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Webcast Summary

4Q20 Market & Strategy Update

This year is shaping up to be one of the most extraordinary we've ever seen—with COVID-19 upending markets and economies, not to mention the severe cost to human life. Market volatility continues to spike, but aggressive fiscal and monetary stimulus that has been deployed globally is helping to ensure the eventual economic recovery. We have reasons to be optimistic given positive news about progress toward a vaccine and significant recent improvements regarding therapeutics to treat those with Covid. Economic reopenings continue—albeit unevenly given the path of the virus—but the threat of broad-based lockdowns has largely passed and a global recovery is beginning to gain traction. We believe spread products ultimately should be beneficiaries of the economic recovery.

COVID-19 Update

- An overall resurgence in cases (not deaths) implies more cautious consumer behavior ahead.
- The diminished mortality rate suggests renewed broad-based lockdowns are unlikely.
- The effectiveness of certain therapeutic treatments has increased dramatically over the last few months.
- There is continued optimism that a vaccine could be ready later this year—due to promising developments seen in clinical trials—and more widely available in 1H21.
- Although progress continues at a pace of "two steps forward, one step back," with respect to economic reopenings, we continue to see positive developments.

Market Review

- Coronavirus-related growth setbacks have meaningfully reduced global and US growth.
- The fall-off in global aggregate demand is by far the steepest in recent history, but a global economic recovery appears to have started.
- Global central banks have provided a tidal wave of monetary accommodation, significantly above what we saw through the entire global financial crisis.
- US fiscal stimulus in the form of the CARES Act extended unemployment benefits and helped to turn personal income growth positive.
- US goods sectors have seen a return in demand, but output is only gradually improving. Meanwhile, US service sectors are just beginning to revive with challenges remaining for restaurants, hotels, movie theaters, etc.
- The US housing sector has experienced a V-shaped recovery but credit spreads have lagged due to continued uncertainty and less direct intervention from the Federal Reserve (Fed).

- In the eurozone, low inflation rates persist.
- China's economic recovery is gaining traction, which is a crucial factor for overall global growth, but demand has not fully returned.
- Japan's new Prime Minister, Yoshihide Suga, has continued his predecessor's macroeconomic policy. We are optimistic that he will undertake meaningful structural reforms.

US Economic Outlook

- Economic activity has seen a very positive improvement over the last quarter, but many challenges remain; we are cautiously optimistic, expecting a difficult road ahead.
- Regarding the 2020 presidential election, early indicators are shifting toward a "blue sweep" that would show Biden/Harris winning and Democrats gaining majorities in both the House and Senate.
- If the Democrats do sweep then we expect much greater and more sustained fiscal stimulus to follow, along with the continuation of very accommodative policy from the Fed.
- Regardless of the latest polls, we expect the presidential races to tighten, so by no means is a Democratic win or sweep guaranteed.
- The Fed will be very slow to raise rates, as indicated by the recent unambiguous remarks from Fed Chair Jerome Powell.

Global Economic Outlook

- The world economy still faces a protracted period of output slack; resumption of pre-Covid growth levels could take as long as two years and may require continued policy help.
- While the market is showing renewed confidence in rising inflation rates, we're not so sure this is the case given the extraordinary amount of global slack, which we think could take years to be utilized.
- US and global inflation rates are expected to be very subdued.
- Global central banks should remain extraordinarily accommodative, and global fiscal policy should remain very supportive as well.
- Even after recovery begins, central banks are expected to keep rates ultra-low.
- **China:** The economic recovery is gaining traction, with factories opening faster than their global counter-parts, boosting the strength of exports.
- **Japan:** Although Japan has a new prime minister, not much is expected to change over the short term; however, PM Suga's policies should benefit over the long term.

Investment Themes

- Relative to other mature markets, US credit markets continue to be attractive to the global investor.
- Spread products ultimately should be beneficiaries of the economic recovery, and outperform sovereign bonds around the world.
- **High-yield:** Current valuations better reflect the latest market expectations. This asset class is now higher quality and more liquid, as demonstrated by the growth of BBs measured by par value. Spreads have moved lower and we expect to see an uptick in defaults through the end of the year.
- **Investment-grade:** We continue to view investment-grade bonds as a "cornerstone investment," and they have benefited from the Fed's direct purchase of investment-grade bonds (including fallen angels) for the first time ever.

- **EM:** Local currency EM debt prices are very depressed. A weak global growth outlook makes it challenging for these countries to bounce back. Despite the challenged environment there are some opportunities within EM.
- **China:** Local onshore bonds offer attractive valuations and room for foreign ownership to grow.

Q&A Highlights

- With trade tensions around the world increasing, deglobalization is a powerful theme. Even if Trump is replaced we'll see some lingering effects of his policies.
- Our view regarding the Fed has not been out of consensus. Even if the Fed reaches its 2% inflation and 4% unemployment targets, we still expect short-term rates to be anchored at zero. This assumes global growth remains a long slog, which is our outlook.
- Uncertainty around the 2020 presidential election is very high. The changes in voting methods (in-person vs. mail-in) are also adding to the confusion. Both political parties are at odds about how this should play out. If there is a decisive victory it won't be as much of an issue, but a tight race could delay the results for weeks or months, as we saw in 2000. Even this, however, would likely have minimal impact for long-term fixed-income investors.
- Protecting a portfolio that is overweight spread risk, we need to have a ballast in the portfolio that benefits when global growth slows, as our yield curve strategies have done in the past. If we see higher than expected growth, our diversification strategies may lose value, which we are comfortable with given the bigger picture. Managing currency risk within portfolios is another tool we can use to create additional diversification.