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Webcast Summary

4Q19 Market & Strategy Update

With interest rates around the globe at or near all-time lows, and an abundance of negative-yielding debt, fixed-income investors everywhere are facing yield starvation. Add to that the commitment from many central banks to keep rates low until inflation moves up substantially and it could be quite some time before we see short rates rise. This will only serve to increase the already high demand for US investment-grade issues from global investors. We continue to believe that spread sectors will outperform Treasuries and sovereign bonds, which are underpinned by the low policy rates. These low interest rates in the developed market can be very beneficial to emerging market bonds, which despite their volatility, we still believe have the best potential upside in the entire fixed-income market.

Market Review

- Global growth has continued to be very low by historical standards, but we believe it will be resilient.
- Core inflation in the developed world has remained very low—lower than even our dovish estimations—despite the steadily improving unemployment rates.
- Central banks recently have begun to focus their policy decisions on inflation outcomes rather than the traditional factors of GDP or unemployment forecasts.
- The Federal Reserve (Fed) underscored its commitment to wait for realized inflation before tightening policy. Comments from Fed Chair Jerome Powell indicated that the Fed is willing to give the labor market more room to run (and perhaps even risk overheating) if that's what it takes to see higher inflation.
- European Central Bank (ECB) President Mario Draghi recently declared that the ECB would be willing to be more accommodative going forward, citing downside risks to eurozone growth—including Italy's budget situation and Brexit—as well as low inflation.
- Manufacturing activity has continued to weaken globally, and appears to be exacerbated by the pervasive uncertainty surrounding the US/China trade relationship.

US Economic Outlook

- We continue to expect modest growth in the US, of about 2% for the year, underpinned by positive consumer data in the form of a high savings rate and low debt-service ratio.
- The US economy appears to be in good shape moving forward, with unemployment rates at multi-decade lows and the stock market around all-time highs.
- We think the Fed should not consider raising rates until inflation gets above its target and stays there for a sustained period of time.

Global Economic Outlook

- We expect a continuation of the low-growth and low-inflation environment we've seen globally, which will necessitate not only a tremendous amount of monetary accommodation but an ongoing commitment to that accommodation.
- We think global growth will be resilient, if modest. Challenges to this view include the desynchronization of global growth (with the US leading the rest of the world) and fears of widespread manufacturing weakness.
- Headwinds to global growth persist with the ongoing trade tensions and global debt loads at all-time highs, but much of that burden is now on government balance sheets and can be financed at low rates.
- **Europe:** Eurozone growth remains the principal source of global growth worries, but the European Central Bank leadership has made a new commitment to accommodative policy and has simultaneously downgraded its inflation outlook, which is positive for future easing.
- **Japan:** We're guardedly optimistic on Japan's outlook, given its steadily decreasing unemployment rate and core inflation rate barely above zero. The Bank of Japan recently indicated that it is also prepared to further ease policy until inflation actually hits its 2% target for a sustained period.
- **China:** We expect stimulus measures to remain in place until signs of economic stabilization appear. We're still optimistic that a trade deal with the US can be made, but even if it doesn't happen soon we don't think that China's growth will suffer significantly as a result.

Investment Themes

- With nearly $17 trillion of negative-yielding debt worldwide, the US is virtually the only destination in the global search for yield.
- **High-yield:** While we do not currently have a meaningful overweight in high-yield, we think opportunities are available in specific issues and specific names.
- **Investment-grade:** BBBs have been the best performing sector of the investment-grade corporate bond market. Relative to other mature markets, US credit markets are very attractive to global investors. In all of the developed world, 93% of the investment-grade yield is found in the US. And while BBB issues have very high leverage levels, we are encouraged by the concerted efforts of management teams to delever.
- **China:** China continues to see healthy domestic demand and we think any improvement in trade talks or an actual deal with the US would be very positive.
- **EM:** Even with the challenges facing EM, which include downgraded global growth, low global inflation and the persistent trade tensions, we think the resulting valuations are compelling.
- **MBS:** We think the fundamentals are still very sound in mortgage credit, both in commercial real estate and in the homeowner space.

Q&A Highlights

- Repo market dislocations have been a meaningful challenge and we're following the issue closely. However, we don't view it as a systemic problem. We suspect that the US government might put a facility in as early as next month that would supply liquidity on an ongoing basis.
- While Alan Greenspan recently predicted it's only a matter of time before negative rates reach the US, we're not so sure. We think the Fed would do everything in its power to prevent it.
- We do not foresee the Trump impeachment inquiry significantly disrupting investment markets. We expect it to garner a lot of attention, but turn out to be much less of a challenge than, say, the first six months of the Bill Clinton impeachment process was.