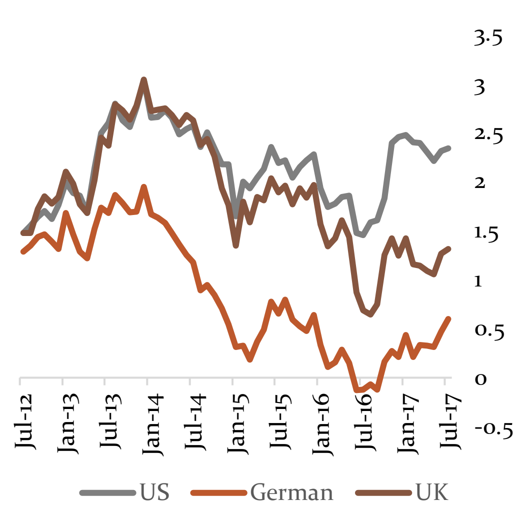
Fixed-Income Markets

Contents

The U.S. government might be well positioned between the world of stocks and bonds, but when both markets show a different outlook, the Fed might have to deal with the failure of one. To begin, we will reflect on some U.S. government developments that took place throughout the days 10th, 12th & 13th of July 2017. We will then follow up with some figures to get a better idea about developments in the U.S. as the market has quite the contagion effect.

Following that, we will discuss what green bonds are & understand the bigger picture of how a bond represents more than just fixed income. Finally, we will consider the situation of Greece and its current plan of action on how to restore confidence, given its current situation.

10 Year Government Bond Yields



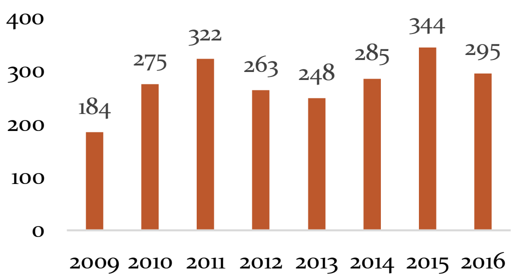
Spotlight 1: U.S. Government

Long-dating yields have been stubborn and refuse to move higher, even though the Fed shows its enthusiasm to wind down its bloated balance-sheet later in the Year. The catch comes in when the Fed decides to increase the funds rate, especially with depressed inflation. This means a flatter yield curve or worse, a flatter yield curve that might invert. Remember that circumstances like this have usually preceeded every recession in the past 50 years.

The latest US government treasury movements took place recently, starting on Monday 10th July 2017. Debt prices of the American government were higher on Monday morning as investors keenly awaited the release of economic data and were eyeing auctions. The benchmark 10-year Treasury notes was lower at 2.373%, as was the 30-year Treasury bond at 2.927%.

The interesting slice starts on Wednesday, 12th July 2017. Federal Chair Yellen, during her testimony on Capitol Hill, said that she expects a plodding shrinking of their $4.5 trillion bond portfolio. She mentioned “Because the neutral rate is currently quite low by historical standards, the federal funds rate would not have to rise all that much further to get to a neutral policy stance". Just to be clear, the neutral level is the point where the Fed's benchmark rate is neither accelerating nor restraining the economy. The current target for the funds rate

Global Clean Energy Investment ($bn)

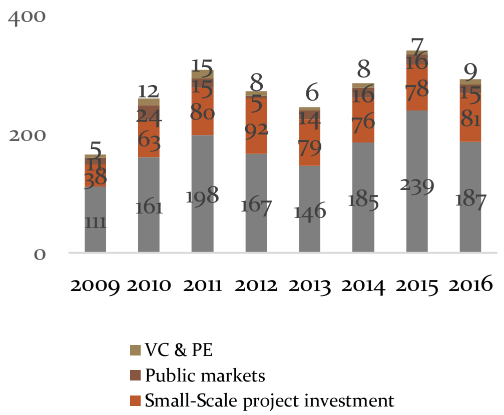


is 1% to 1.25%, while inflation is around 1.4%. On Wednesday, the Treasury Department auctioned $20 billion in 10-year notes at a high yield of 2.325%. The split of the take was between Indirect bidders (including major central banks) at 64.8% and Direct bidders (including domestic money managers) at 5.7%.

On Thursday, the Wall Street Journal reported that the ECB is likely to indicate, in September, that its asset purchase program will be gradually wound down next year. The report assisted a yield left in Europe & in the U.S. The 10-year Treasury note benchmark yield was again higher at 2.343% as was the 30-year Treasury bond at 2.913%. Yields were under pressure after Yellen mentioned that the U.S. economy was healthy enough for further rate hikes & the winding down of its portfolio.

In a market where the prices are auto-corrected based on demand and supply, only a few people can influence it? Keeping what has happened in mind, and how it is possible, we might see the Fed couple the rate hikes in the future with another strategy or abandon a few hikes altogether.

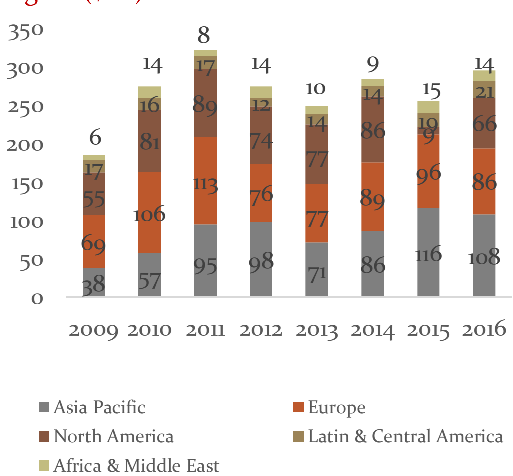
Global Clean Enery Investment by Asset Class ($bn)



Spotlight 2: Green Bonds

Green bonds were created to fund projects that have positive environmental and/or climate benefits. Proceeds from these bonds are earmarked for green projects but are backed by the issuer's entire balance sheet. An average global 2°C warming is one of the most important targets in climate policy negotiations. It is considered as the threshold between what is considered acceptable and what implies dangerous. Banks have started to gain a bigger understanding of the more important issues as fields like this and other 'big picture' areas are now starting to gain coverage. Companies can show their prevailing sentiment in the market and the world issues by its products. Although, while a lot of companies are able to walk-the-walk, very few can talk-the-talk. Participation of issuances of such bonds (green bonds) and other backed products can be considered a decent estimate.

Global Clean Energy Investment by Region ($bn)

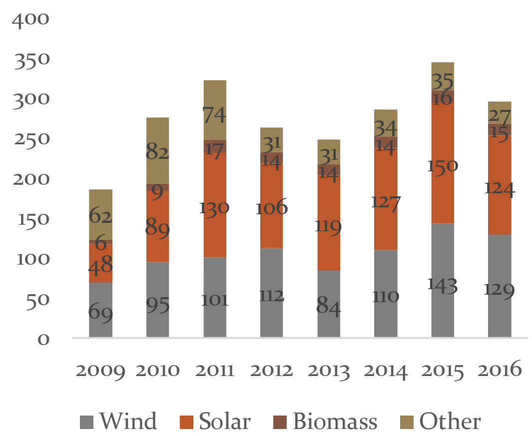


At COP15 in Copenhagen, in 2009, nations agreed that to "stabilize greenhouse gas concentration in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system," we must reduce global emissions so as to hold the increase in global average temperature below 2°C above pre-industrial levels and co-operate in achieving the peaking of global and national emissions as soon as possible. Even if this objective is achieved, significant risks and costs will be borne by citizens, businesses, investors and governments around the world.

Green bond issuance has doubled since last year to reach a record total of $84 billion, thanks in part to a giant green bond issued by China's Bank of Communications. The market has seen growth in issuance from all sectors and regions this year, with the largest increases coming from China, according to the Green Bond Database published by Environmental Finance.

The section answers a philosophical question rather than a financial one. Global Warming is the problem of the hour and is on the spot-light, hence, Green-Bond. Tommorow, it might be something else. The point is that big financial institutions can cater to any problem at any time. In a world with so many contracts and hard & fast rules, the flexibility of banks is surprisingly spot-on.

Global Clean Energy Invesment by Sector ($ bn)



Spotlight 3: Bond Market Test by Greece

With rising liquidity and volatility, we should see other governments take actions to get into a better financial & strategic position.

Greece is expected to commence its return to the bond market, in 2018. But having fixed its 3rd bailout program, Athens might decide to test the waters by issuing a new bond in a few days. Although testing the market in this fashion gives some good data about the liquidity and the trust of the market, going through with the issuance just for this reason, gives the market insight into the expectation of the government.

Greece has no urgent need to pull money from the bond markets. The European stability mechanism (ESM) will feed the debt-ridden country with low rate loans until the end of the bailout program in July 2018. This funding gives Athens a chance to test the market without major risks to its credibility in the capital markets after a tumultuous period of Grexit scare.

Last time Greece issued bonds was in 2014 with a yield of 4.95%. The goal of current Prime Minister Alexis Tsipras is a lesser yield. According to the European Commission's figures, the tide is turning for Greece. It ran a budget deficit of 15.1% in 2009, which had been turned into a surplus of 0.7% in 2016, and this is expected to progress in 2017 as more savings are found.

The most obvious issue which comes to mind here is the problem of 'Moral Hazard' and how it should be dealt with. We can view the aspects from both angles, first, failure of a government should not seep into the people as it can be supported by bigger ones and second, we can view the failure as a simple market correction where the natural course takes control and gives rise to a more efficient form of government.

Current State of Yields:

Country	10-Year Yield (%)	YTD Change	1M Change (bps)
USA	2.332	-8.9	16.8
China	3.585	35.7	5.4
Brazil	10.325	-107.5	-18.5
Germany	0.594	29.5	30.8
France	0.861	2.6	21.7
UK	1.039	-34.3	0.6
Russia	7.75	-65	5
Australia	2.715	0.8	34.5

As on 21st July 2017

Upcoming Events:

For people interested in following the world of debt markets & fixed-income. There are some events which you can follow & if allowed, participate in.

- Fixed Income Leader Summit. November 7th – 9th 2017 in Amsterdam.
- The FOMC holds eight regularly scheduled meetings during the year and other meetings as needed. The upcoming meets in 2017 are on July 25th-26th, September 19th-20th, October/November 31st – 1st & December 12th-13th.

Sources: Bloomberg, CNBC, WSJ, OECD, Clean Energy Pipeline, Climate Bonds & Environment Finance

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