



Schroder Fixed Income

Inflation, the Fed and the Bond market

October 21, 2015

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Agenda

I. Inflation

- Where is it?
- Are we looking at the right measures?

II. The Fed

- What are they looking at?
- Do I really care?

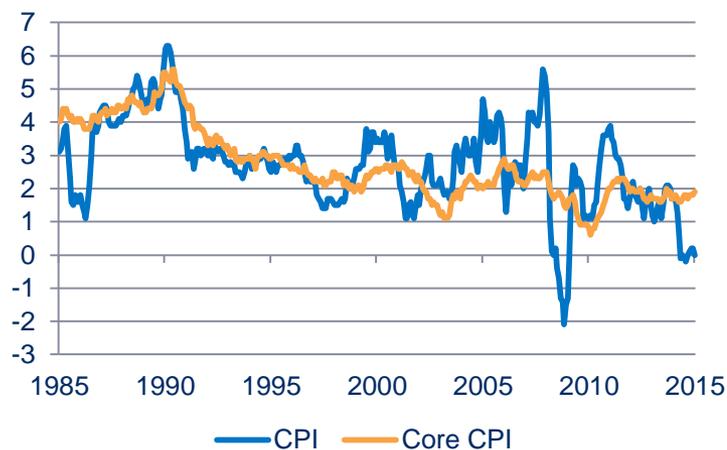
III. The Bond Market

- Why are bond yields so low?
- Are we in a bond bubble?
- How do I invest?

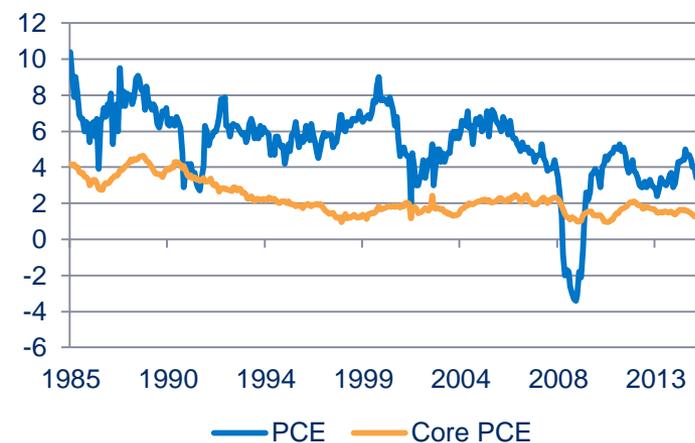
Inflation – Traditional measures

Very little signs of widespread price pressure

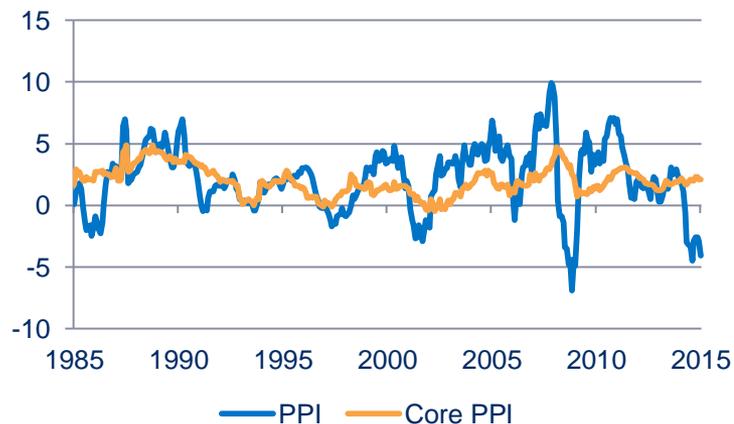
CPI vs. Core CPI



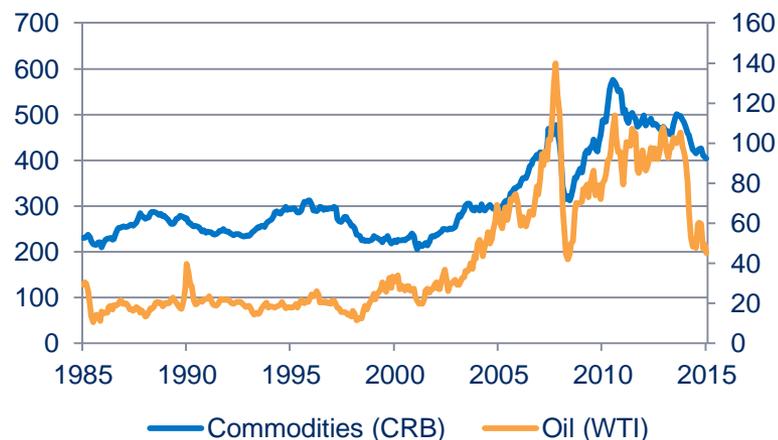
PCE vs. Core PCE



PPI vs. Core PPI



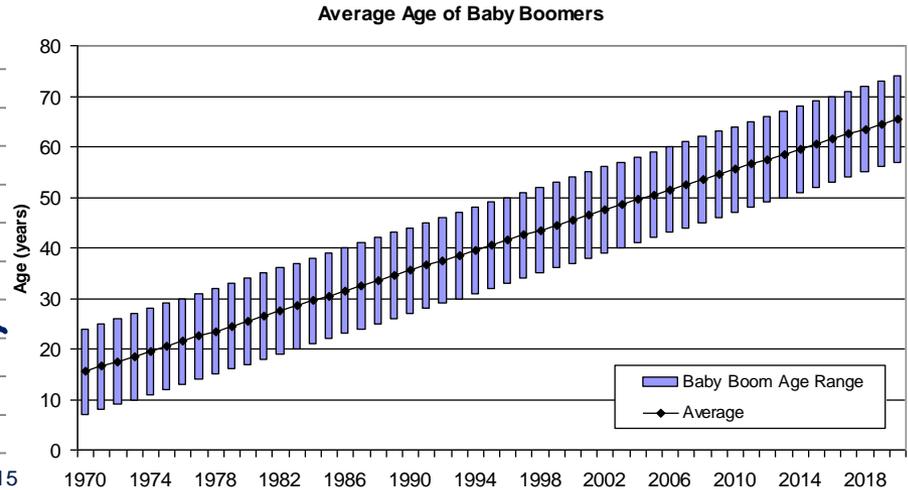
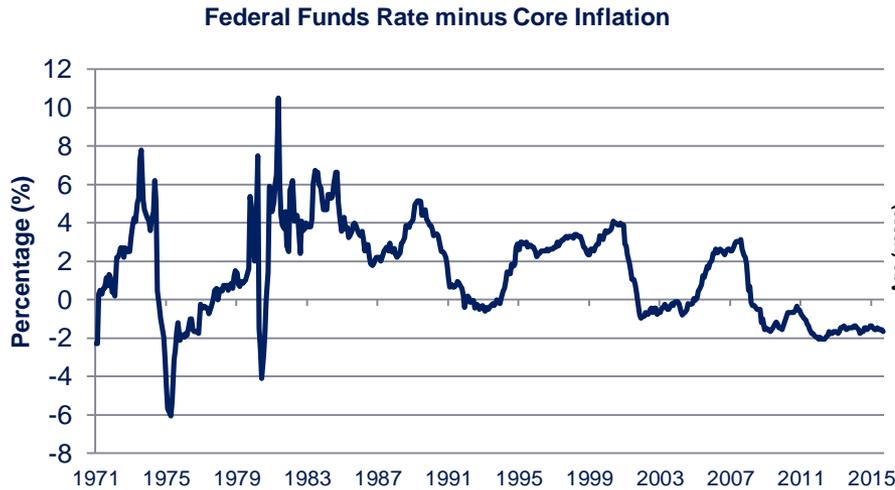
CRB vs Oil



Source: Bloomberg

Inflation – Unconventional measures

Have we been looking in the right place?



Impact of Negative REAL Interest Rates

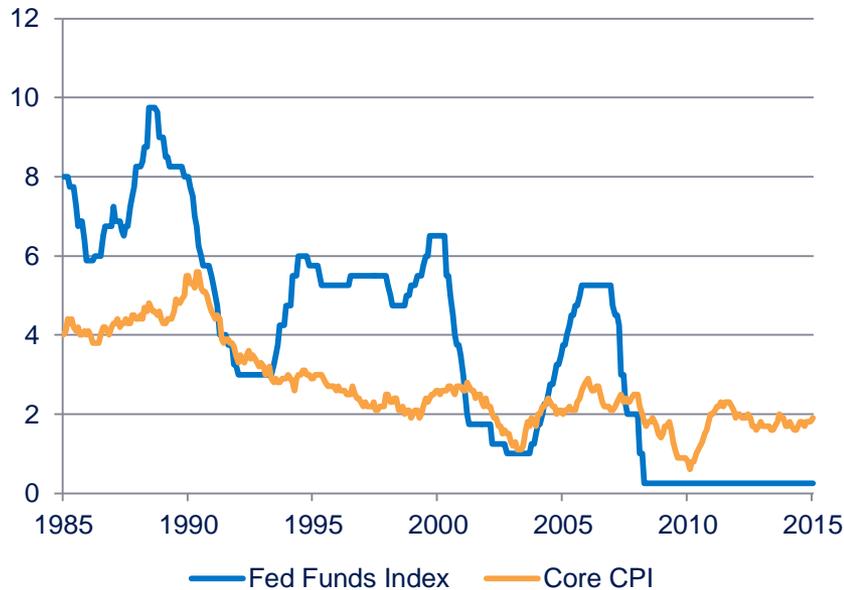
	Negative Real Rates	Boomer Age	Price Increases	When
I	Jun 1974 – Oct 1977	20 – 23	Consumer Goods/Services	Late 1970's
II	Nov 1991 – Jan 1994	37 – 40	Stocks/Financial Assets	Late 1990's
III	Oct 2001 – Dec 2004	47 – 50	Housing	Mid 2000's
IV	Mar 2008 – Now	55 – 58	Healthcare/Bonds	Early 2010's

Source: Schroders

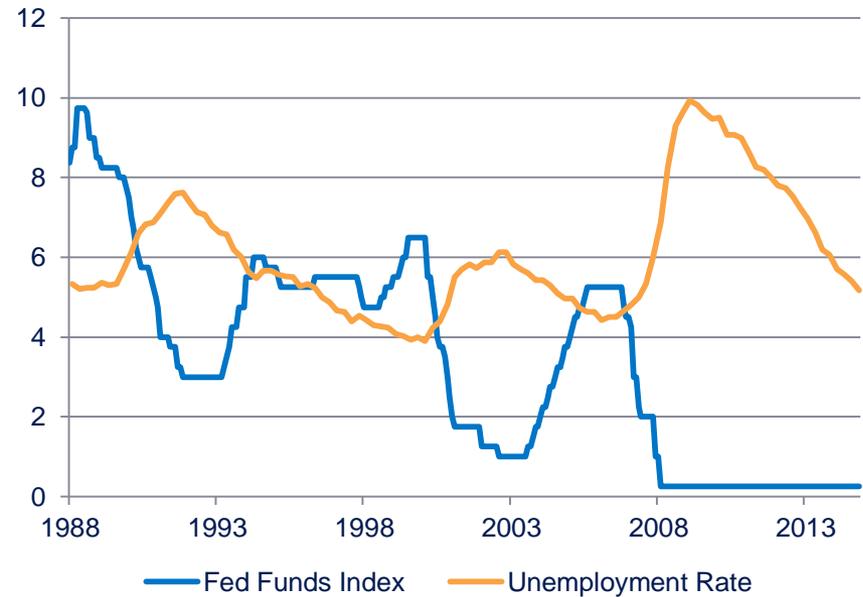
Federal Reserve

Traditional inputs

Fed Funds Rate vs. Core CPI



Fed Funds Rate vs. Unemployment

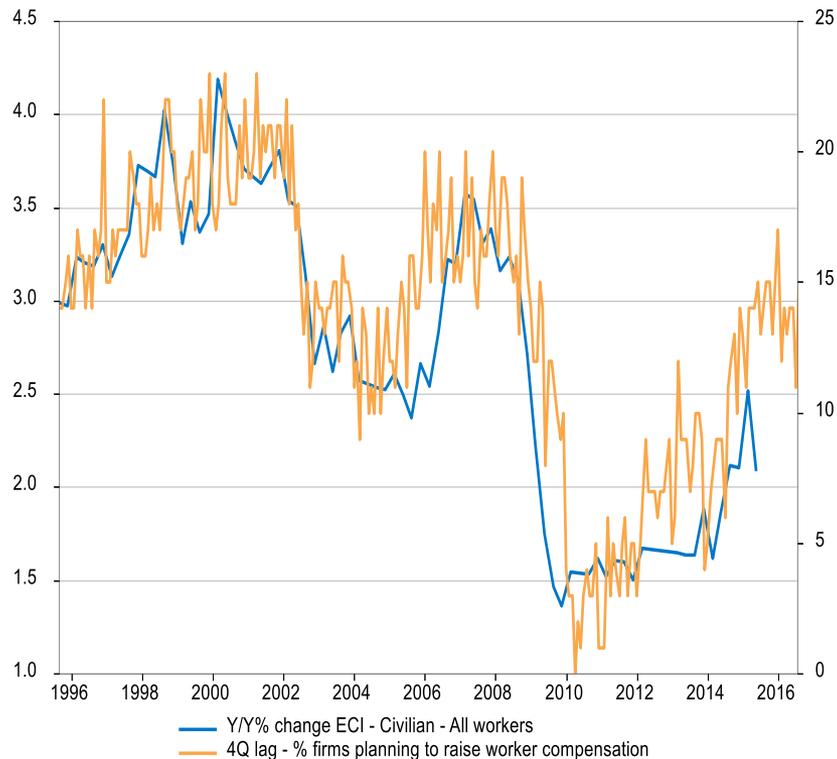


Source: Bloomberg

Federal Reserve

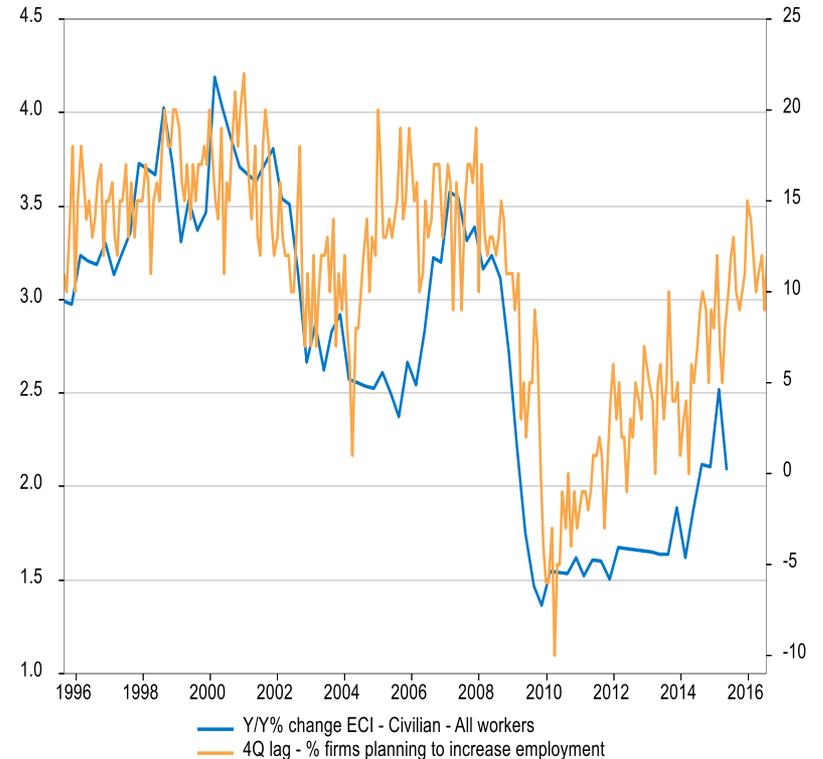
Precursors to wage acceleration

NFIB plans to raise wages



Source: Thomson Reuters Datastream, Schrodgers, Updated 28/08/2015

NFIB plans to increase hiring



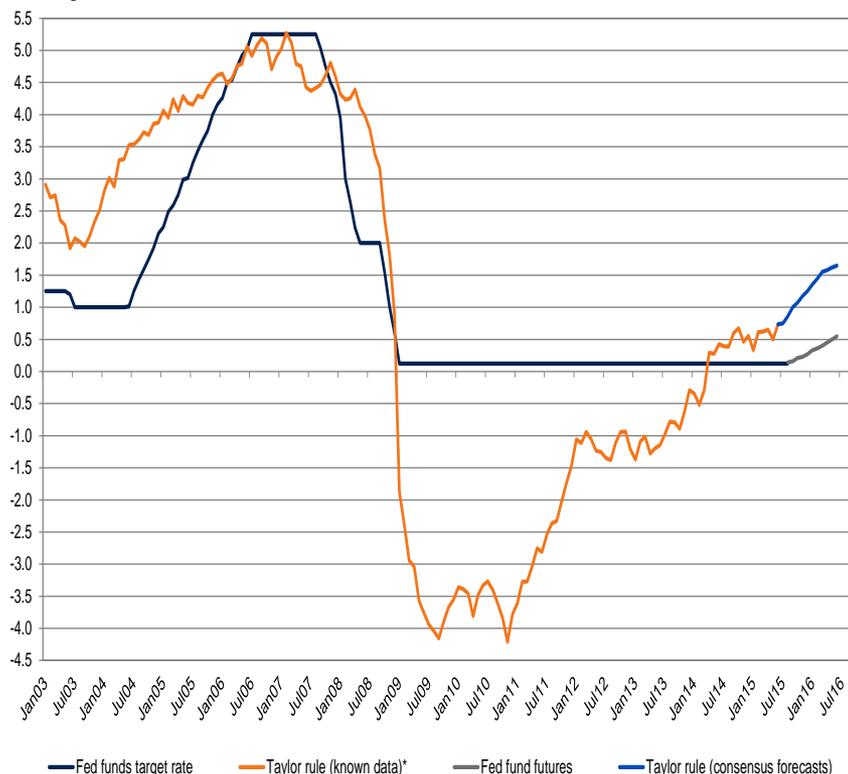
Source: Thomson Reuters Datastream, Schrodgers, Updated 28/08/2015

Source: NFIB, Thomson Reuters Datastream, Schrodgers

Federal Reserve

A combination of optimism, fear and confusion

Taylor Rule



What's holding up the Fed?

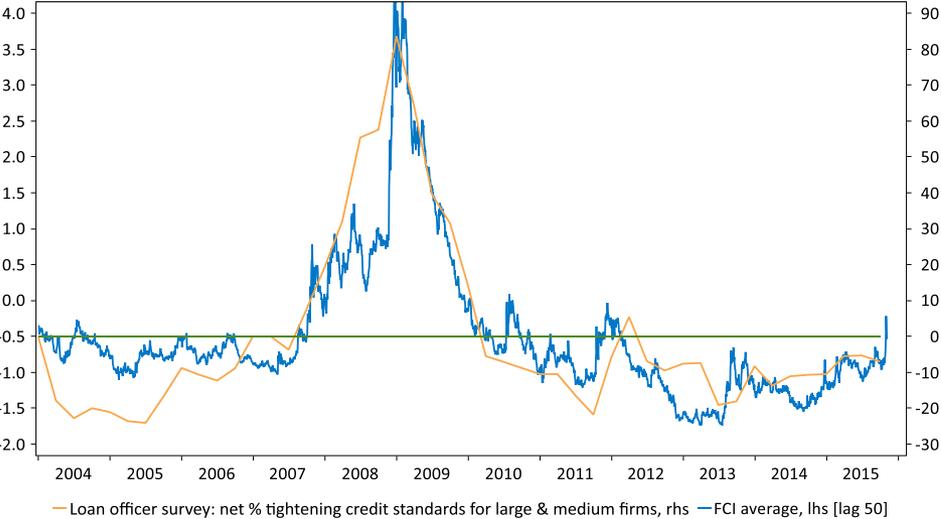
- US growth has been less than normal
 - Soft CapEx
- Financial conditions have tightened
 - USD strength
 - Credit conditions
- Inflation is not widespread
 - Wages
 - Technology
- Global growth has disappointed

Source: Schroders. Data as of September 2015.

Federal Reserve

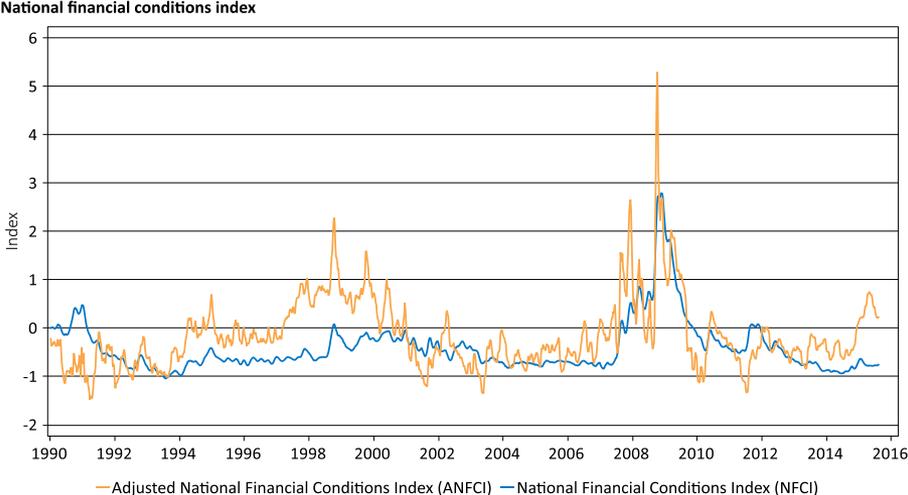
Tighter financial conditions weighing on their decision

Schrodgers' Financial Conditions Reading



Source: Macrobond, Schrodgers, 28/08/2015

Chicago Fed Financial Conditions

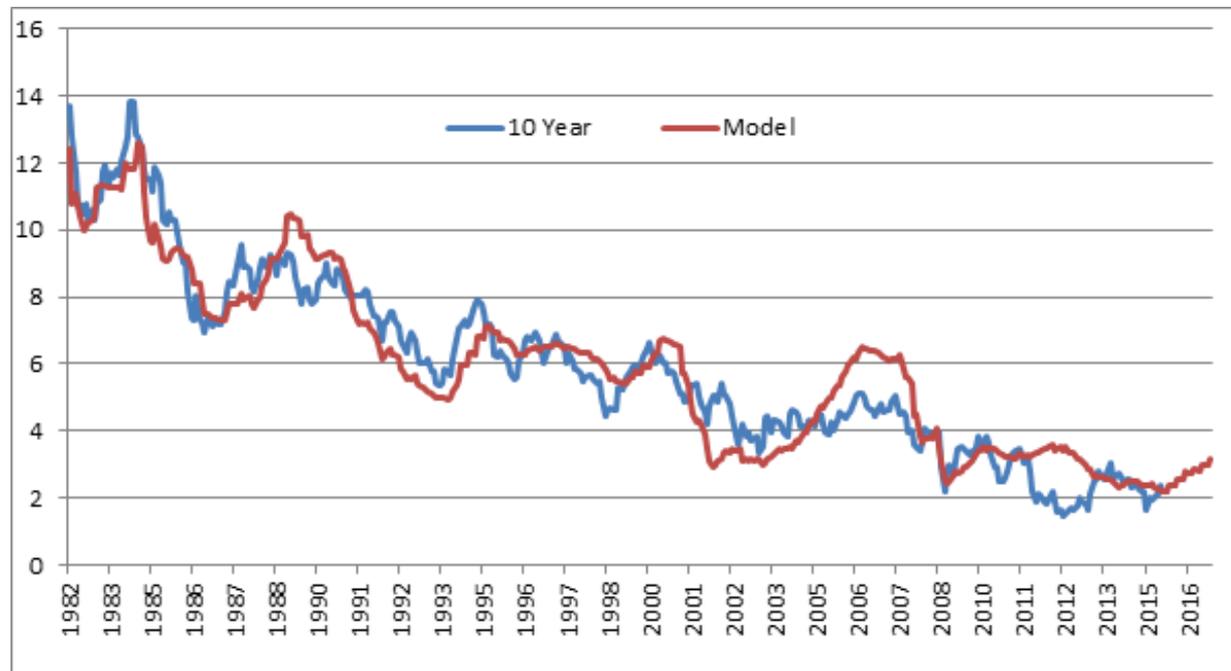


Source: Macrobond, Schrodgers, 01/09/2015

Source: Schrodgers, Federal Reserve. Data as of September 2015.

US Bond Market - Treasury yield fair value

Why are long term yields so low?



Current model output: 2.19%, rising over time (as shown above) using the following assumptions:

- CPI YOY continues to run at 0.2%
- FF rises a quarter of a percentage point per quarter starting in September
- Deficit -2.4% run rate
- GDP qoq runs at 3%
- Fed balance sheet remains unchanged
- Dec 2015: 2.54 (model) vs 2.26 (forward curve)
- June 2016: 3.12 (model) vs 2.38 (forward curve)

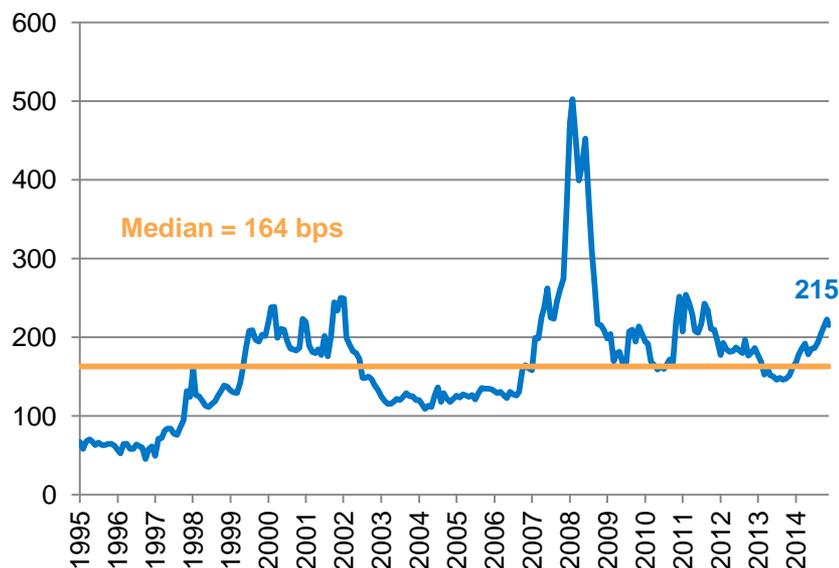
Source: Schroders, Data through September 2015. The views expressed reflect those of the Schroders Fixed Income team and these may change over time.

US Bond Market – Corporate risk premium

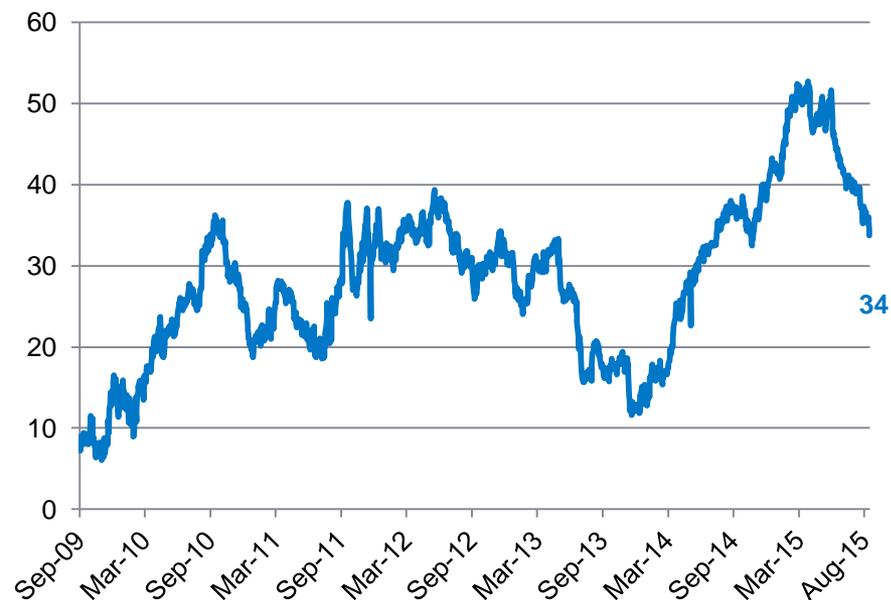
Long-maturity Investment grade corporates becoming attractive

US IG long corporate index

Option Adjusted Spread (bps)



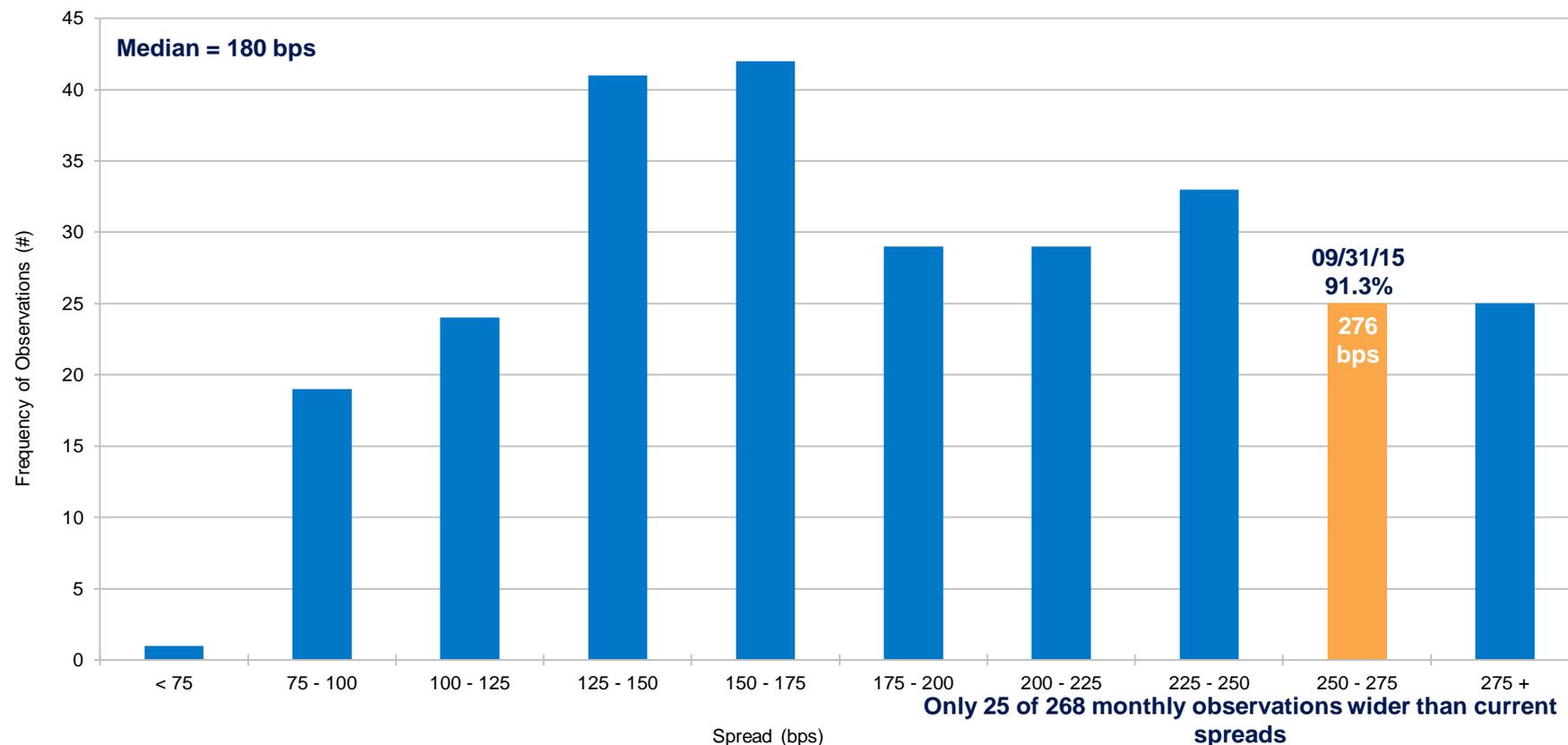
10s30s spread curve (bps)



Source: Barclays, JP Morgan; as of September, 2015

US Bond Market - Observation of Long US BBB spreads

Since 1993, spread levels elevated despite solid US fundamentals

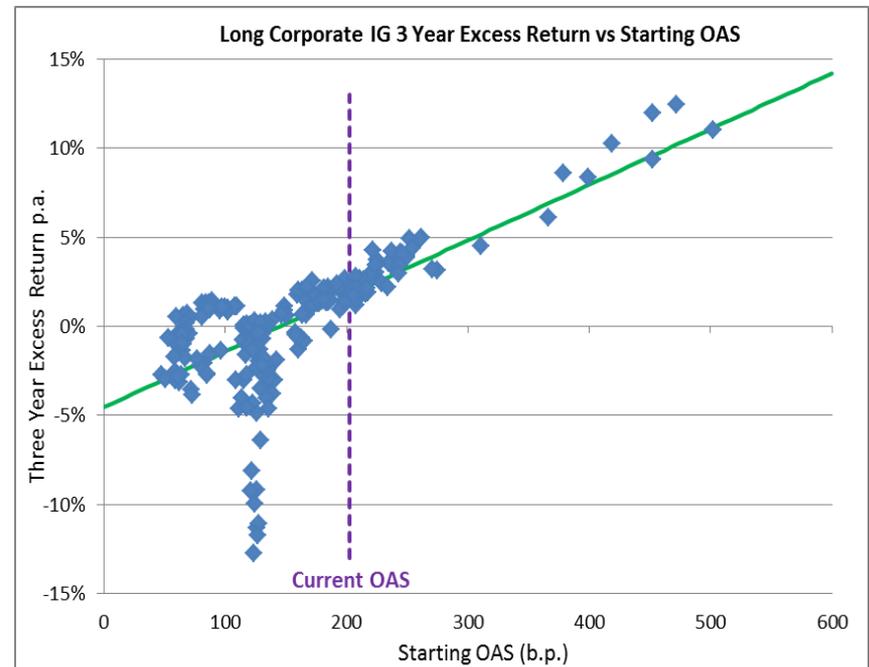
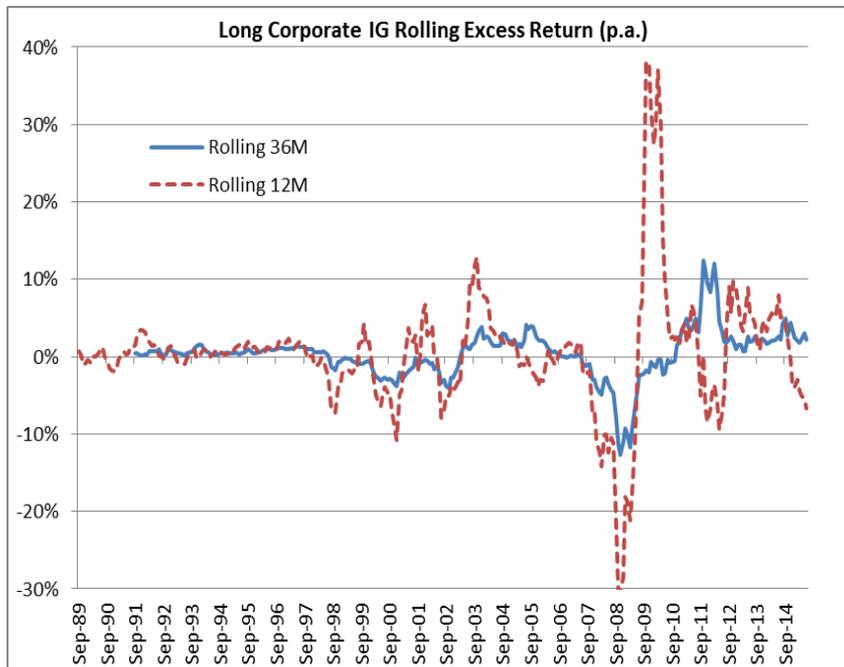


Source: Barclays; as of August 31, 2015. Sectors mentioned is for illustrative purposes only and is not a recommendation to buy or sell. The views and opinions contained in this presentation may change and there is no guarantee that any forecasts or opinions will be realized. Past performance is not a guarantee of future results. The value of an investment may go down as well as up and is not guaranteed. Please refer to the important information slide for more details.

US Bond Market - Purchase price matters

Excess returns (to treasuries) dependent on beginning risk premium

- Over medium term time periods changing OAS levels have historically driven excess returns
- As a result, starting valuations / spreads can have a large impact on realized results
- We believe this supports an active, value focused approach to credit allocation



Value focused active credit allocation has the potential to deliver index outperformance

Source: Barclays POINT, Schroders Based on Rolling 3-year periods beginning May 31, 1993 through June 2015. Index used is the Barclays Long Corporate A-rated or better Index. Actual results would vary. Past performance is no guarantee of future results. Other periods would have achieved different results. The views reflect those of the Schroder US Fixed Income investment team and are subject to change over time. Please refer to the important information section for more details.

Conclusions

I. Inflation

- US economic slack is gradually being used up
- Globalization and technology will prevent inflation from surging

II. The Fed

- The Fed will remove accommodation – very slowly
- Slow global growth and tepid wage pressures will keep them cautious, for now

III. The Bond Market

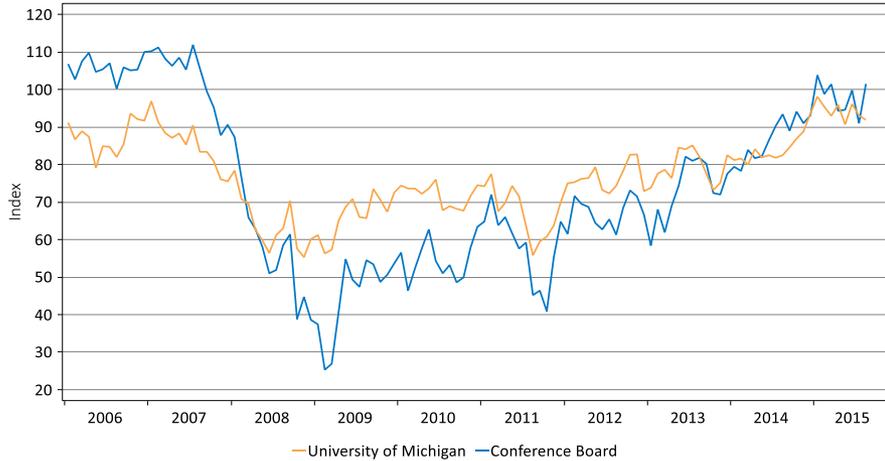
- Short term yields will move upward, slowly, along with Fed policy
- Long term yields may remain frustratingly low unless inflation picks up
- The best value is currently in mid-rated corporate bonds

Thank you!

Appendix

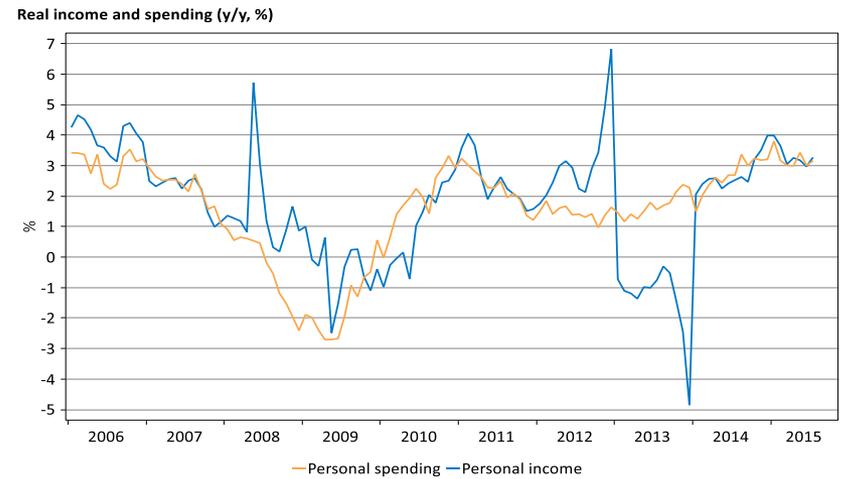
Appendix slide 1 – Consumer

Confidence survey evidence is mixed



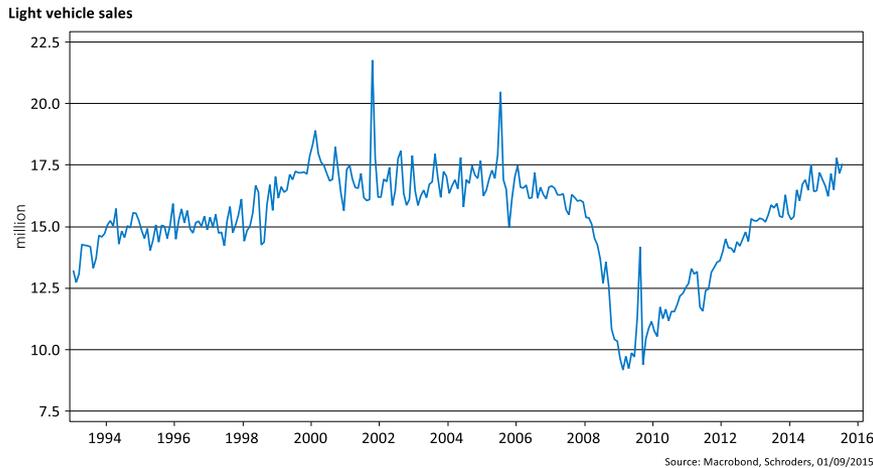
Source: Macrobond, Schroders, 01/09/2015

Spending on improving trend



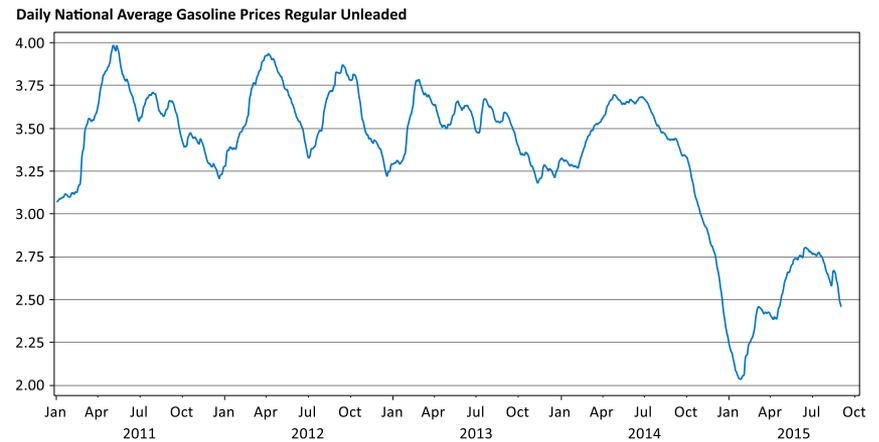
Source: Macrobond, Schroders, 01/09/2015

Vehicle sales remain good



Source: Macrobond, Schroders, 01/09/2015

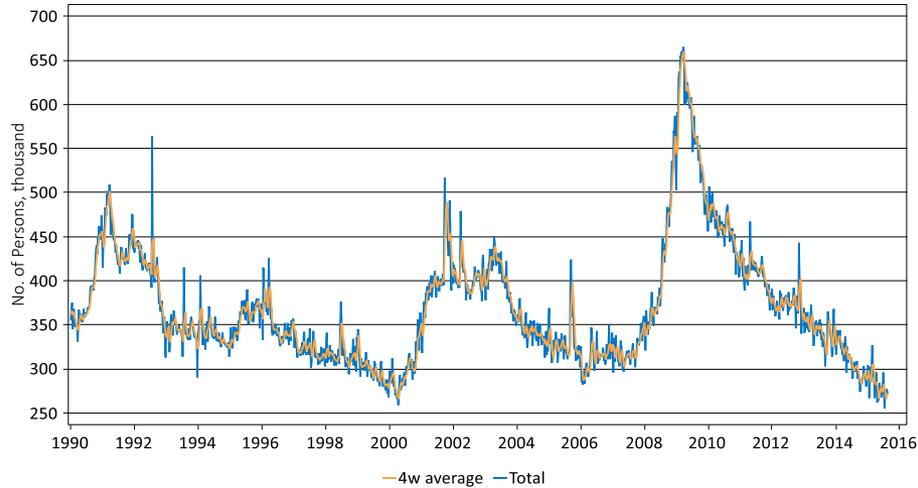
Falling gasoline should continue to boost consumers



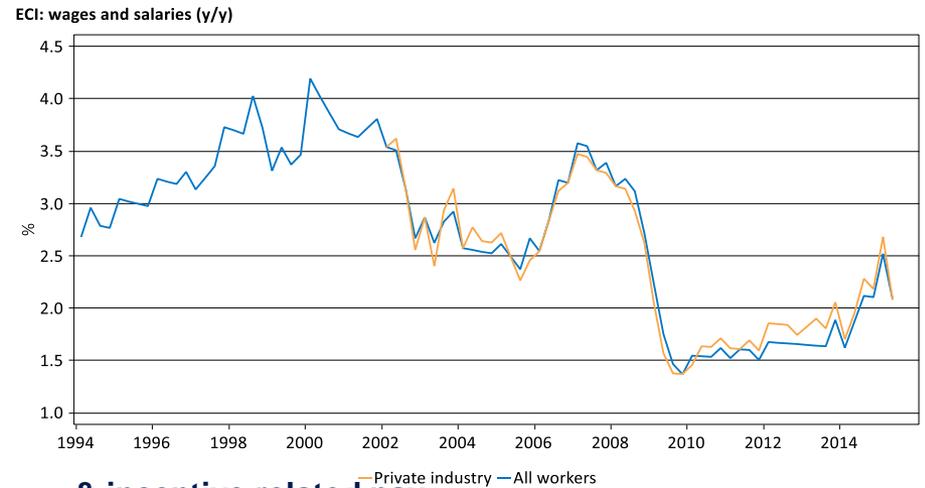
Source: Macrobond, Schroders, 01/09/2015

Appendix slide 2 – Labour market

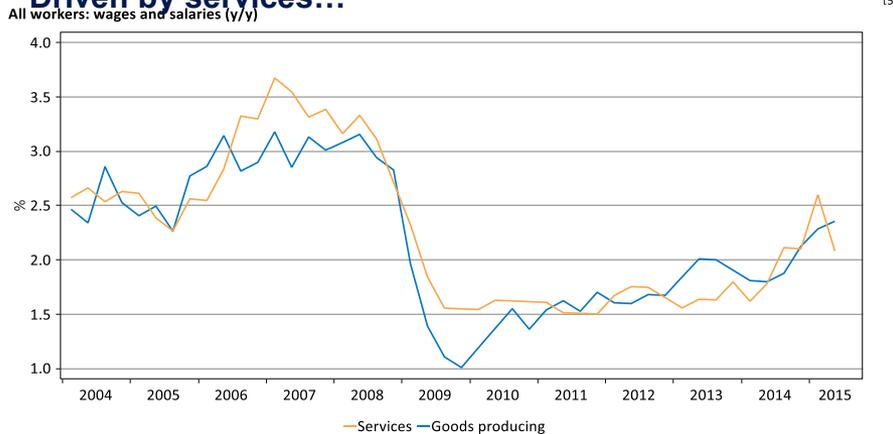
Jobless claims continue to hit multi-decade lows



But ECI soft...



Driven by services...



& incentive related pay

Source: Macrobond, Schroders, 01/09/2015

Up-And-Down In ECI Concentrated In Sales Incentives



Source: Macrobond, Schroders, 01/09/2015

Important information

All investments involve risks including the risk of possible loss of principal. The market value of the portfolio may decline as a result of a number of factors, including interest rate risk, credit risk, inflation/deflation risk, mortgage and asset-backed securities risk, government securities risk, foreign investment risk, currency risk, derivatives risk, leverage risk and liquidity risk. Frequent trading of the portfolio may result in relatively high transaction costs and may result in taxable capital gains.

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Slide 11: Index Definitions

The Barclays Long Corporate Index is a broad bond market index covering the US investment-grade fixed corporate bond market. The index consists of publicly issued corporate and specified foreign debentures and secured notes. Specifically rated indices used herein reflect components of the Long Corporate Index which have been segregated based on ratings assigned by the NRSROs.

Excess Return is the difference between the per annum compound return of the relevant corporate index over the entire period. Any index referenced herein is a fully invested index that includes income and does not include any transaction costs, management fees or other costs. Within the investment-grade universe, portfolios managed by the Schroder Value investment team differ substantially from the indices presented, including with respect to the number and type of issuers and issues held, sector allocation and material characteristics. It is not possible to invest directly in an index.

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