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Webcast Summary

Macro Opportunities Strategy Update: Navigating the Rate Cut Landscape

Global inflation continues to moderate, though the path remains uneven across different economies. Central banks are anticipated to shift from tightening to easing monetary policy later in 2024, creating a favorable backdrop for sovereign bonds and other fixed-income sectors. Macro Opportunities is positioned with long duration and exposure to emerging markets and select credit positions while being short the US dollar. The strategy actively trades macro themes when value dislocates from pricing in an effort to maximize long-term total returns. Currently, we favor emerging market debt and currency exposures such as the Mexican peso.

Global Outlook

- The eurozone is on a low-growth trajectory, with inflation getting close to target levels and wages moderating. This should set the stage for the European Central Bank (ECB) to likely begin cutting rates as early as June.
- In the UK, inflation remains sticky due to higher energy prices despite depressed growth, suggesting the Bank of England (BoE) may lag behind the ECB in starting to cut rates.
- Japan is the one major economy where rates could potentially rise further as the Bank of Japan (BoJ) maintains a hawkish stance amid sticky inflation driven by higher wages.
- China's economy is expected to avoid a recession, with the IMF forecasting GDP growth of 4% to 4.5%, which should have a disinflationary impact on the global economy through lower export prices.

Key Emerging Market Drivers

- Emerging market (EM) central banks are expected to follow major central banks such as the Federal Reserve (Fed) in cutting rates later in 2024, which should benefit EM local debt exposures.
- As the Fed signals rate cuts and the US dollar potentially weakens, this should provide a tailwind for EM currencies.
- The beta of EM ex-China has decreased, meaning that China's economic performance is less tied to its growth compared to the past.
- Geopolitical tensions between the US and China are seen as potentially benefiting other EM economies such as India, Indonesia and Mexico for investment flows.

Macro Opportunities' Performance

- The strategy ended 2023 strongly, marking the 10th year of positive returns in its 12-year history.
- The historical track record of outperformance following periods of volatility provides confidence looking forward.
- While 2024 has challenged fixed-income investors overall, the current backdrop sets up attractive opportunities for the strategy's performance ahead.

Why Macro Opportunities Is Well-Positioned

- As global inflation moderates, especially in the US, it sets up an attractive environment for the strategy.
- The Fed, ECB and BoE have signaled they need more data before they start to ease, which is expected to happen over the coming quarters—a potentially favorable backdrop.
- The portfolio's current 5.2% carry provides staying power and allows overweight positions in high-conviction themes like duration in case of a Fed policy error.
- The strategy's long-dated duration position benefits if the Fed needs to cut rates in the event that growth surprises to the downside.

Sector Exposures

- The strategy maintains a robust allocation to EM debt, as a high-conviction theme that should benefit when EM central banks follow the Fed in cutting rates.
- Within credit, the portfolio is long select investment-grade names in financials and industrials where we see value, while trimming broad investment-grade and high-yield index exposures.
- Commodity-driven currencies like the Mexican peso, Australian dollar and Brazilian real are favored currency exposures within the portfolio.

Portfolio Positioning

- The portfolio maintains a fairly long duration position of around 8.5 years, near the upper band of 10 years, reflecting the high-conviction view on rates.
- It holds a modest short in front-end US rates but is overweight the 2- to 5-year and 20- to 30-year segments of the yield curve.
- Alongside the US, the portfolio is long German bund and UK gilt duration as those economies are seen as closer to recession.
- Within rates, the portfolio is short Japanese government bonds given the BoJ's relatively hawkish policy stance.

Investment Themes

- EM local currency sovereign debt remains a high-conviction theme, as EM central banks are expected to cut rates following the Fed, which should benefit this asset class.
- Commodity exposures are favored as slowing but positive global growth is expected to support commodity prices.
- Agency mortgages managed on a tactical basis provide exposure to high-quality spreads that should benefit from falling interest rate volatility.

Q&A Highlights

- In response to a question about the 2024 US elections, there is less perceived policy differentiation between Republicans and Democrats this cycle compared to past elections, particularly on issues like fiscal policy and stance toward China.
- Regarding potential geopolitical risks, the portfolio is positioned with hedges like long US duration and commodities while short euro and short British pound to prepare if there is a risk-off environment where spread products sell off.
- With respect to Japan, while valuations suggest the yen is stretched at current levels around 155 to the dollar, the currency's weakness may be capped around 160 where the Ministry of Finance could intervene to support it.

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