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Webcast Summary

3Q21 Market & Strategy Update

Our outlook is starkly optimistic that humanity will triumph over the pandemic globally, and that economic activity will return to pre-pandemic levels eventually. In the meantime, however, we're in the midst of undeniable inflation, though most measures make comparisons from year-ago figures which were near the depths of the crisis. We continue to expect that fiscal and monetary policy should remain supportive, interest rates will stay range-bound, the inflation spike will prove to be transitory and sectors overall will recover with time. Our investment focus is on reopening spread products which we expect to outperform US Treasuries and sovereign bonds, and we believe that emerging markets should particularly benefit.

COVID-19 Update

- Despite significant progress with COVID-19 vaccine "first movers" such as the US, UK and Israel, rolling waves of infections continue around the world.
- The Covid delta variant is more contagious than prior variants, leading to an uptick in cases worldwide.
- We believe vaccination is the answer; manufacturing and logistics are the challenge.

Market Review

- The global economy is gaining traction but faces a protracted period of output slack.
- Resumption of activity to pre-Covid levels could take as long as two years; the fall-off in global aggregate demand is by far the steepest in recent history.
- Global governments have provided enormous amounts of stimulus, and while the stimulus to date has been substantial, the question remains whether it will be sufficient in mitigating permanent damage to global economies or if more will be required.
- Fiscal impact on US GDP growth has been positive this year, but is expected to be negative next year, and obtaining increased fiscal thrust may become more politically difficult.
- US labor market dislocation remains significant, with seven to eight million people who still need to be put back into the employment market.
- US Treasury rates rose sharply in 1Q21, but have since retraced meaningfully.

Inflation

- The rise in inflation is expected to be transitory by the Federal Reserve (Fed) and we tend to agree, noting that the secular headwinds to global inflation persist.
- While the Federal Open Market Committee's medium-term inflation outlook remains benign, Fed Chair Jerome Powell signaled a willingness to adjust, should upside risks materialize.

- The risk, however, that the Fed may be wrong and inflation might move higher than it expects, has moved up sharply.
- Secular inflation in the eurozone is likely to remain muted for an extended period, allowing the European Central Bank to focus on ensuring favorable financing conditions.

Global Economic Outlook

- US growth is strong this year, but we expect it to moderate. Homebuilding and manufacturing have largely returned to pre-pandemic levels, but we need to see more from the service sector, and it continues to improve.
- We expect Europe to recover to pre-crisis activity levels, but not before the end of 2022. Despite renewed Covid lockdowns, 70% of the European adult population is still expected to be vaccinated by the end of July 2021.
- We believe that the recovery of the Japanese economy will persist as the global economy recovers, especially considering the unprecedented scale of fiscal and monetary stimulus that are in place globally.
- Overall, we see the near-term cyclical global outlook as being very strong given that we're in the midst of a robust economic reopening. Longer-term, we think growth and inflation rates will downshift.

Investment Themes

- **Spread sectors:** Spreads are tight but credit quality has improved while defaults have dropped sharply. Overweighting spread sectors has been a positive contribution to performance across the board, but it's been a little uneven and more muted recently.
- **Investment-grade:** The US has the highest yields in investment-grade credit and remains attractive to the global market. Generally, we see opportunity whenever rates or spreads go up.
- **High-yield:** Spreads are tight, but credit quality has improved while defaults have dropped sharply.
- **Bank loans:** Loan fundamentals remain intact and improving while yields remain attractive.
- **Structured product:** The agency mortgage market is vulnerable to policy risk; Fed policy and Biden administration priorities are both creating distortions in the agency mortgage market; we are underweight agency mortgages.
- **EM debt:** Local currency emerging market (EM) debt prices are very distressed and we believe continue to present selective opportunities.
- **China:** We're very constructive on China and think it offers an attractive valuation with respect to yields.

Q&A Highlights

- While the consensus is calling for inflation to be "transitory" the timeframe is certainly a bit vague. We expect inflation to moderate after 3Q21.
- If US growth progresses as we expect, we think there will be a gently flattening US yield curve. However, if growth disappoints, we believe the Fed will likely delay the rate hikes currently expected.
- We think China's growth deceleration will be mild, especially as it has adjusted its reserve requirement ratio for banks. We believe growth in China will stabilize and create a solid backdrop for EM overall.