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Webcast Summary

1Q21 Market & Strategy Update

While we might have all hoped to find respite in the new year, 2021 is clearly off to a rough start. The events in Washington, DC on January 6 shook our democracy to the core as the world looked on, and COVID-19 has continued its rampage with a resurgence in many parts of the globe. Yet, we're optimistic that the political news will settle down and the Covid-induced economic damage will abate now that the "gamechanger" vaccines have arrived. We believe there is value in many "reopening" trades, especially in the latter part of this year as more people are vaccinated and businesses worldwide can resume operations. We see investment opportunities tied to the global recovery, especially in emerging markets (EM) debt and spread products.

COVID-19 Update

- COVID-19 cases have increased in many places this winter—with the US, UK and South Africa among the places of greatest concern—and the pandemic is far from over.
- We are encouraged by the arrival of Covid vaccines, but realize there are challenges ahead with vaccine administration.
- The virus is evolving and has spawned new, more infectious variants first detected in the UK and South Africa, but existing vaccines are proving effective against these variants.

Market Review

- Global governments have provided enormous amounts of fiscal stimulus to help aid the recovery.
- The Federal Reserve (Fed) provided more monetary stimulus in the first three months of the Covid crisis than it did in all of the great financial crisis (GFC).
- The fall-off in global aggregate demand is by far the steepest in recent history, but we did see a "V-shaped" recovery from the depths in March 2020.
- The net income gain from the CARES Act payments sent directly to households has helped to offset the decline of personal income.
- Consumer fundamentals in the US have improved since Covid first arrived, with an increased savings rate being used to reduce debt, and lower interest rates helping to decrease the consumer debt burden to its lowest level in 20 years.
- US housing has also experienced a V-shaped recovery but spreads have lagged due to continued uncertainty and less direct Fed intervention.
- US labor markets have been severely wounded, with permanent job losses, and minorities suffering at disproportionate levels.

- In Europe, low inflation—which fell to an all-time low of 0.2%—is making the European Central Bank's job ever more complicated.
- China was reasonably successful at containing the spread of Covid, which it experienced first, and is ahead of most of the world regarding its economic recovery.
- Japan is in the throes of its own Covid challenges currently, but is supported by both monetary and fiscal policy. Longer term, we expect structural reforms to be very positive.
- Global levels of negative yielding debt were remarkably high even before the pandemic, but are now approaching all-time highs.

US Economic Outlook

- With Democrats taking control of the government, even if by a slim margin, increased spending is likely. This includes additional fiscal stimulus expected in 1Q21.
- After Covid-related setbacks for residential real estate, we believe the outlook for housing in the US is very strong.
- While both the Fed and the market have expectations for a gradual rise in inflation, we're not so sure. We are keeping an open mind and will not rule it out, but it is not our base case.

Global Economic Outlook

- Even as Covid-related damage begins to clear, the world continues to face global slack challenges and massive debt burdens that will impede future growth.
- Eurozone inflation is likely to remain muted for an extended period, abstracting from significant base effects in 2021 due to tax changes.
- Global central banks should remain extraordinarily accommodative, and global fiscal policy should remain very supportive as well.
- **Europe**: We expect Europe to recover to pre-crisis activity levels, but not before the end of 2022.
- **China**: There are nascent signs of economic normalization, with leading indicators that are encouraging, fiscal policy that is becoming supportive and financial market conditions that are also supportive of growth.
- **Japan**: With Japan's new prime minister, Yoshihide Suga, not much is expected to change over the short term; however, over the longer term Suga's reform-oriented policies might boost Japan's productivity and potential growth rate (suggesting higher equity prices and an appreciating yen).

Investment Themes

- US rates are relatively attractive on both a hedged and unhedged basis relative to other developed market countries.
- The loan asset class distress ratio is now below pre-Covid levels. We see improving fundamental profiles and hold a positive outlook for loans.
- Reopening spread products are an opportunity. While they have moved significantly, we think there's still a lot more room and they should outperform US Treasuries and sovereign bonds around the world.
- **High-yield** and **investment-grade**: For the most part, we think high-yield and investment-grade bonds have been fully re-priced and we're rotating out of them selectively, in favor of loans.

- **Bank loans**: Loans had underperformed high-yield pretty meaningfully last year, so we view the spreads there as pretty attractive.
- **EM**: Local currency EM debt prices are very depressed. Despite the challenged environment, we believe there are some opportunities within EM.
- **China**: Local onshore bonds offer attractive valuations and room for foreign ownership to grow.

Q&A Highlights

- The Fed should hold steady with its accommodative policy. We believe long-term rates are moving up for the right reasons—the improving outlook and real economic growth.
- The Biden administration may very well change tax policy as they have vowed to undo the recent tax cuts. That could be a headwind for risk assets, but we think it is not likely to be first and foremost on their agenda given the current difficulties in the economy.