28 August 2020

Rates and Credit

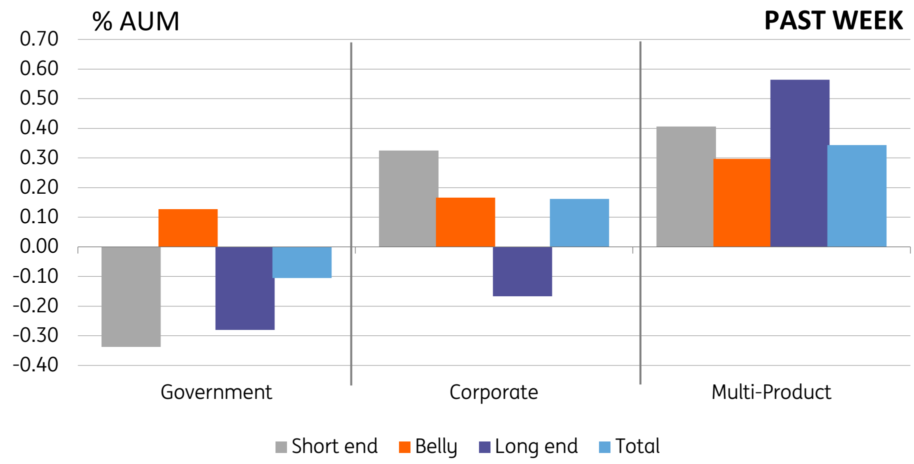
Note: The data in this report relies heavily on EPFR Global data and references the week ended August 26th 2020

Global debt flows

Steepening trend is tactical; expect a reversion

Flows show a paring back of duration exposure, mostly in governments, but also in corporates. This appears to us to be more tactical than structural, suggesting that these will be reversed in weeks to come. Buying of risk remains thematic, from high yield to emerging markets, which saw decent balanced inflows.

Graph of the week: Outflows from long ends last week (including corporates)



Source: EPGR Global, ING estimates

Seven things learnt from latest flows data

1) The curve steepening theme of late is evident from flows, as there has been some clear underweights set in long end funds. This has been especially of note in government funds, but has also been a feature in corporate funds in the past week.

2) That said, there is also evidence of outflows from money market funds alongside inflows to corporates generally including high yield. Hence there remains firm evidence of players looking to get long spread where possible.

3) It would not surprise us to see another week of long end outflows, but we doubt it becomes a precipitous move. The fact remains that average inflation targeting cannot guarantee inflation in the first place.

4) Large output gaps should see a bid return to long duration plays on any material cheapening up of long end rates. The flows into US inflation funds have acted to drive down real rates – not the best way to achieve higher inflation expectations.

5) The inflow process to emerging markets remains reasonably solid. Relative stability in core rates is helping, and heightened volatility surrounding Powell's ambition to target average inflation ahead has not had a material effect on EM.

6) Hard currency continues to outperform, as some higher beta local currency markets have struggled. More recent data point to an improved appetite for local currency, helped in no small way by a weaker USD tendency.

7) Total returns are still running in the red year-to-date for EUR high yield. But, overall global high yield inflows have more than matched prior outflows. With the USD 5yr CDS index now below 400bp there is quite a benign default risk in the price.

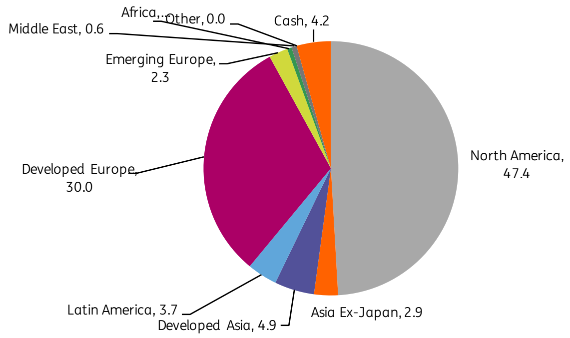
Padhraic Garvey
Regional Head of Research, Americas
ING Financial Markets LLC/ING Capital Markets LLC
New York +1 646 424 7837
padhraic.garvey@ing.com

View all our research on Bloomberg at RSEP INGX<GO>

Contents

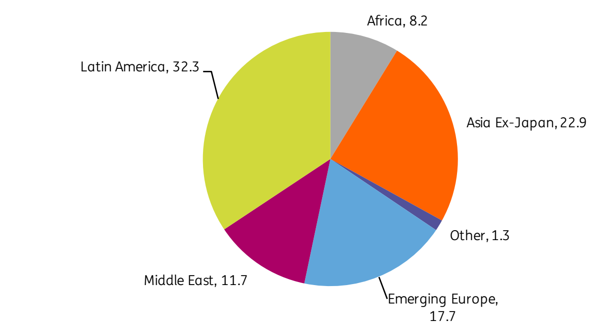
Global Manager (average) Allocations by Region

Fig 1 Global allocations for latest month (%)



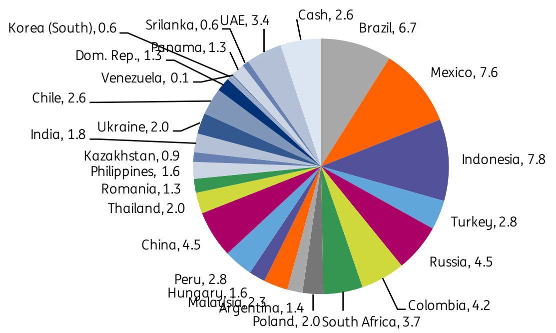
Source: EPFR Global, ING estimates

Fig 2 EM allocations for latest month (%)



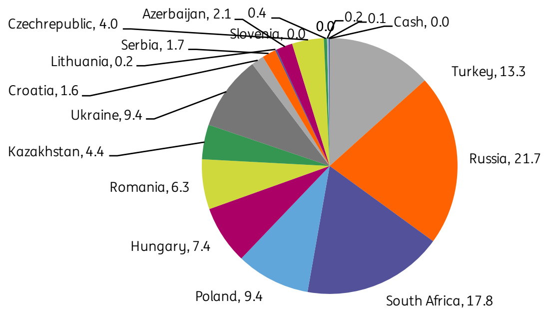
Source: EPFR Global, ING estimates

Fig 3 EM detailed allocations for latest month (%)



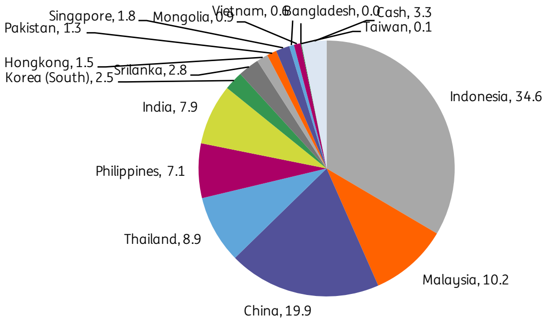
Source: EPFR Global, ING estimates

Fig 4 EMEA allocations for latest month (%)



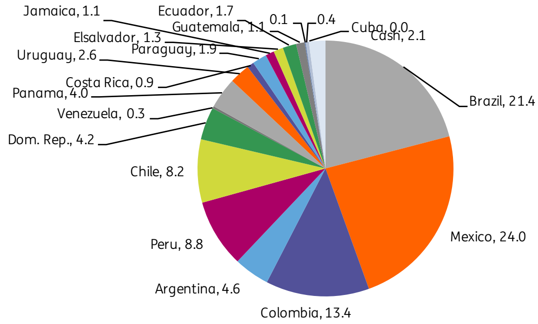
Source: EPFR Global, ING estimates

Fig 5 Asia EM allocations for latest month (%)



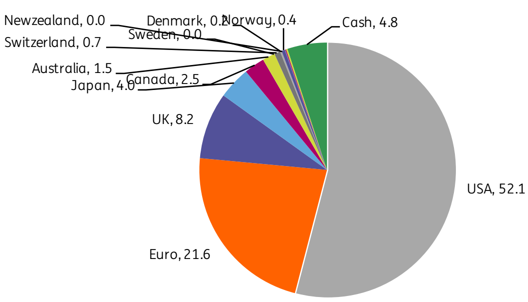
Source: EPFR Global, ING estimates

Fig 6 Latam allocations for latest month (%)



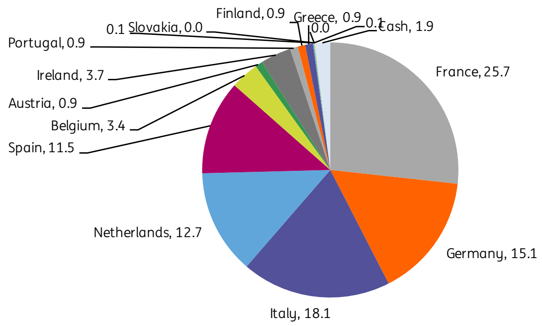
Source: EPFR Global, ING estimates

Fig 7 Developed allocations for latest month (%)



Source: EPFR Global, ING estimates

Fig 8 Eurozone allocations for latest month (%)



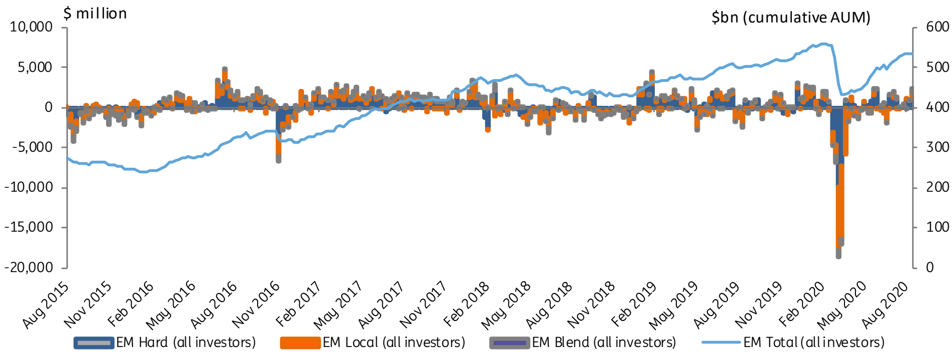
Source: EPFR Global, ING estimates

Emerging markets

Emerging Markets – Summary themes

- An inflow theme to emerging markets remains very much intact (Figure 10). And its been quite balanced for a change. Inflows to hard currency funds were ahead of inflows to local currency funds, but only just.
- Blend funds in fact saw the largest of the proportional inflow, a good indication of growing indifference between hard and local currency; tentative evidence of a change in the dominant preference for hard currency seen in recent months.
- Remember, in the past quarter, hard currency funds added 4% to assets under management (excluding total returns). Over the same period, local currency funds saw a moderate outflow (Figure 14). Dollar weakness ahead can put this in reverse.

Fig 9 Feature Chart: Inflows continue to dominate; not dramatic but persistent



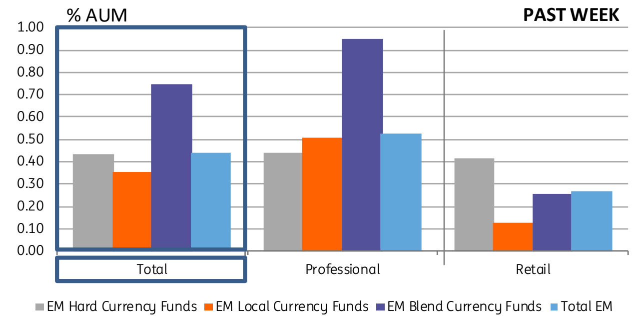
Source: EPFR Global, ING estimates

- The blue line in the graph above (Figure 9) is a catch-all for cumulative assets under management, in the sense that it captures not just the flows but also the change in valuations, including FX effects (all translated back to USD). The precipitous fall in March captures outflows and falls in price. The subsequent rise was initially more about price than inflows, but hard currency inflows have been a persistent driver.
- In EMEA, we note a reduced allocation to Turkey, Russia, Romania and Ukraine versus an increased allocation to S Africa, Poland, Kazakhstan and Czech (Figure 26 vs Figure 27). Latest flows show more outflows from Turkey (Figure 34).
- In Asia, allocation to India and Thailand is moderately down while allocation to Indonesia, Philippines and China is moderately up (Figure 28 vs Figure 29). Latest flows additional more inflows to China (Figure 42).
- In Latam, allocation to Mexico, Colombia, Peru and Chile is down, while allocation to Brazil and Argentina is moderately up for the latest month (Figure 30 vs Figure 31). Latest flows show some returning inflows to Colombia, Argentina and Peru (Figure 38). Brazil still lags in terms of flows though in the past month.
- In Africa and Middle East allocation to Israel and Ivory Coast is down, while allocation to UAE and Saudi Arabia is up (Figure 32 vs Figure 33).

BOTTOM LINE: The inflow process to emerging markets remains reasonably solid. Relative stability in core rates is helping, and the heightened volatility surrounding Powell's ambition to target average inflation ahead has not had a material effect on EM. The tendency for the USD to trek a weaker path remain a support, especially for issuers that hold USD liabilities, but also from a wider EM perspective. Many centres however continue to struggle from Covid-induced collapses in growth and spikes in fiscal deficits, with Latam here under particular scrutiny. Hard currency continues to outperform, as some higher beta local currency markets have struggled. More recent data point to an improved appetite for local currency, helped in no small way by a weaker USD tendency.

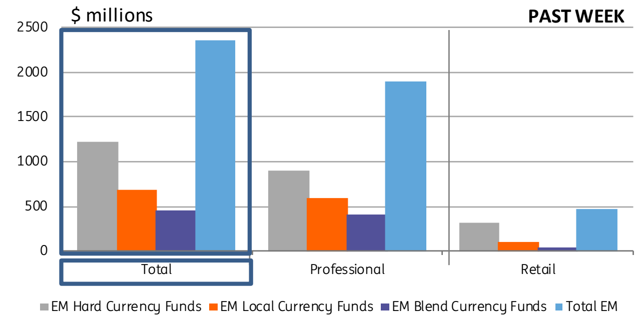
Emerging market Fund Flows

Fig 10 Change in the past week (%)



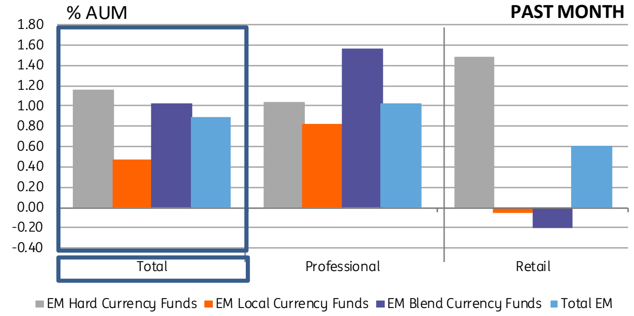
Source: EPFR Global, ING estimates

Fig 11 Change in the past week (US$m)



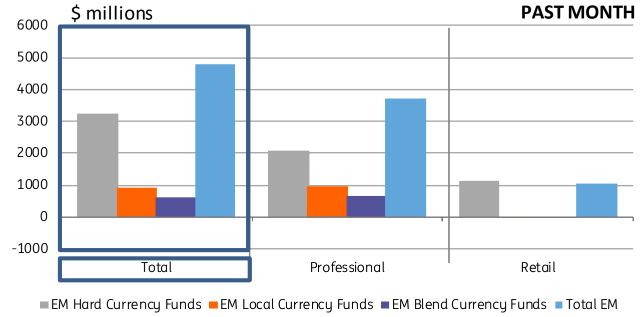
Source: EPFR Global, ING estimates

Fig 12 Change in the past month (%)



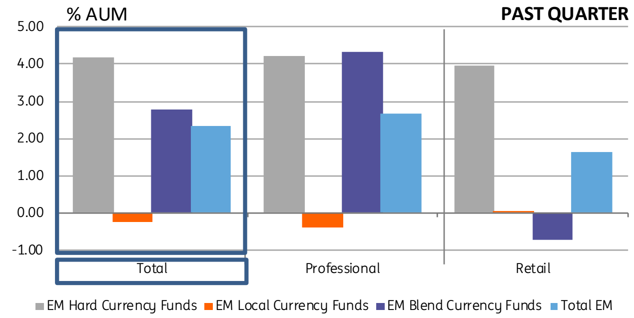
Source: EPFR Global, ING estimates

Fig 13 Change in the past month (US$m)



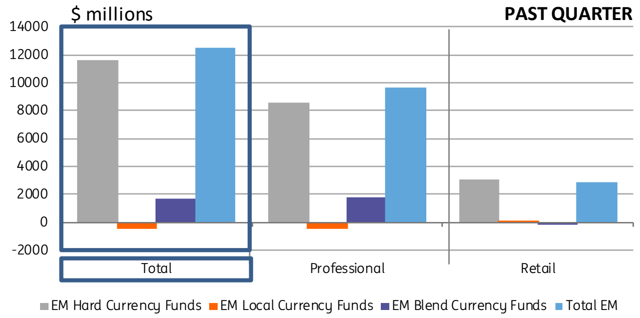
Source: EPFR Global, ING estimates

Fig 14 Change in the past quarter (%)



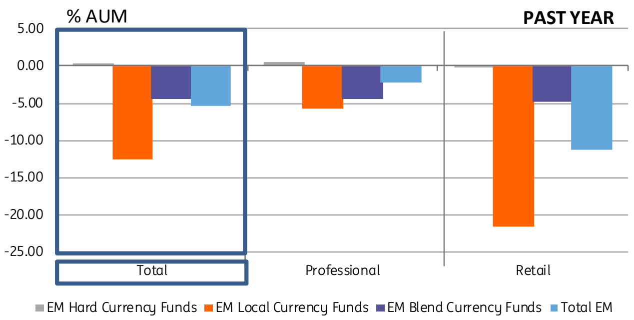
Source: EPFR Global, ING estimates

Fig 15 Change in the past quarter (US$m)



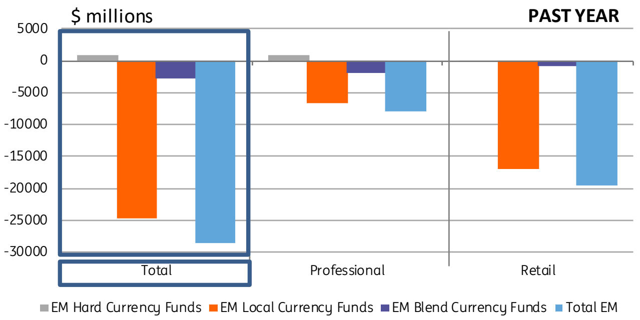
Source: EPFR Global, ING estimates

Fig 16 Change in the past year (%)



Source: EPFR Global, ING estimates

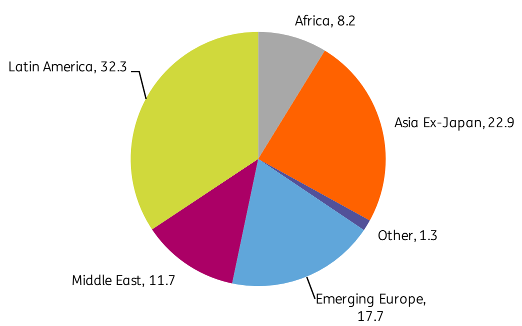
Fig 17 Change in the past year (US$m)



Source: EPFR Global, ING estimates

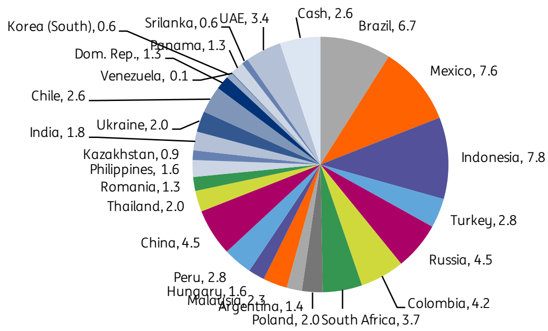
Global EM Manager Asset Allocations

Fig 18 GEM allocations for latest month (%)



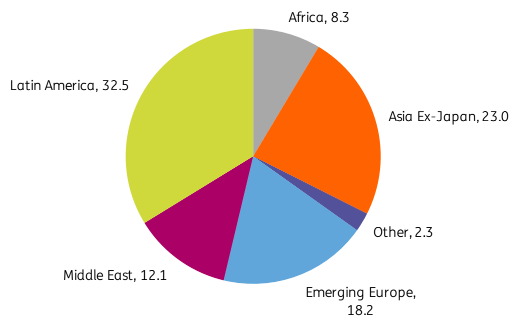
Source: EPFR Global, ING estimates

Fig 19 GEM detailed allocations for latest month (%)



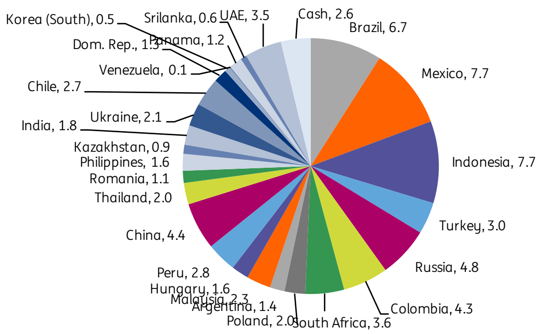
Source: EPFR Global, ING estimates

Fig 20 GEM allocations one month ago (%)



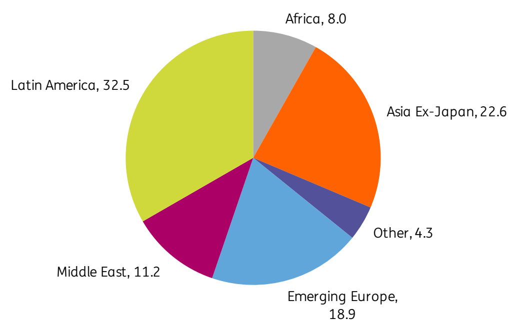
Source: EPFR Global, ING estimates

Fig 21 GEM detailed allocations one month ago (%)



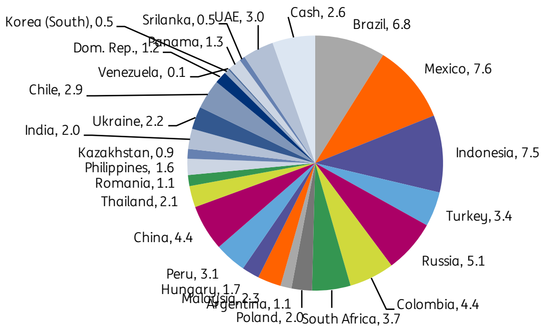
Source: EPFR Global, ING estimates

Fig 22 GEM allocations one quarter ago (%)



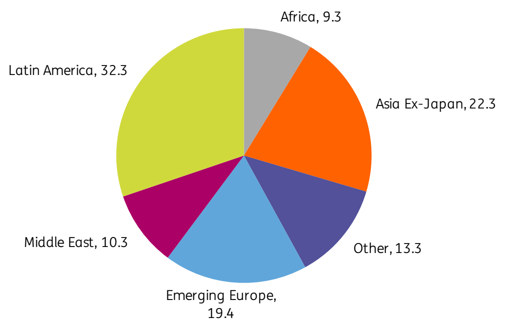
Source: EPFR Global, ING estimates

Fig 23 GEM detailed allocations one quarter ago (%)



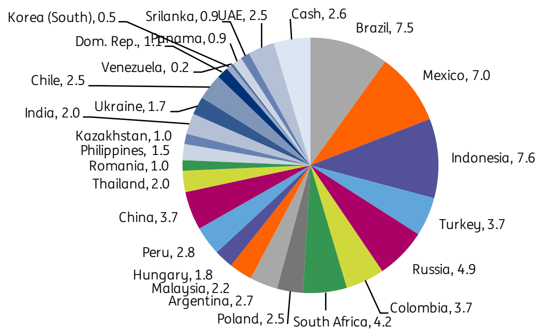
Source: EPFR Global, ING estimates

Fig 24 GEM allocations one year ago (%)



Source: EPFR Global, ING estimates

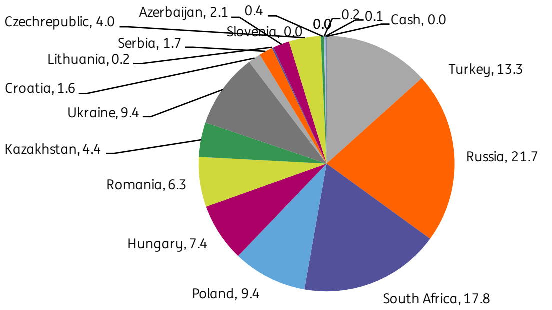
Fig 25 GEM detailed allocations one year ago (%)



Source: EPFR Global, ING estimates

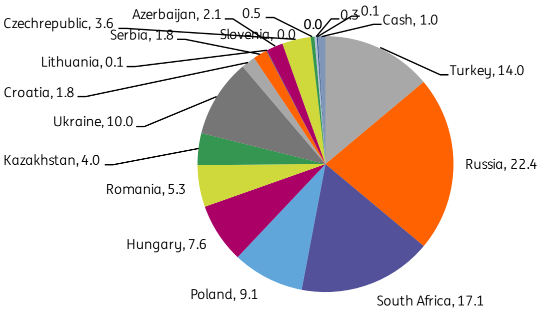
Regional EM Manager Asset Allocation

Fig 26 EMEA allocations for latest month (%)



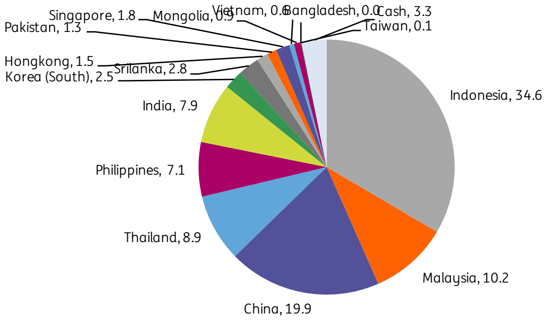
Source: EPFR Global, ING estimates

Fig 27 EMEA allocations for previous month (%)



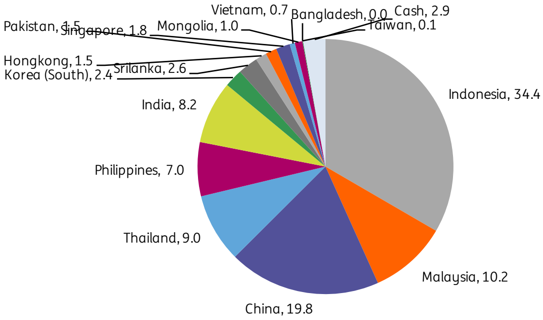
Source: EPFR Global, ING estimates

Fig 28 Asia allocations for latest month (%)



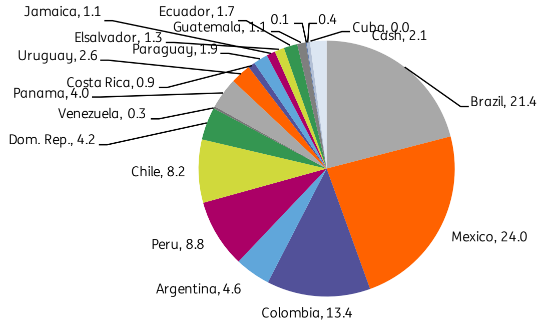
Source: EPFR Global, ING estimates

Fig 29 Asia allocations for previous month (%)



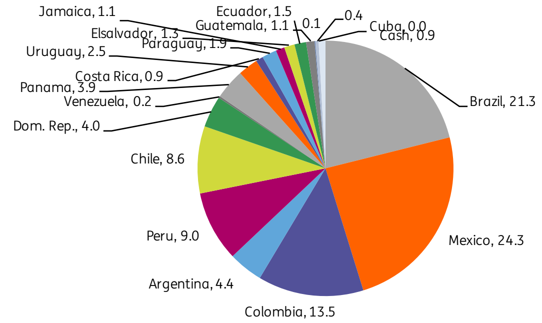
Source: EPFR Global, ING estimates

Fig 30 Latam allocations for latest month (%)



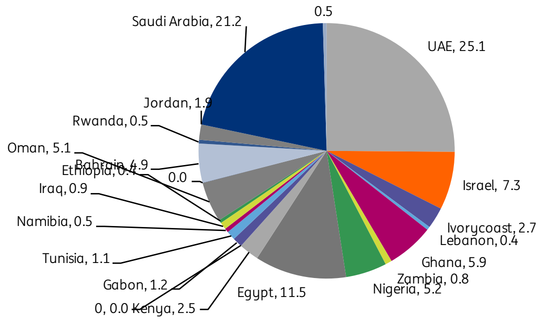
Source: EPFR Global, ING estimates

Fig 31 Latam allocations for previous month (%)



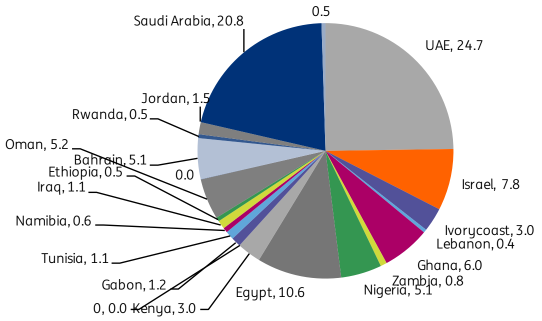
Source: EPFR Global, ING estimates

Fig 32 Africa & ME allocations for latest month (%)



Source: EPFR Global, ING estimates

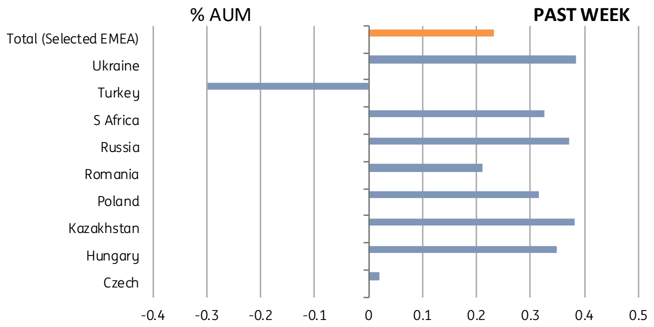
Fig 33 Africa & ME allocations for previous month (%)



Source: EPFR Global, ING estimates

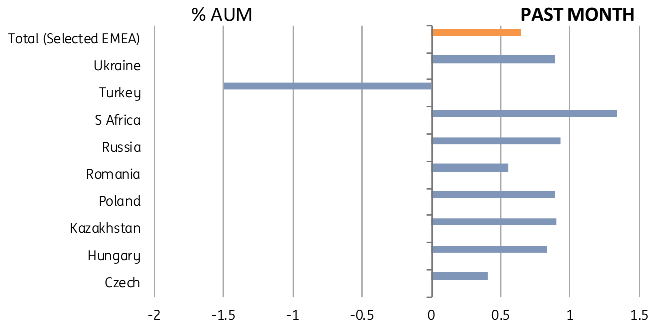
Selected EMEA and Latam Country Flows

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



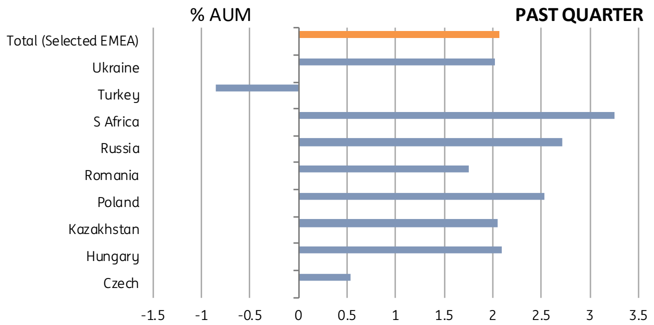
Source: EPFR Global, ING estimates

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



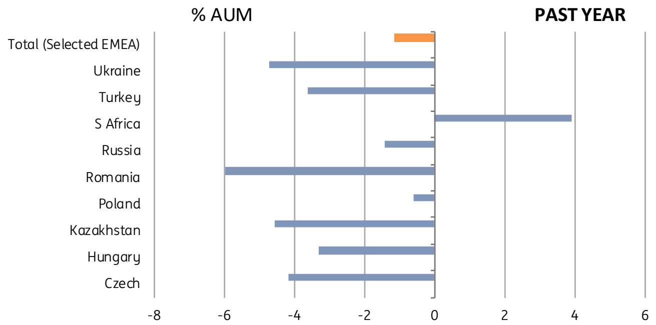
Source: EPFR Global, ING estimates

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



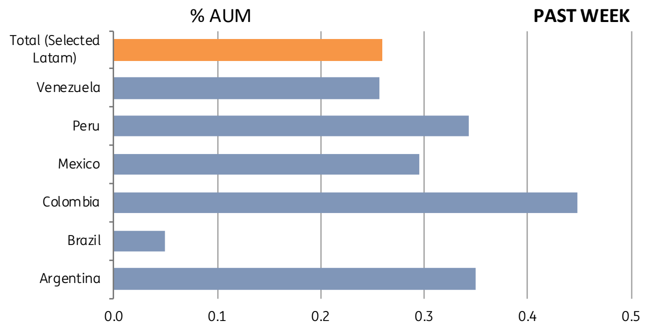
Source: EPFR Global, ING estimates

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



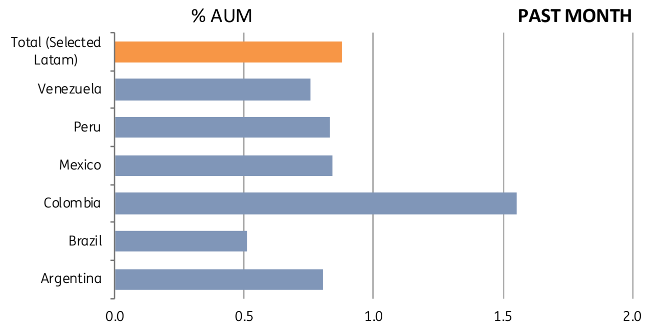
Source: EPFR Global, ING estimates

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



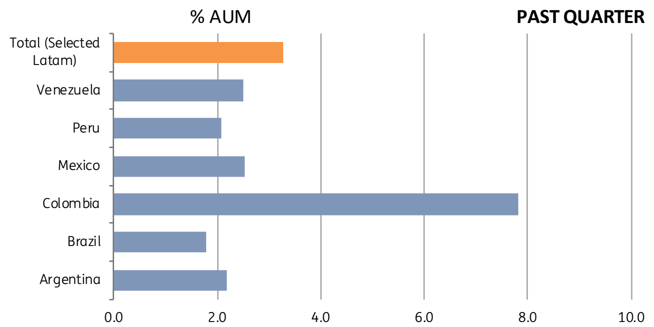
Source: EPFR Global, ING estimates

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



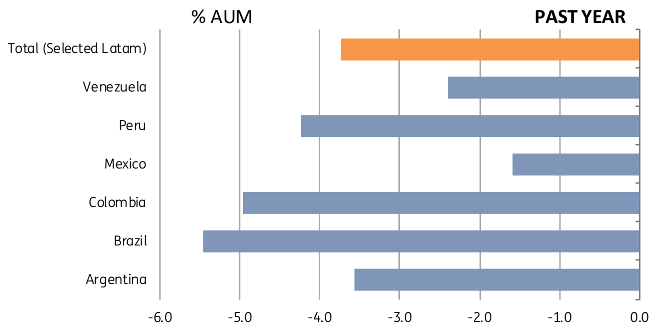
Source: EPFR Global, ING estimates

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



Source: EPFR Global, ING estimates

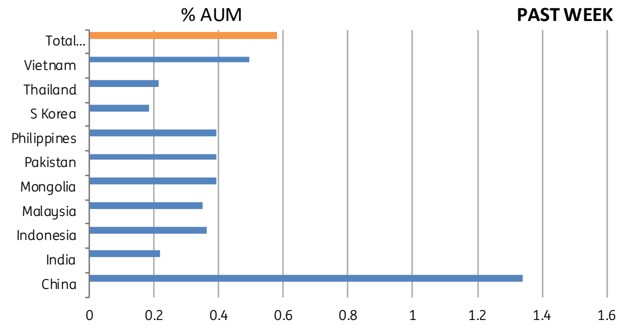
Fig 41 Latam – Change in the past year (%)



Source: EPFR Global, ING estimates

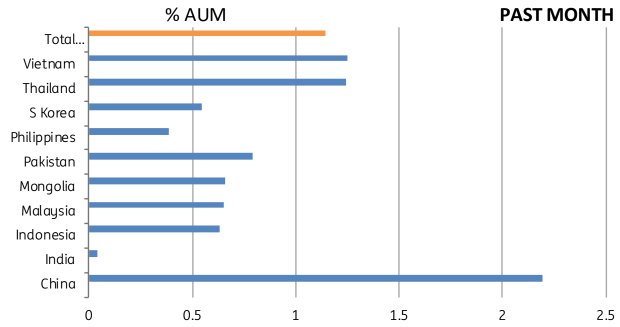
Selected Asia and ME/Africa Country Flows

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



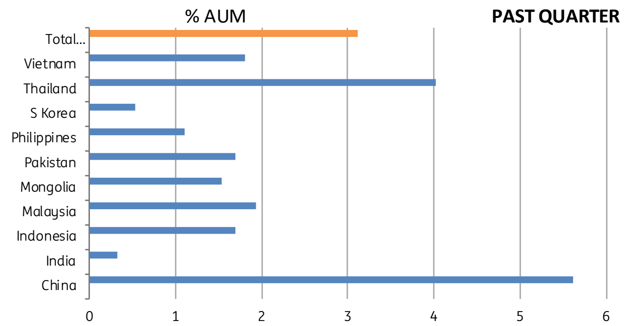
Source: EPFR Global, ING estimates

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



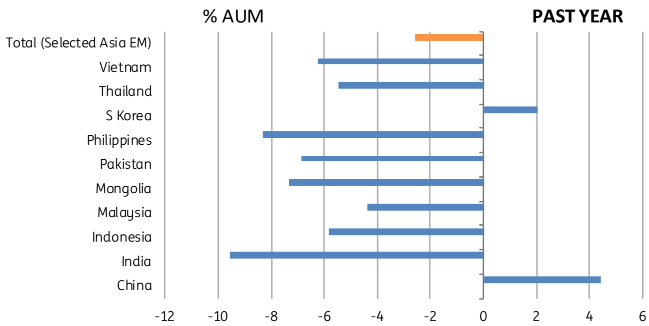
Source: EPFR Global, ING estimates

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



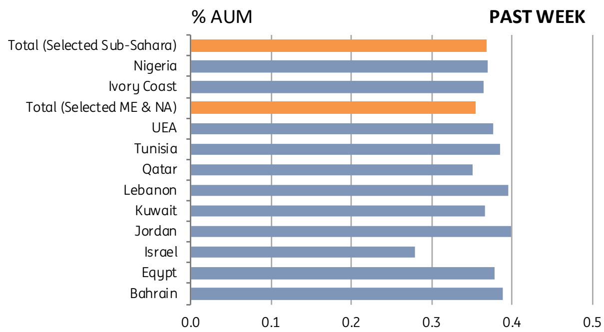
Source: EPFR Global, ING estimates

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



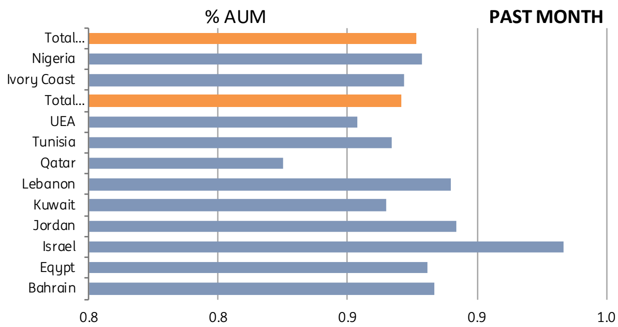
Source: EPFR Global, ING estimates

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



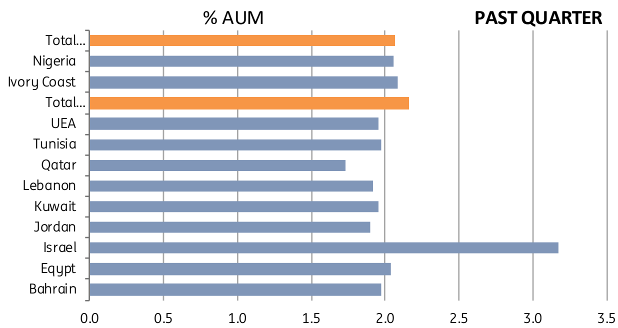
Source: EPFR Global, ING estimates

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



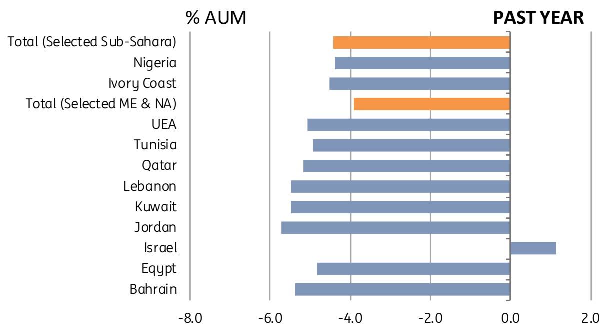
Source: EPFR Global, ING estimates

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



Source: EPFR Global, ING estimates

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



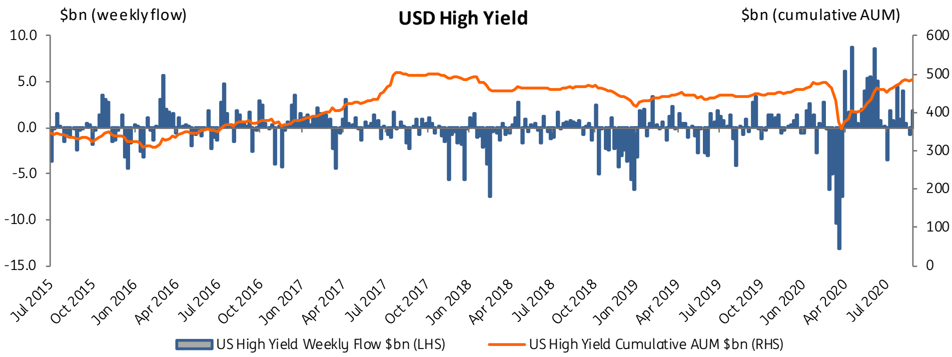
Source: EPFR Global, ING estimates

High Yield

High Yield – Summary themes

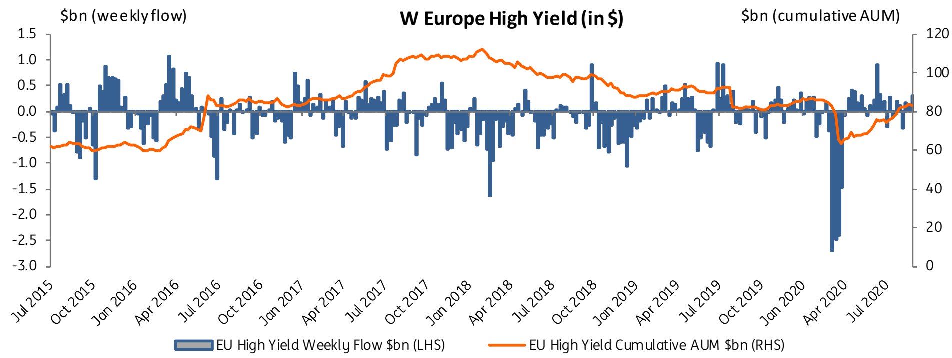
- Inflows to high yield have maintained a steady pace, albeit more subdued of late (Figure 54).
- The bulk of the inflows in a relative sense continue to be into USD high yield, which continues to run at three times the pace of EUR high yield (Figure 57).

Fig 50 USD high yield: Outflows morph to renewed robust inflows, leading the way



Source: EPFR Global, ING estimates

Fig 51 EUR high yield: Outflows morph to renewed robust inflows, but more subdued



Source: EPFR Global, ING estimates

- The orange line in the graphs above is a catch-all for cumulative assets under management, in the sense that it captures not just the flows but also the change in valuations, including FX effects (all translated back to USD). The precipitous fall in March 2020 captures the prior outflows and big build in discount to par. The subsequent rise is a reflection of inflows and price appreciation right across the high yield space. The recovery in USD high yield (Figure 50) has been more impressive than that of EUR high yield (Figure 51).

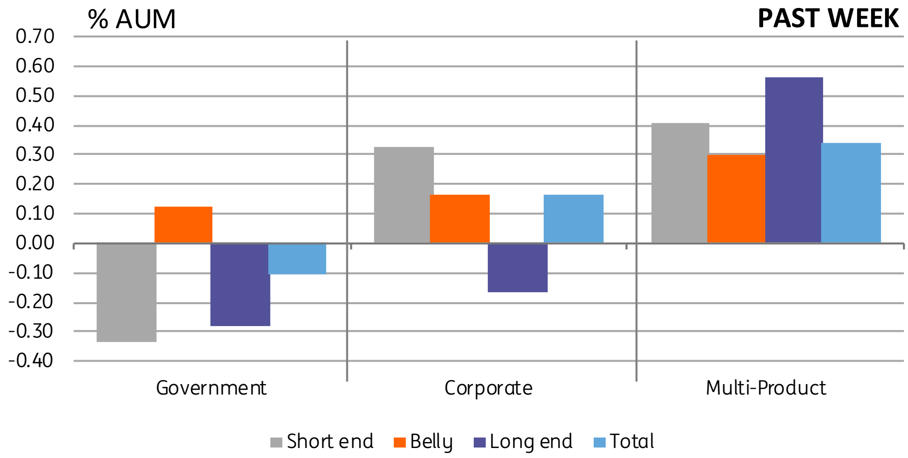
BOTTOM LINE: Not only was there a classic elevation in default risk as economies jumped to a recessionary state, but the collapse in the oil price was an additional stress factor in this space, in particular for US high yield. Hence the prior outflows. However fast forward to the past couple of months and there has been a re-rating of prospects in high yield. Total returns are still running in the red year-to-date for EUR high yield. But, overall global high yield inflows have more than matched prior outflows. With the USD 5yr CDS index now below 400bp there is quite a benign default risk in the price.

Developed Markets

Developed Markets – Summary themes

- Government funds have seen outflows over the past month (Figure 55). The bulk of the outflows have been from long end funds and front funds (less outflows from belly funds). This has also been in evidence in the past week (Figure 53).
- In fact the striking feature of the past week is outflows seen from long end funds not just in governments, but also in corporates (Figure 52). Overall there were still inflows into corporates, but more of a shorter duration type.
- This was the week in which Powell affirmed the much anticipated move to average inflation targeting, which by definition reduces the protection offered by Fed policy to long dated bonds; a non pre-emptive stance heightens risks there.
- That said, with no material inflation on the horizon given the size of the output gap built, alongside the lack of success enjoyed by the ECB and BoJ in manufacturing inflation, there is no material need for back ends to get too concerned just yet.

Fig 52 Feature Chart: Long end fund outflows dominate in the past week



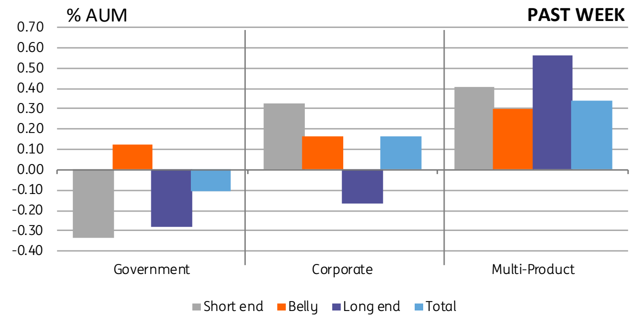
Source: EPFR Global, ING estimates

- Inflows to USD inflation funds continued last week (Figure 54), and are still showing large inflows in the past quarter. Outflows from EUR funds still dominate though (Figure 58), and these continued in the past week. There is an implied belief there that the US stands a greater chance of building some inflation, eventually.
- Money market funds continue to see a trickle of outflows, especially US money market funds. Some of this reflects a shift away from ultra-low yielding product where possible. That said, even lower yielding European product has managed to see some inflows over the past month (versus clear US money fund outflows).

BOTTOM LINE: The curve steepening theme of late is evident from flows, as there has been some clear underweights set in long end funds. This has been especially of note in government funds, but has also been a feature in corporate funds in the past week. That said, there is also evidence of outflows from money market funds alongside inflows to corporates generally including high yield. Hence there remains firm evidence of players looking to get long spread where possible. It would not surprise us to see another week of long end outflows, but we doubt it becomes a precipitous move. The fact remains that average inflation targeting cannot guarantee inflation in the first place. Large output gaps and general macro angst should see a bid return to long duration plays on any material cheapening up of long end rates. Meanwhile, flows into US inflation funds have acted to drive down real rates; not the best way to achieve higher inflation expectations.

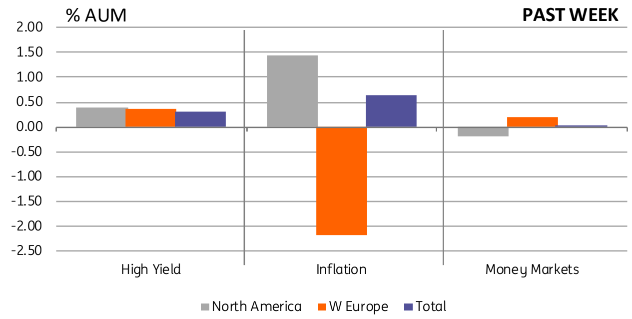
Developed Markets Net Fund Flows

Fig 53 Change in the past week (%)



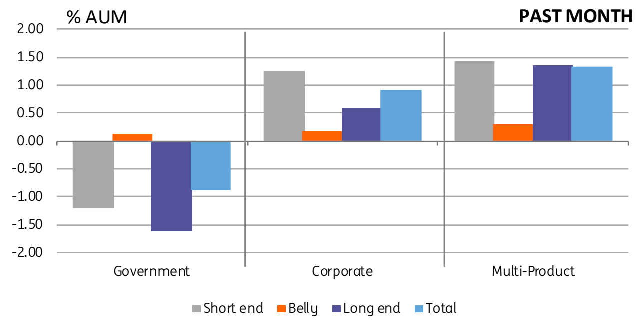
Source: EPFR Global, ING estimates

Fig 54 Change in the past week (%)



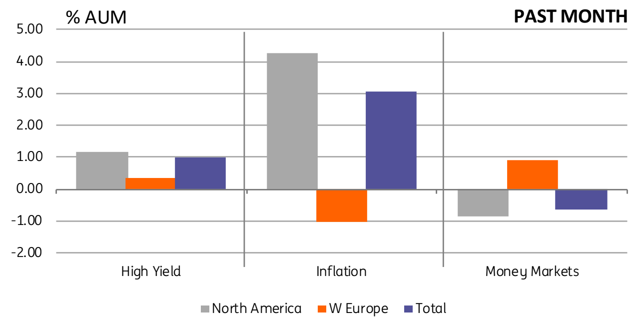
Source: EPFR Global, ING estimates

Fig 55 Change in the past month (%)



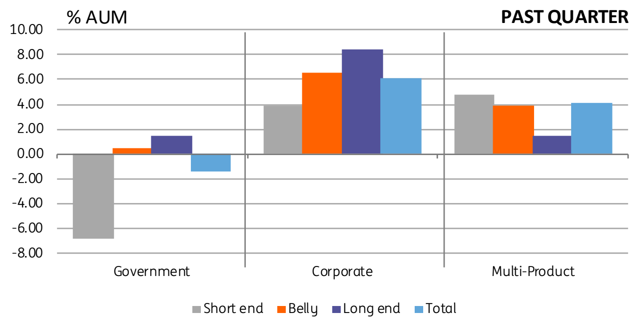
Source: EPFR Global, ING estimates

Fig 56 Change in the past month (%)



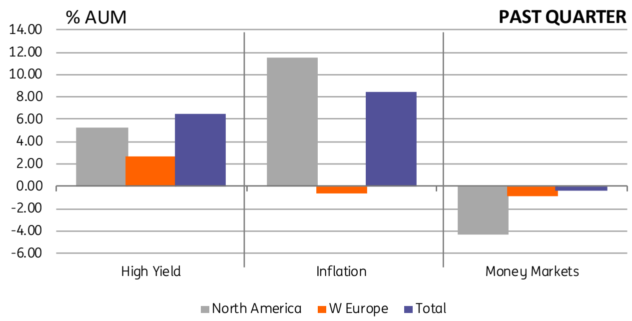
Source: EPFR Global, ING estimates

Fig 57 Change in the past quarter (%)



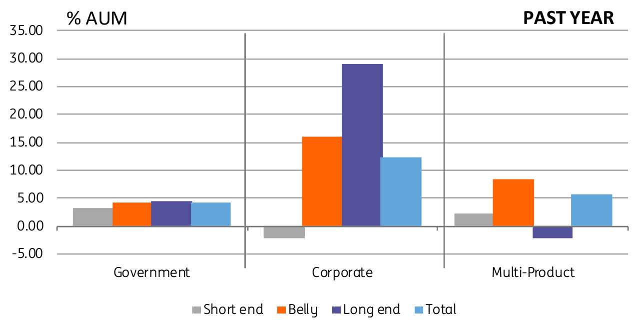
Source: EPFR Global, ING estimates

Fig 58 Change in the past quarter (%)



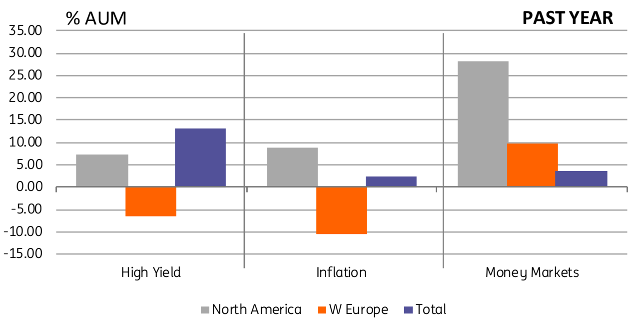
Source: EPFR Global, ING estimates

Fig 59 Change in the past year (%)



Source: EPFR Global, ING estimates

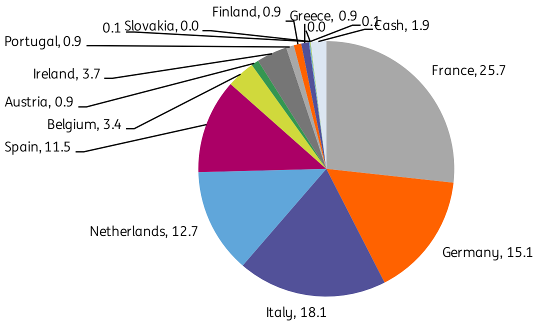
Fig 60 Change in the past year (%)



Source: EPFR Global, ING estimates

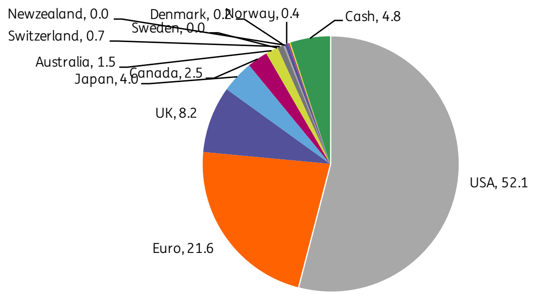
Global DM Manager Asset Allocations

Fig 61 Eurozone allocations for the last month (%)



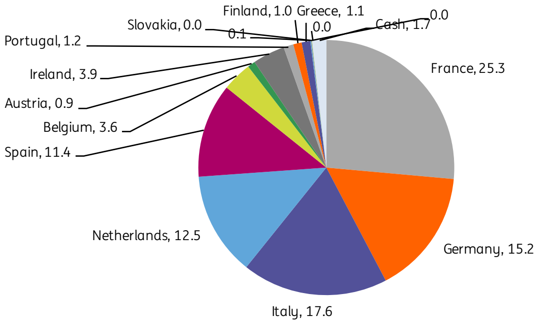
Source: EPFR Global, ING estimates

Fig 62 Global DM allocations for the last month (%)



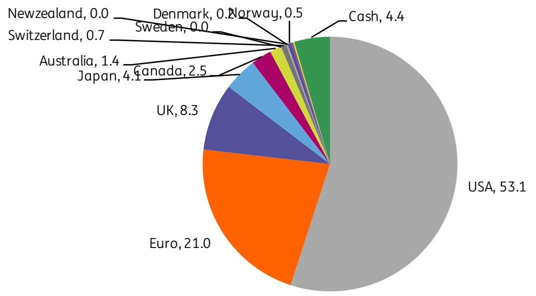
Source: EPFR Global, ING estimates

Fig 63 Eurozone allocations one month previous (%)



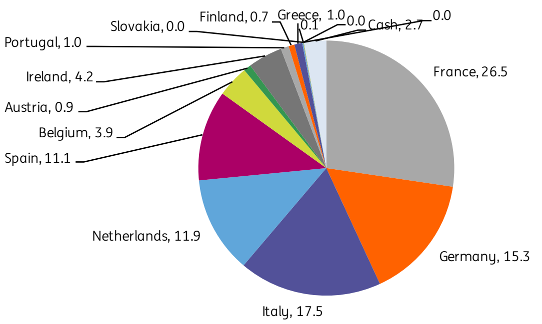
Source: EPFR Global, ING estimates

Fig 64 Global DM allocations one month previous (%)



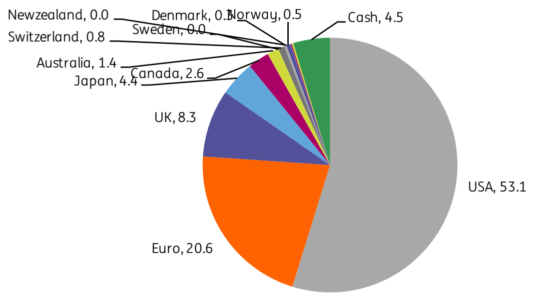
Source: EPFR Global, ING estimates

Fig 65 Eurozone allocations one quarter ago (%)



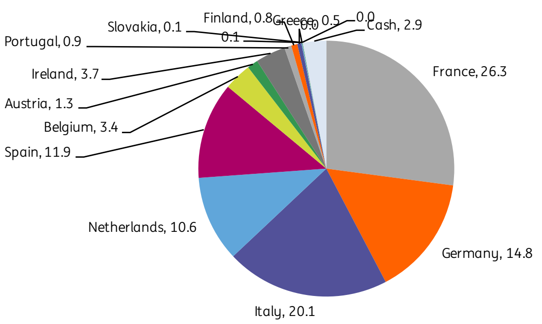
Source: EPFR Global, ING estimates

Fig 66 Global DM allocations one quarter ago (%)



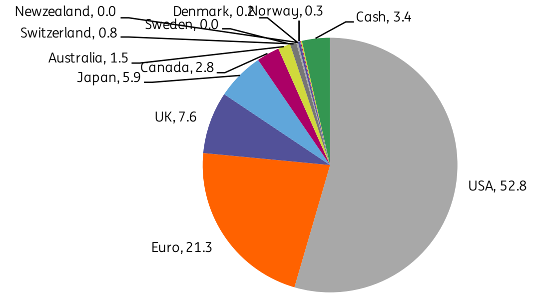
Source: EPFR Global, ING estimates

Fig 67 Eurozone allocations one year ago (%)



Source: EPFR Global, ING estimates

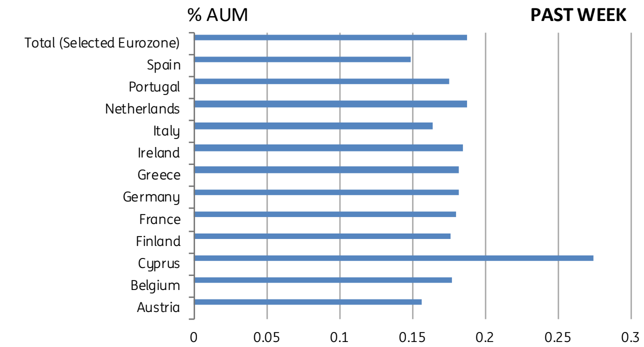
Fig 68 Global DM allocations one year ago (%)



Source: EPFR Global, ING estimates

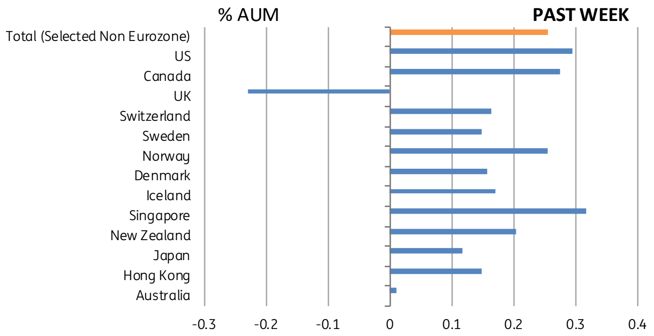
Developed Markets Country Flows

Fig 69 Eurozone – Change in the past week (%)



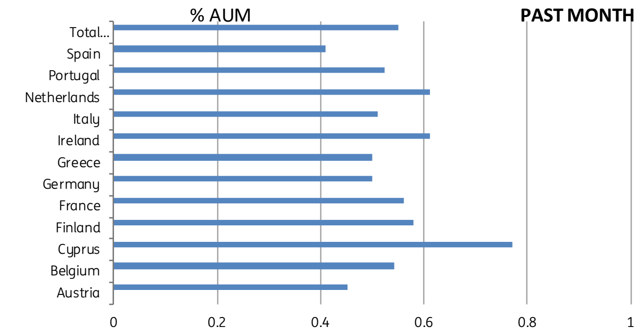
Source: EPFR Global, ING estimates

Fig 70 Non Eurozone – Change in the past week (%)



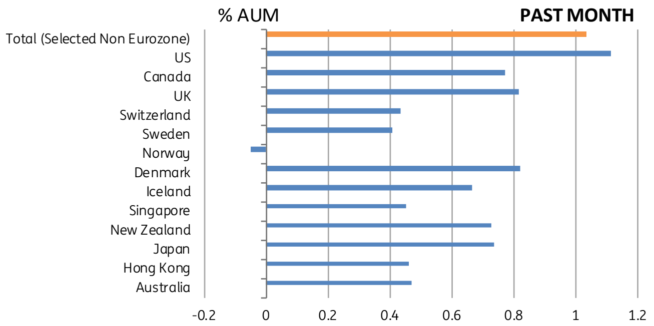
Source: EPFR Global, ING estimates

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



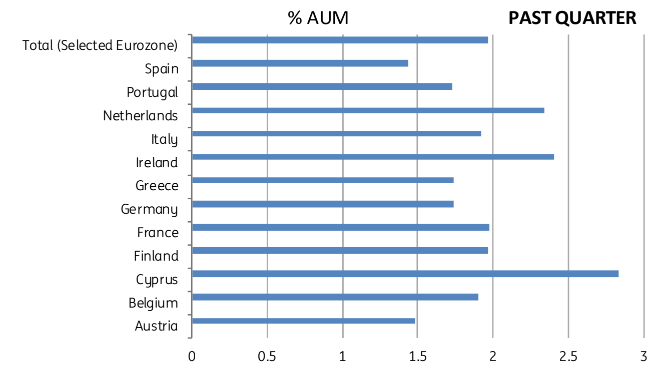
Source: EPFR Global, ING estimates

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



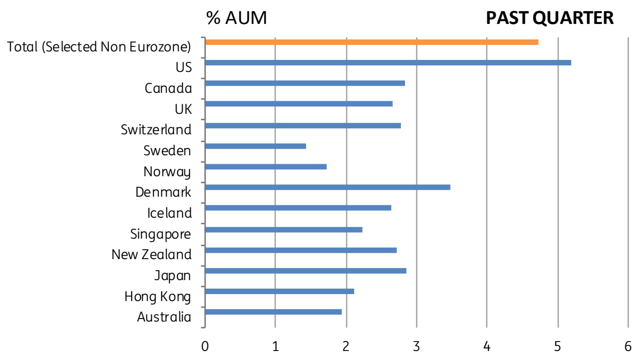
Source: EPFR Global, ING estimates

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



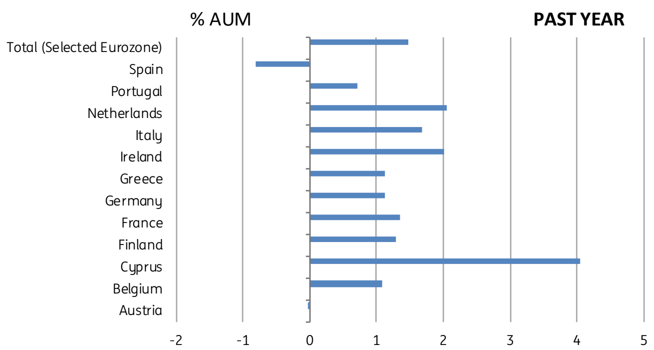
Source: EPFR Global, ING estimates

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



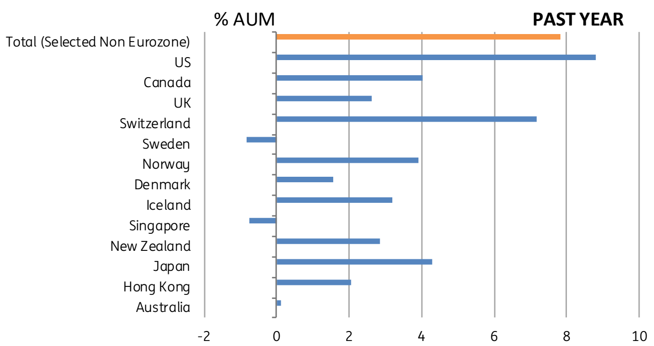
Source: EPFR Global, ING estimates

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



Source: EPFR Global, ING estimates

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



Source: EPFR Global, ING estimates

Disclaimer