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Webcast Summary

3Q20 Market & Strategy Update

The investment backdrop has changed considerably since last quarter. Global fiscal and monetary policy intended to help mitigate the detrimental economic effects of the pandemic have taken nothing less than a "shock and awe" approach. Business reopenings in the US happened faster than expected, but some have recently reversed course after a spike in infection rates. While the far-reaching effects of COVID-19 and the accompanying lockdowns comprise the key driver of today's economic challenges, we are encouraged by the progress to understand and treat the virus. In fact, we believe the path of recovery will largely follow that of the medical battle against COVID-19. Even though we've had a very strong recovery in asset prices already this year, we expect spread products to be the best beneficiaries of a recovery, and they should still outperform sovereign bonds.

COVID-19 Update

- The advances around the world toward developing a COVID-19 vaccine have almost become a race, which we view as a very positive factor.
- In the US, the growing COVID case count has the potential to complicate the economic reopenings, as we've seen infection spikes in some states, forcing a reversal of course.
- The global death rates related to COVID-19 appear to be under control; as such, we believe renewed large-scale lockdowns are unlikely.
- While the virus has obviously been the principal cause of the extraordinarily sharp and steep global economic contraction, it has also been behind the tremendous policy response that aims to put a floor under the degree of difficulty that the globe is experiencing while and until a recovery can take hold.

Market Review

- This continues to be one of the most extraordinary periods we've ever seen in global history—economically, medically and from a policy response standpoint.
- Broad-based reopenings of global economies continue, but not without setbacks, as guidance continues to evolve based on infection rates.
- Global central banks have provided unprecedented, massive amounts of stimulus, significantly above what we saw through the entire global financial crisis (GFC).
- Financial conditions have improved sharply, with the Federal Reserve (Fed) purchasing Treasury and MBS securities, along with direct payments to households via the CARES Act.
- The Fed has mentioned keeping policy rates low until perhaps 2022 or 2023, and continues to promote an asymmetric policy of its willingness to let inflation rise above its 2% target if needed to help ensure the eventual recovery.

US Economic Outlook

- Economic uncertainty is spectacularly high.
- Inflation expectations for this year generally range from -0.1% to 2.5% (core PCE), but we cannot completely dismiss the idea that inflation could take off.

Global Economic Outlook

- An incipient global recovery appears to be gaining traction.
- The medical battle against COVID-19 will take time and prolonged efforts, but we are encouraged by recent developments.
- Central banks will remain extremely accommodative to stem the tide of deflation.
- Even after the recovery clearly begins, central banks will maintain easy policy and keep interest rates ultra-low.
- The timing and slope of the eventual recovery is still very uncertain.
- **China:** The economic recovery is picking up steam, and the country has sufficient headroom to implement both fiscal and monetary measures to maintain growth momentum.

Investment Themes

- Given the deep level of pessimism and valuations, we believe in being long spread product with an emphasis on being selective to those products that can withstand the pain of another downturn.
- **High-yield:** Valuations look selectively attractive; high-yield should benefit from Fed support. Fallen angels have boosted the overall return profile.
- **Investment-grade:** We view investment-grade bonds as a "cornerstone investment." Yields remain attractive relative to USTs; valuations remain depressed and the Fed has signaled unwavering support.
- **Non-Agency MBS:** The housing market has been a positive surprise as prices continue to appreciate and mortgage applications have skyrocketed; however, spreads remain elevated within the non-agency residential MBS (NARMBS) space due to the lack of Fed support and continued uncertainty around forbearance.
- **EM:** The overriding priority is containing downside rates. Aggressive monetary policy will anchor rates at low levels, while EM FX can act as a macro relief valve.

Q&A Highlights

- We believe that the Fed intends to keep interest rates pinned at a very, very low level and will keep financial conditions easy. We take the Fed at its word that it does not plan to implement yield curve control (YCC) measures over the short term.
- We think that over time the strength of the US dollar is likely tied to the path of global recovery. With an eventual recovery, we expect the dollar to be mildly weaker versus the other major currencies.