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2019 Fixed-income Manager Survey

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Snapshot

- We polled the sub-advisors within our U.S. investment-grade fixed-income strategies about their outlooks for interest rates, monetary policy and bond-market conditions in 2019.
- These managers forecasted a slightly steeper U.S. Treasury yield curve for 2019, and suggested the U.S. business cycle has either almost or already peaked, but none placed a high probability on a recession this year.
- Based on their survey responses and our observations, we believe they're taking a cautious investment approach as we move further into the late stages of a long economic expansion.

What does the future hold? That's the overarching question we sought to clarify by polling 14 sub-advisors within our U.S. investment-grade fixed-income strategies about their outlooks for 2019. Of course, no one can predict the future with perfect precision. But we believe our sub-advisors possess unique insights on interest rates, monetary policy and bond-market conditions that make their projections worthy of special consideration.

Taken together, we were able to pinpoint a consensus outlook across our diverse roster of fixed-income managers—whose assets under management range from about $40 billion to the trillions, all with strategies driven by global analytical coverage.

We began collecting manager responses in December amid the sharp climb in volatility at the end of the fourth quarter. Several important factors in markets and the economy have evolved since then, so it's important to consider our findings in the appropriate context.

Looking Back

How did the managers' projections fare last year? Let's look at some examples:

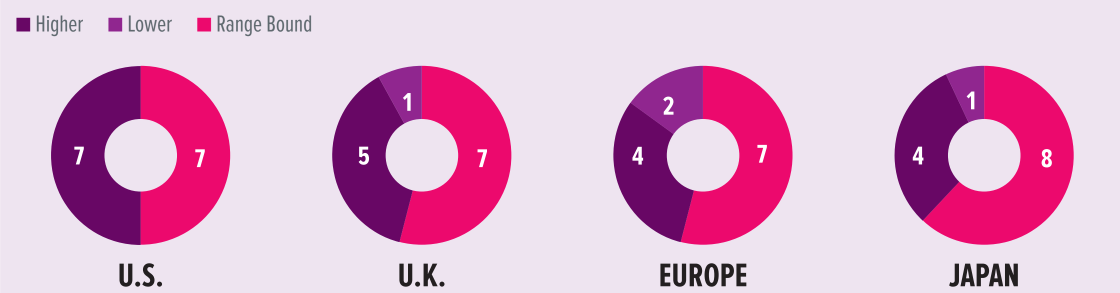
- Near-uniform expectations for higher rates in the U.S. and U.K. were correct. However, the 60% of managers that foresaw higher eurozone rates were incorrect. Greater-than-realized expectations for Europe stood out in multiple areas, representing one of the only persistent mismatches between projections and reality. Two-thirds of managers expected range-bound rates in Japan, which held true outside of late-year volatility.
- For U.S. Treasurys, year-end estimates were almost perfect; average forecasts were within 10 basis points (bps) of the actual year-end level for the 10-year U.S. Treasury yield (estimate of 2.76% versus year-end level of 2.69%). However, average projections for intra-year lows and highs were biased to the low side.

- In terms of inflation, average year-end projections for core measures of personal consumption expenditures (PCE) and the consumer price index (CPI) were each about 20 bps below their realized levels (forecasts of 1.71% and 2.03%, respectively, versus year-end levels of 1.9% and 2.2%).
- Low inflation expectations could partially explain why managers expected an average of three rate hikes by the Federal Reserve (Fed), rather than the four that came to pass.

Where will interest rates go in 2019?

A majority of surveyed managers said they expect interest rates to remain range-bound across major developed-world economies in 2019. Projections for higher rates were slightly less pervasive—except in the U.S., where they were given equal probability. Managers expressed thin expectations for lower rates in Europe, the U.K. and Japan.

Exhibit 1: Managers Don't Foresee Lower Rates in 2019

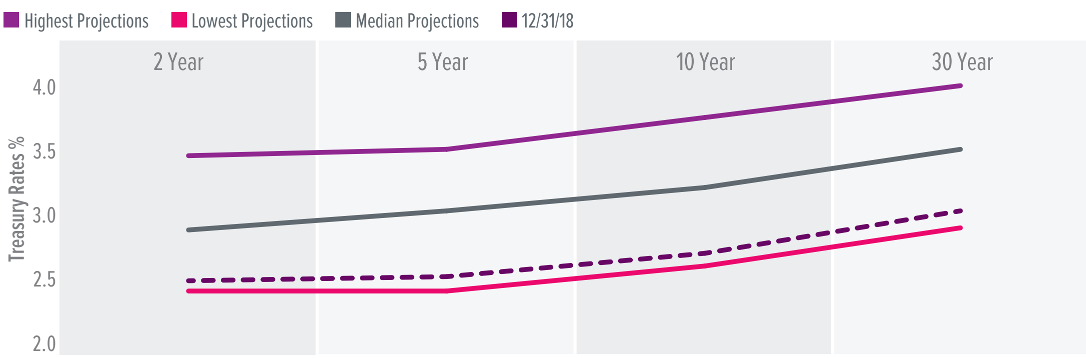


Source: SEI

How will U.S. Treasurys finish 2019?

The median manager forecasted a slightly steeper U.S. Treasury yield curve for 2019, with a smaller increase in short-term rates outpaced by larger increases for intermediate-to-long-term rates. The lowest year-end 2019 projections were about 10 bps below 2018's ending levels across the curve, while the highest projections were about 1% above year-end 2018.

Exhibit 2: Treasurys Expected to Climb by Year-End

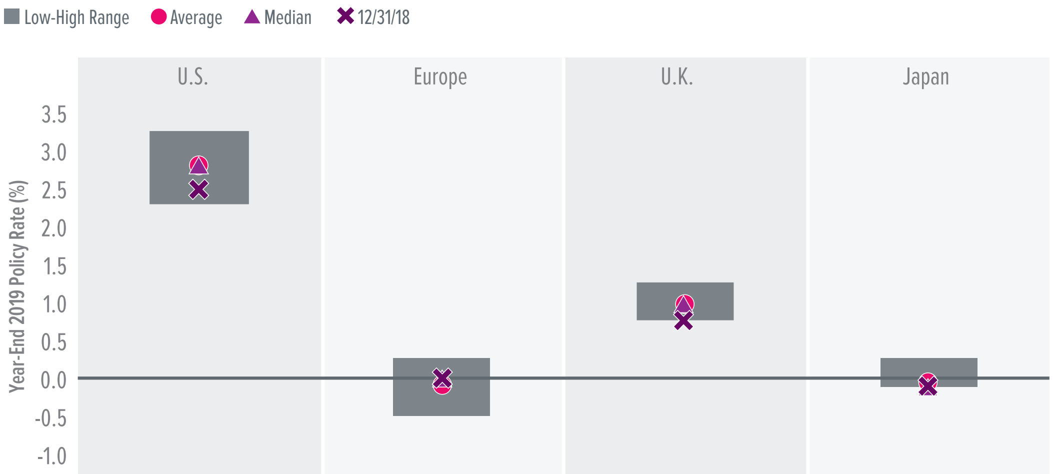


Source: SEI, U.S. Department of the Treasury

Where will government policy rates end 2019?

In the U.S., the median manager asserted expectations for two hikes to the fed-funds rate by year-end (from its current range of 2.25% to 2.50%). However, it's possible to imagine a softer outlook developing on this particular question; since we began compiling survey responses in December, statements and meeting minutes from the Federal Open Market Committee have painted a more dovish picture. Median projections for policy rates in Europe and Japan were for no changes over the course of 2019. Median projections in the U.K. suggested a quarter-point increase to the benchmark interest rate; however, it's important to note that the Bank of England's (BOE) policy path will be largely determined by the Brexit outcome. A disorderly divorce could compel the BOE to cut rates, while a favorable transition could create cause to increase rates.

Exhibit 3: Managers Expect Higher U.S. and U.K. Policy Rates by Year-End

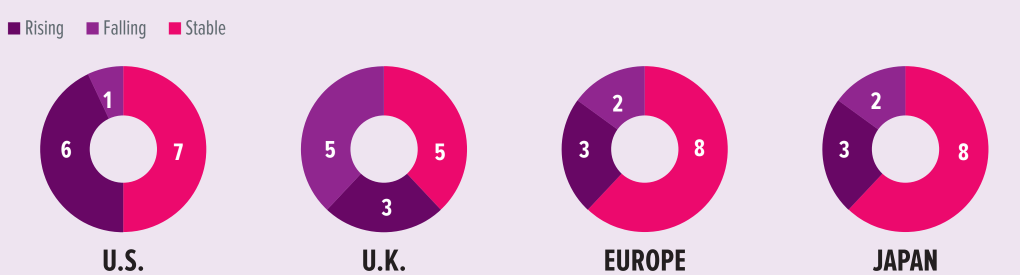


Source: SEI, Board of Governors of the Federal Reserve System, European Central Bank, Bank of England, Bank of Japan

Where will inflationary pressures go in 2019?

The outlook for inflation varied from region to region. Managers were divided when it came to the U.S. Half anticipated stable inflation, while slightly less than half foresaw mounting inflationary pressures. As for the U.K., where the inflation rate registered a two-year low in January due to cheaper energy prices, managers expressed equal expectations for stable and falling inflation; the country's future inflationary pressures are also partially contingent upon Brexit negotiations, as poor outcomes could compel the BOE to swiftly cut interest rates. Expectations for Europe and Japan were mostly for stable inflation.

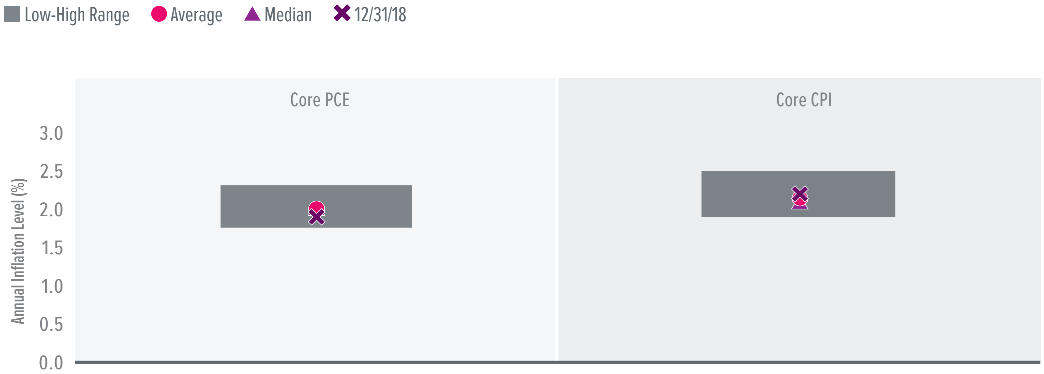
Exhibit 4: Price Pressures Projected to be Mostly Muted



Source: SEI

Survey respondents offered a relatively consistent range of expectations for year-end 2019 U.S. inflation levels across two primary measures: the core PCE index (the Fed's preferred measure of inflation) and core CPI.

Exhibit 5: Expectations Fairly Consistent Across Traditional and Market-Based Inflation Measures

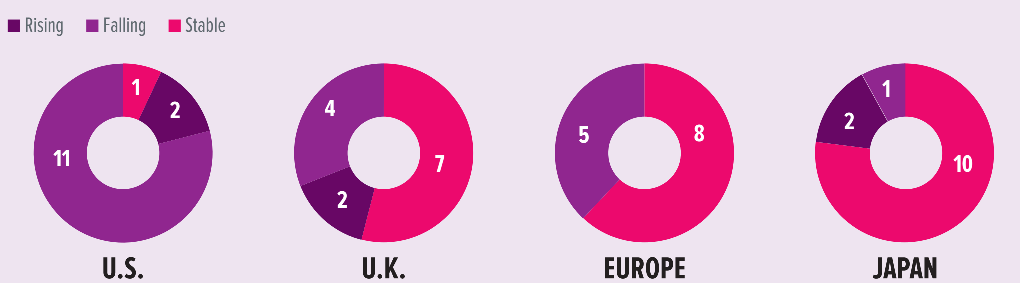


Sources: SEI, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Federal Reserve Bank of St. Louis

What is the outlook for global economic growth?

The most compelling findings of our survey were arguably those centered on expectations for economic activity (relative to that of the fourth quarter of 2018). A large majority of managers said they expect slowing U.S. economic growth in 2019 after accelerating last year, while most projected stable growth for Japan, Europe and the U.K. Notably, Europe was the only area for which zero respondents predicted economic acceleration.

Exhibit 6: The U.S. Economy Looks Set for Slower Growth as Other Regions Chart More Stable Paths



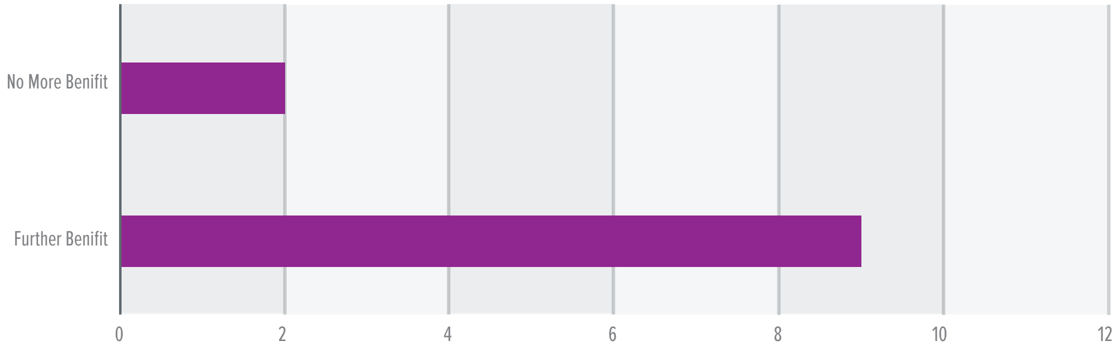
Expectations for economic growth relative to the pace recorded in the fourth quarter of 2018. Source: SEI

Have benefits of tax cuts run their course?

Surveyed managers largely said they expect the U.S. tax-reform bill (which went into effect in 2018) to provide a continued boost to the economy in 2019—albeit to a smaller degree, using language like "diminishing residual effects" and "overall growth impact likely lower." Multiple responses said the tax-cut tailwind would likely only last through the first half of this year.

On a related note, all survey participants said they do not anticipate additional fiscal stimulus measures in 2019.

Exhibit 7: U.S. Tax Cuts Expected to Further Benefit Earnings and Economic Growth



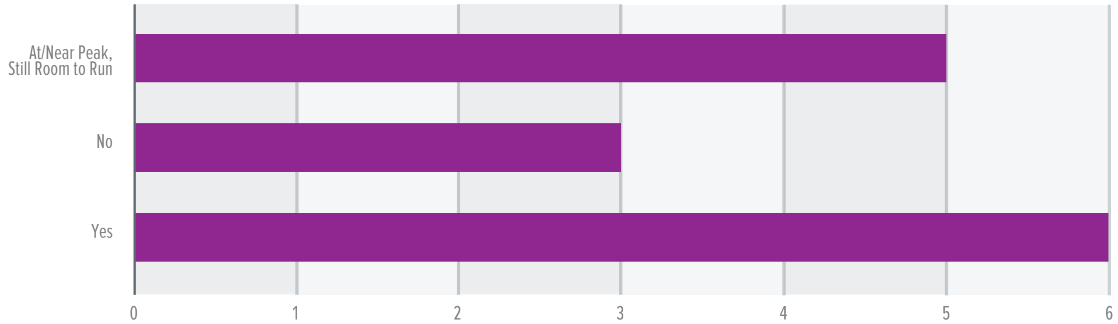
Source: SEI

Has the U.S. business cycle peaked?

A large majority of our surveyed managers believe the U.S. business cycle has either almost or already peaked. Notably, however, most also asserted that they don't necessarily associate business-cycle peaks with sharp declines in economic activity—explaining, for example, that peak earnings don't preclude profits growth from remaining strong for the foreseeable future. It's also worth noting that no managers placed a high probability on a recession this year.

Based on the managers' survey responses and our observations (in many conversations with managers over recent months), we believe they're taking a cautious approach to the range-bound conditions of the bond market as we move further into the late stages of a long economic expansion.

Exhibit 8: The View from the Top of the Business Cycle



Source: SEI

Important Information

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