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Webcast Summary

4Q21 Market & Strategy Update

Coming out of a once-in-a-lifetime pandemic is not without its challenges, but overall the global recovery appears to be intact. We continue to be optimistic about global growth, which has recently downshifted but remains on firm footing. We believe the near-term cyclical outlook is very strong, but over the longer term will downshift to pre-Covid trend levels. Inflation has been challenging over the short term, but we expect it to ease meaningfully into next year. The recovery of reopening sectors, disrupted by delta variant-related setbacks, has been delayed but not derailed. As momentum builds for the eventual successful defeat of Covid, emerging markets should particularly benefit.

COVID-19 Update

- The end of the pandemic is in sight; per our Coronavirus Task Force, we believe Covid is heading toward the common endpoint for all prior coronaviruses and evolving into a less lethal variant.
- 49.3% of the global population has already received one dose of a Covid vaccine, and an accelerating vaccination rate will be a powerful tailwind.
- Vaccinations are the answer, but resistance remains an impediment to the global reopening.

Market Review

- This has truly been an extraordinary period of time, with an abundance of monetary and fiscal policy experimentation.
- Global growth and inflation rates have both been relatively strong as economies emerge from lockdowns and consumer activity resumes.
- A big change this year was an increase in fiscal thrust from the Biden administration. However, we realize the Biden budget will be difficult to pass through Congress as the Democratic Party remains split on the issue.
- The deleveraging of the Chinese real estate sector will have far-reaching effects. The Evergrande situation is not a crisis or "Lehman moment" but has implications on the cyclical growth outlook.
- Emerging markets (EM) have lagged the pickup in global growth.
- Unlike in 2013, EM central banks have already started to roll back ultra-easy pandemic policies.

Inflation

- Inflation has exceeded our forecast as well as that of the Federal Reserve (Fed), but we believe inflation is still largely transitory.
- Most of the current inflation is merely a rebound of prices from declines seen during the shutdown.
- Overall, global inflation has been unremarkable and we expect it to eventually revert to pre-pandemic trends.

Global Economic Outlook

- The near-term cyclical outlook is very strong; longer term, both the global growth rate and inflation should downshift.
- The global economy is gaining traction but faces a protracted period of output slack.
- The resumption of activity to pre-Covid levels could take as long as two years.
- Global fiscal support will also be winding down as we move forward and will act as another headwind.

US Economic Outlook

- Monetary policy accommodation will be reduced going forward, but we make the important distinction that the Fed's tapering of bond purchases is not the same as monetary tightening.
- With the Fed committed to tapering, risk asset volatility should increase.
- US Treasury rates should remain range-bound—our estimate for the yield of 10-year US Treasuries is 1.25%-1.75%.

Investment Themes

- **Spread sectors:** The current environment leads us to overweight spread product and is the number one use of our risk budget.
- **Investment-grade:** Since late last fall, we've been rotating out of US investment-grade credit, though not because we're negative; we've reduced our overweight and are still positive. From a global perspective US investment-grade credit has the highest yields and remains the largest market in the world.
- **High-yield:** Spreads are tight, but credit quality has improved while defaults have dropped sharply. The proportion of BBs in the index is higher as many investment-grade names that were downgraded into high-yield are restoring creditworthiness (rising stars).
- **Bank loans:** Loan fundamentals remain intact and improving while yields remain attractive. If we start to see higher rates, this sector should perform well.
- **Structured product:** We favor mortgage credit exposure on the strength of the US housing market. Despite the rapid rise in home prices post-Covid, the housing market appears to be on solid ground with light supply and affordability at long-run equilibrium.
- **EM debt:** Local currency EM debt prices are very distressed and we believe continue to present selective opportunities.
- **China:** While China can be viewed as both an EM or DM (developed market), we consider it more of a DM. We're very constructive on China and think local onshore bonds offer attractive valuations and will benefit from any easing policy deployed by the government to support growth challenges.

Q&A Highlights

- The Fed is now on a pre-programmed path, as it will be tapering bond purchases all the way through the summer of 2022. We think the Fed has now bought itself some time to weather a pretty tough inflationary period if it continues.
- With global monetary policy becoming less accommodative and fiscal stimulus being reduced at the same time, we realize growth is decelerating and there should be additional volatility in spread sectors. Our base case has been that next year we should see much more moderate but still positive growth.
- The US dollar usually tends to be highly negatively correlated with global growth. As a result, when global growth beats expectations, the dollar typically weakens. And with the Fed tapering while China's growth is weakening, this was very positive for the dollar.