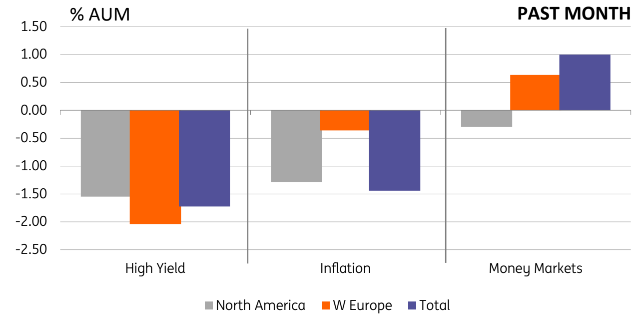
Source: EPFR Global, ING estimates

Fig 57 Change in the past month (%)



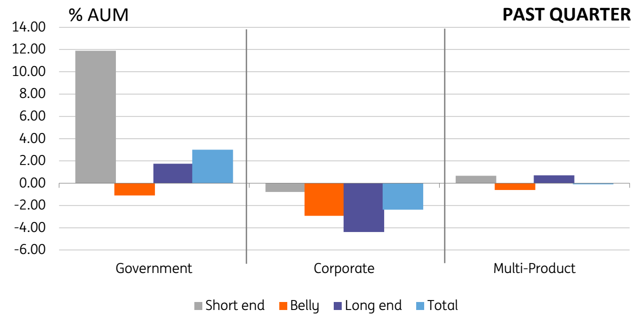
Source: EPFR Global, ING estimates

Fig 58 Change in the past month (%)



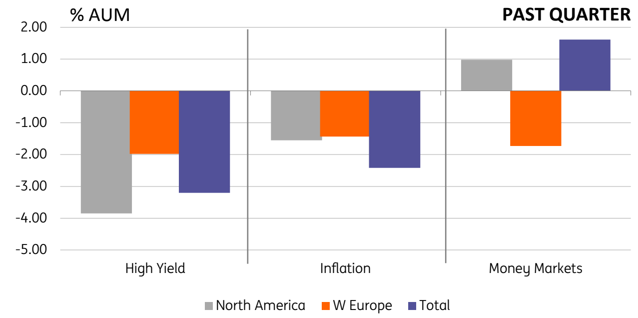
Source: EPFR Global, ING estimates

Fig 59 Change in the past quarter (%)



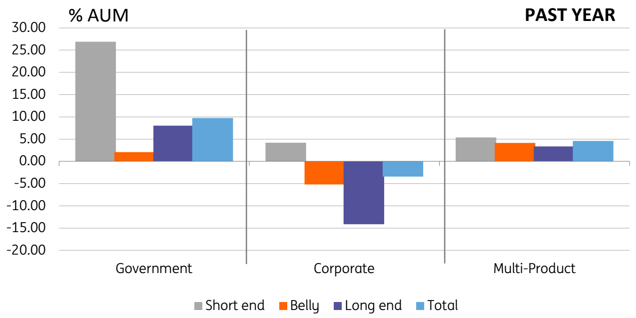
Source: EPFR Global, ING estimates

Fig 60 Change in the past quarter (%)



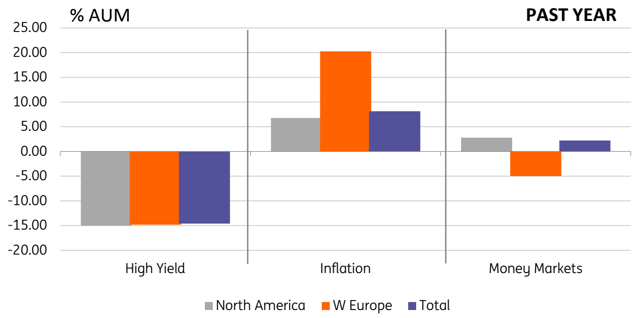
Source: EPFR Global, ING estimates

Fig 61 Change in the past year (%)



Source: EPFR Global, ING estimates

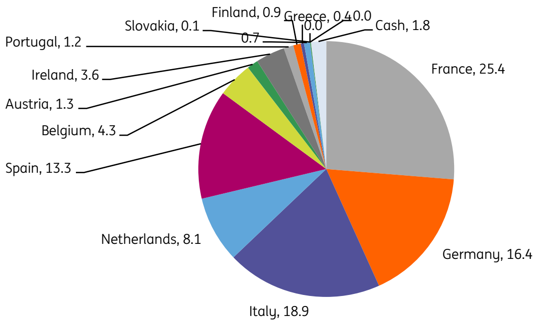
Fig 62 Change in the past year (%)



Source: EPFR Global, ING estimates

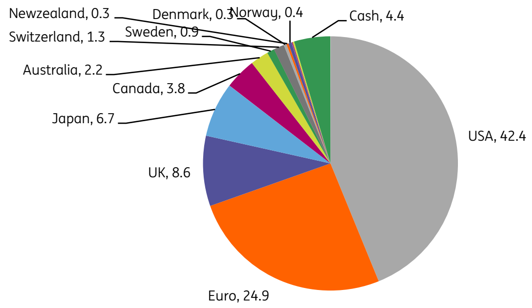
Global DM Manager Asset Allocations

Fig 63 Eurozone allocations one month ago (%)



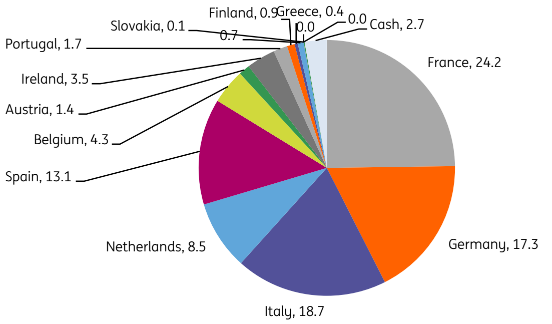
Source: EPFR Global, ING estimates

Fig 64 Global DM allocations one month ago (%)



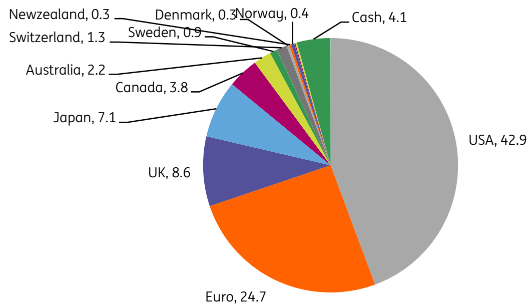
Source: EPFR Global, ING estimates

Fig 65 Eurozone allocations two months ago (%)



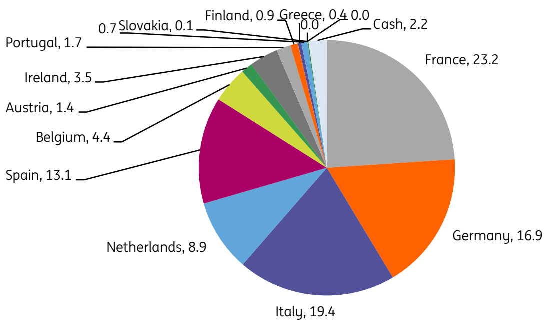
Source: EPFR Global, ING estimates

Fig 66 Global DM allocations two months ago (%)



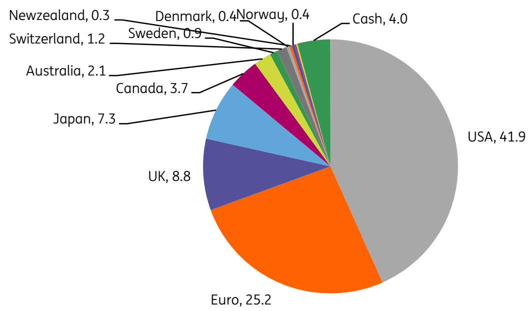
Source: EPFR Global, ING estimates

Fig 67 Eurozone allocations one quarter ago (%)



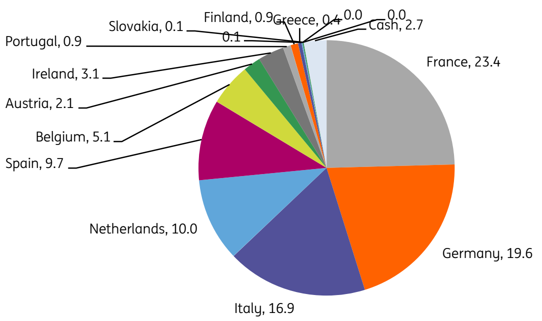
Source: EPFR Global, ING estimates

Fig 68 Global DM allocations one quarter ago (%)



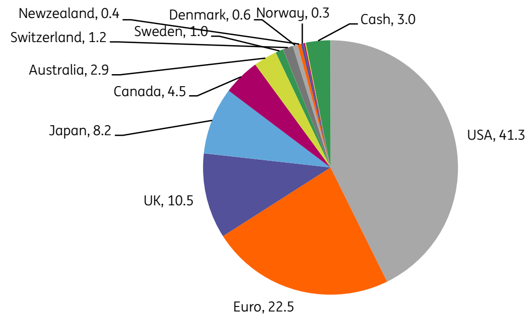
Source: EPFR Global, ING estimates

Fig 69 Eurozone allocations one year ago (%)



Source: EPFR Global, ING estimates

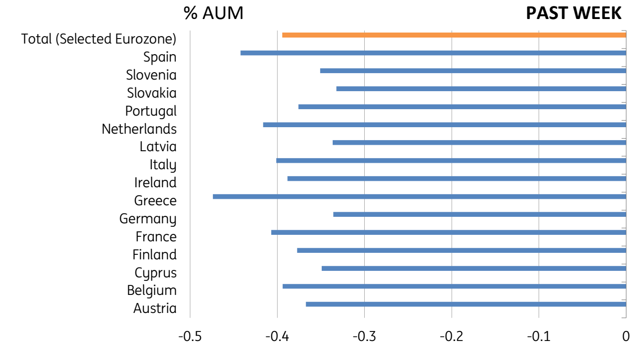
Fig 70 Global DM allocations one year ago (%)



Source: EPFR Global, ING estimates

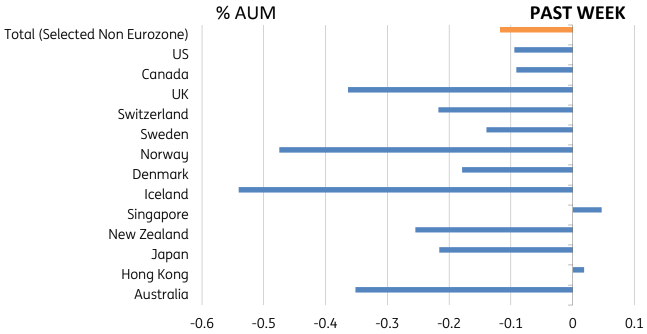
Developed Markets Country Flows

Fig 71 Eurozone – Change in the past week (%)



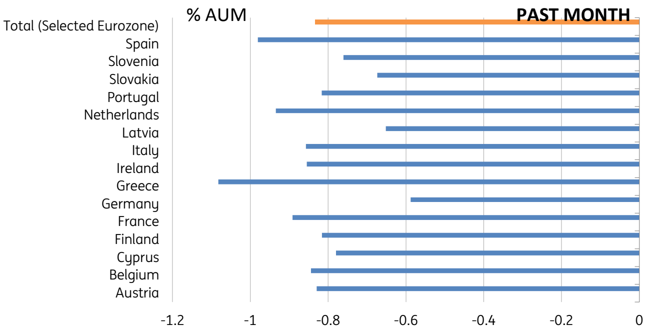
Source: EPFR Global, ING estimates

Fig 72 Non Eurozone – Change in the past week (%)



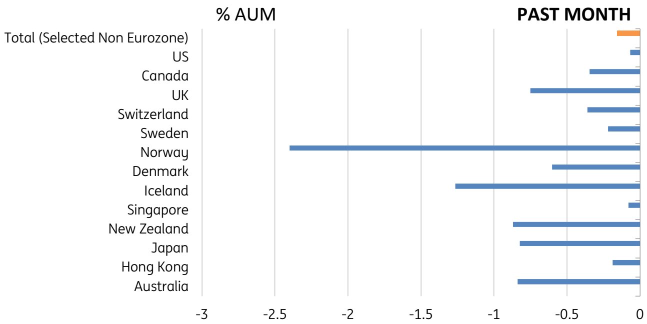
Source: EPFR Global, ING estimates

Fig 73 Eurozone – Change in the past month (%)



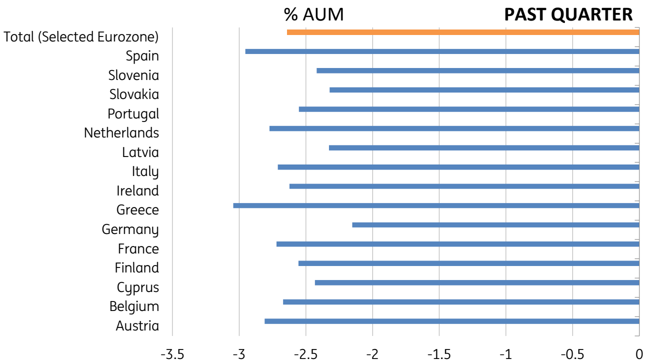
Source: EPFR Global, ING estimates

Fig 74 Non Eurozone – Change in the past month (%)



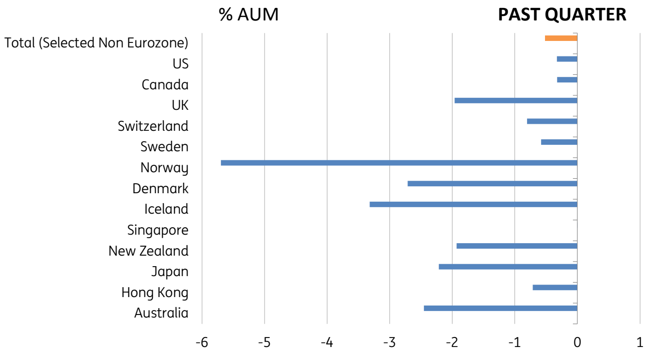
Source: EPFR Global, ING estimates

Fig 75 Eurozone – Change in the past quarter (%)



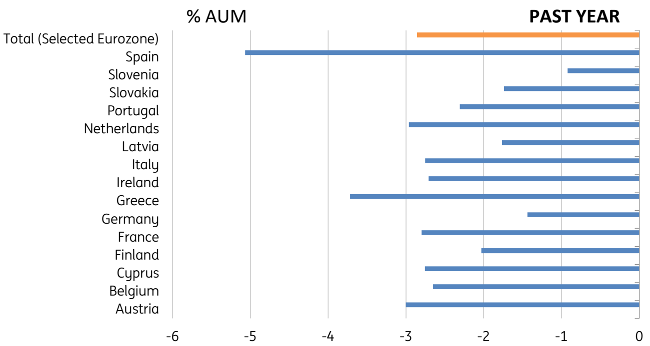
Source: EPFR Global, ING estimates

Fig 76 Non Eurozone – Change in the past quarter (%)



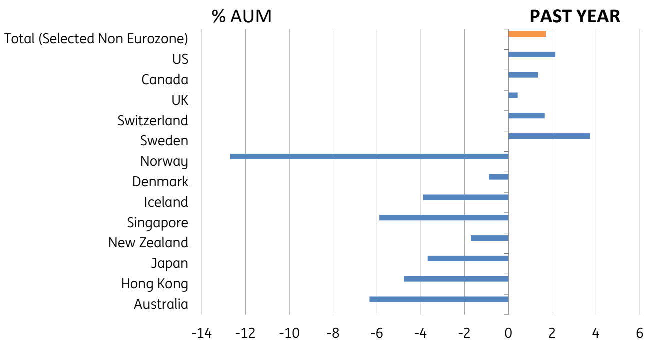
Source: EPFR Global, ING estimates

Fig 77 Eurozone – Change in the past year (%)



Source: EPFR Global, ING estimates

Fig 78 Non Eurozone – Change in the past year (%)



Source: EPFR Global, ING estimates

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