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Webcast Summary

4Q18 Market & Strategy Update

The uneven global recovery continued, with disparate growth rates upending market expectations once again as US growth accelerated beyond consensus estimates while global growth lagged. Our thought now is that the optimism for US growth is a bit overdone and pessimism around lethargic global growth rates has swung too far to the downside. As such, we expect a slight pullback in US growth and an uptick for the global economic expansion. We view central bank policy as a linchpin keeping the recovery on track and we expect central bankers to continue to move cautiously and adjust policy as needed, based on market realities and not on static models. Our hope is for clear communication and minimal uncertainty as unexpected monetary policy moves will undoubtedly lead to even greater volatility. The biggest threat to the ongoing recovery is the persistent air of protectionism as illustrated by the tough trade talk and escalating tariffs; they have the potential to create a further drag to growth. Given these challenges, we continue to believe that emerging markets (EM)—although very volatile—should outperform.

Market Review

- US interest rates remained attractive by all historical standards and relative to all other developed markets.
- The US spread sectors have generally held up over the first half of 2018 while the rest of the world has been more challenged.
- Weakness outside of the US led to widespread negative returns, with EM underperforming significantly.
- Trade policy has been the most substantial threat to the global recovery, as we have not had an era of protectionism in the last 30 years.

US Economic Outlook

- We expect US growth to slow slightly next year with inflation remaining moderate.
- While we think wage pressure will continue to be benign, the housing market may be reaching a peak.

Global Economic Outlook

- Slowing money growth suggests low global inflation; we expect that global growth and inflation will moderate.
- Global monetary policy will continue to play a major role in the recovery, and must be carried out carefully. We expect more volatility like we saw this year should central banks misjudge the market or mishandle communication regarding policy moves.
- **Europe:** European growth, despite massive pessimism about the challenges of Brexit and Italy, has actually been sturdy and we expect that to continue. Going forward, we expect a European growth rate between 1.5% and 2.0%.
- **Japan:** Japan's current fiscal and monetary policy mix supports moderate growth.

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Investment Themes

- We think the "divergence trade," whereby the US is moving in an opposite direction from non-US issues, will abate.
- **High-yield:** The high-yield default rate is declining sharply. Our focus is on BB bonds with "rising star" status that have the potential to be upgraded to investment-grade within a short period of time; we are paying close attention to issue selection.
- **Investment-grade:** The growth of BBB bonds has been incredible with BBBs now comprising 45% of the credit index ($2.7 trillion). We favor metals and mining, sub-banking, energy and US credit issues.
- **EM:** EM inflation remains remarkably subdued; EM valuations look attractive both on a historical basis and relative to developed markets.

Q&A Highlights

- The new US-Mexico-Canada Agreement (USMCA) deal is a big positive for Mexico, and while we've reduced our position there marginally because of the improvement in prices, we remain optimistic about the total return potential in Mexico.
- Our view is that in a very low inflation environment where inflation is contained and moving up very slowly if at all, higher short-term rates are actually going to lead to flatter yield curves.
- Our baseline scenario is for a soft Brexit deal but we think there are a lot of related risks, and that the market's pessimism is misplaced regarding Italy falling off a cliff or Brexit causing some meaningful implosion in Europe.
- Global debt is very detrimental to the long-term growth outlook and eventually the fiscal easing we've seen lately may be replaced by some type of fiscal tightening that would bring the growth rate down.

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