Global Bond Fixed Income Team Views

By the Loomis Sayles Global Bond Fixed Income Team

SECTOR	OUR CURRENT VIEW	OUR ANTICIPATED STRATEGY
CREDIT		
Global Corporates	Relative credit beta has remained at the lower end of our risk spectrum as we continue to remain cautious given the current volatile macroeconomic backdrop. We continue to believe the economy is in the late stages of the expansion cycle and at the precipice of a downturn. While the corporate fundamental backdrop has been fairly stable leading up to this point, we are beginning to see evidence of some marginal deterioration in leverage and interest coverage metrics. Companies have been losing pricing power and we anticipate profit margins will decline further as a result. We remain very low in risk but still positioned with positive credit beta as a means to help capture a potential carry advantage versus the benchmark.	Relative credit beta is slightly overweight and positioning continues to remain conservative. We are waiting for a better opportunity to increase credit risk. Banking and insurance remain overweights, which we believe could benefit in a higher rate environment. Overweight communications, due to a combination of positive issuer specific stories and general defensive nature of the industry.
High Yield	Our high yield allocation remains low as we continue to be defensive. We believe a weaker growth outlook, reduced earnings expectations, margin pressure, and tight financial conditions could pose significant risks. The significant central bank rate hikes, banking failures, and weaker PMI, ISM, and confidence measures all indicate lower access to capital and a growth slowdown forthcoming, in our view. We remain patient and await a potentially better buying opportunity ahead, considering current valuations and expectations for volatility continue to remain high.	Investments are largely idiosyncratic, issuer specific potential "rising star" candidates. We are currently utilizing less than one quarter of our high yield risk budget, and have continued to reduce exposure. Please note, high yield exposure includes Brazil and South Africa local rates positions
Securitized	We are slightly overweight securitized overall. In Agency MBS, valuations are currently attractive but negative technicals, driven by lack of bank demand, and the Fed buying keeps us cautious. We believe residential real estate performance should be contained given a structural lack of supply, record home equity and conservative underwriting.	Slight overweight in securitized credit, mainly in short non-agency MBS, senior bonds. Slightly overweight Agency MBS on valuation and positive convexity profile.

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CURRENCY		
Dollar view	The US dollar had a choppy quarter ending the period little changed but following July's lower than anticipated CPI print, it drastically weakened against most currencies. While recent momentum has been dollar bearish, we still think that the US dollar may strengthen on investor flight to quality.	Overweight USD vs EUR, GBP, CNY although active position sizes are currently somewhat constrained until uncertainty around inflation's peak and global growth concerns subside.
Developed	Our base case is for a downturn which typically pressures broad FX along with other risk assets. In the Eurozone and UK, growth remains challenged and inflation is proving to be sticky. A soft China reopening has weighed on the value proposition for AUD and NZD and we are finding it hard to see CAD outperform from here.	Underweight EUR vs JPY as the Japanese economy is currently showing more spark and valuations and technicals favor the Yen. Underweight GBP.
Emerging	EM local currencies that we favor have limited external financing needs and potential attractive valuations in our view. We see value in select EM FX valuations but concerns of slowing global growth keep us patient for now. We believe select markets could do well, even if the US dollar rallies.	Overweight ZAR as it looks undervalued even accounting for growth/productivity in our view. Underweight CNY on geopolitical risks, decline in goods exports, and risk of growth shortfall.
YIELD CURVES		
Duration	We are overweight duration led by USD. Falling inflation and challenged global growth make high quality duration look attractive.	Overweight 10-year USD, underweight 10-year JPY. Neutral EUR and GBP. Position sizing is modest
Local EM Markets	We believe select local EM Markets are currently attractive where proactive central bank tightening has resulted in high (ex-ante) real yields and where exports assist with fiscal and trade balances.	Modest overweight EM duration:, S. Africa, Brazil, Mexico, and Indonesia;
KEY RISKS		
	Persistent inflation leading to risk of further central bank tightening and potential policy mistakes. We believe cumulative monetary policy tightening could reveal hidden forms of leverage or additional stresses in the banking and private finance markets. We believe US-Russia-China-Middle East dynamics pose an ever present source of angst. 2024 US presidential election could drive volatility.	As valuations adjust or hard landing risks dissipate, we will look for potential opportunities to add risk in interest rates, currency and credit.

OUTLOOK

- Hawkish Federal Reserve rhetoric and lingering wage inflation drove US bond yields higher in June and early July, but we believe a benign CPI release has abruptly rekindled confidence that the end of the Fed tightening cycle is in sight. We now expect only one more 25bp hike at the July meeting, followed by a pause through year-end. The 3% year-over year headline CPI owed much to energy base effects. The core CPI dropped below 5.0% year-over-year and we expect it to continue trending down.

- Markets celebrated the lower inflation surprise, with bonds and stocks up and the dollar down. The EUR managed to break to new highs for the year and most currencies moved up against the dollar. Credit spreads have tightened, despite the risks of a future slowdown in US growth and earnings, in line with positive equity performance.

- We believe one possible reason for smaller perceived recession risks is that average hourly earnings have begun to run ahead of headline CPI inflation for the first time since the pandemic. This will likely increase disposable income in real terms for a majority of employees. Headline retail sales remains sluggish, though, and the jury is still out on whether a recession can be avoided in 2023 in our view.

- With the exception of the March regional bank volatility, credit spread performance has been benign over the first half of the year. We would normally have expected the combination of slowing growth and rising policy rates to put pressure on company fundamentals and increase bankruptcies. The total stock of distressed debt has increased but investment grade corporate credit spreads have continued to tighten. We believe one possible explanation is that the level of absolute yields in investment grade credit is currently attracting buyers. Adding 1% to a 4% Treasury is more compelling than adding 1% to a 2% Treasury. Also the relative attraction of credit may have been enhanced by the recent volatility of equity returns in our view. However, with pronounced simultaneous economic weakness in the US, the Eurozone, and China, we still look for credit spreads to widen globally before year-end.

- As we now see a combined trend of falling inflation and weak growth, high quality duration appears potentially attractive. We remain cautious on credit, and are equally cautious on non-dollar forex. FX momentum has recently been dollar-bearish. The yen has arrested its bear market and the EUR has rallied nicely, an impressive achievement given recessionary PMIs in the Eurozone in our view. But global growth weakness has been risk-off in past cycles, so we cannot rule out a renewed bout of dollar-strengthening risk aversion.

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