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Webcast Summary

2Q19 Market & Strategy Update

With no apparent threat of rising inflation and with lackluster growth globally, the Fed and other central banks have been emboldened to make explicit that their "overarching goal" is to extend the expansion. This monetary policy support helped spread products regain their footing from a tough 4Q18 to make a great recovery in 1Q19 and we were well positioned to benefit from the rebound. We view the recent inversion of a portion of the yield curve (3-month/10-year rates) as a yellow warning sign rather than a flashing red signal of imminent recession. And while the global growth rate has moderated and is still very modest, we expect it to be slightly better than 3.5% for the year. Headwinds to global growth rates include the ongoing US/China trade dispute and unfavorable demographics. Emerging markets rebounded nicely after a challenging end to 2018, and though volatile, we expect this sector to outperform in the year ahead.

Market Review

- Global growth has downshifted and faces continued headwinds from high debt loads, trade risks and declining demographics.
- The Federal Reserve (Fed) made a dovish pivot, stating that it expects to make zero rate hikes this year.
- Central banks overall are working to extend the expansion, citing no imminent threat of rising inflation.
- The yield curve flashed a warning sign as the 3m/10yr portion of the curve inverted, but the 5yr/30yr portion has been steepening.
- Bond markets around the world rallied significantly, with both Germany and Japan now in negative interest rate territory, making US rates attractive by comparison.

US Economic Outlook

- With low unemployment, high consumer confidence and households deleveraging since the financial crisis, we think financial conditions are supportive of economic growth.
- Strong manufacturing was a big part of the above-trend growth over the last couple of years, and even though it has downshifted back to 2015-2016 levels, we think it remains steady.
- Overall, we're aligned with most forecasters in our view that things in the US are likely to go well this year.

Global Economic Outlook

- Although global growth has downshifted, we expect it to remain sturdy over the course of the year and come in at an annual rate of 3.5% or perhaps slightly higher.
- We expect global central banks to remain very focused on accommodation and on maintaining the expansion.
- We're still very attentive to the possibility of trade risks but think there's room for optimism, at least in the short-term.

- As central banks around the world have stepped up to provide greater accommodation, we expect to see an asymmetry of policy—central bankers could ease policy more given any further deceleration in growth or inflation rates, but there would have to be significant reversals in both before we would expect to see any tightening.
- **Europe:** Given flat debt trends and positive central bank support, we expect growth in Europe to be near trend for the year, at approximately 1.0% to 1.25%.
- **Japan:** We expect moderate growth in Japan, considering its very low unemployment rate, extraordinarily accommodative policy support and inflation rates barely above zero.
- **China:** After a growth slowdown last year, China has been acting aggressively to restore growth by cutting rates, reducing reserve requirements and lowering taxes. As a result, we're optimistic that Chinese growth will improve.

Investment Themes

- After witnessing protracted trade tensions between the US and China, we think there's a real possibility that we could arrive at a deal that would be positive overall for markets.
- **High-yield:** We think there's a relative value opportunity here as bank loan valuations currently look attractive relative to high-yield, which is a rare occurrence historically.
- **Investment-grade:** The 2018 BBB "glut" has turned into a 2019 "debt diet," but we're firm believers that not all BBBs are created equal. We are very selective within sectors and industries, favoring banking, energy and basic industries where we are likely to see further upgrades from the ratings agencies.
- **Emerging Markets (EM):** After a very challenging 2018 (higher US rates, stronger US dollar, downshifting global growth), we think EM presents an exceptional opportunity, though volatile, based on current valuations.
- **MBS:** We view housing fundamentals as favorable but don't see rapid price increases on the horizon. With the underwriting standards remaining strict since the financial crisis, we continue to think that MBS will continue to be fairly strong.

Q&A Highlights

- The VIX volatility index is down, but we still view Brexit as a risk although we don't expect a "no deal" outcome.
- We think EM will benefit now that the expectation of central bank tightening over the short-term is all but off the table.
- We view the recent inversion of the 3m/10yr rates as a sign of caution but not as a definitive predictor of a recession. We will consider it more seriously as a warning of building risks if the inversion persists for several weeks or longer.
- Although global trade and global growth are good for the US, they're actually better for other countries because of the proportion of their economies that are exposed to global trading. Conversely, when global growth downshifts, the dollar tends to remain firm.