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 seeing 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. We are overweight communications on a combination of positive issuer specific stories and general defensive nature of the industry. Banking and insurance remain overweights, and we believe could benefit in a higher rate environment.
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 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 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	In Agency MBS, valuations are currently attractive but technical headwinds remain (lack of Fed and bank buying). We believe residential real estate performance should be contained given a structural lack of supply, record home equity and conservative underwriting.	Overweight in securitized credit, mainly in short non-agency MBS, senior bonds. Overweight Agency MBS on valuation and positive convexity profile.

SECTOR	OUR CURRENT VIEW	OUR ANTICIPATED STRATEGY
CURRENCY		
Dollar view	The US dollar has been strong in recent weeks and we expect continued dollar momentum. Weak global growth (our expectation) should drive risk aversion, a dynamic that typically benefits USD.	Overweight USD vs EUR, GBP, CNY.
Developed	Our base case is for a downturn which typically pressures broad FX along with other risk assets. In the Eurozone, manufacturing and global trade has been soft and energy issues are not resolved. Growth in the UK is challenged while inflation remains sticky. Bank of Japan policy shift and expectations for a global growth slowdown should benefit JPY.	Underweight EUR vs JPY as the Japanese economy is 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. Select markets could do well, even if the US dollar rallies.	Overweight ZAR as it looks undervalued even when accounting for growth/productivity. 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 favor high quality duration. Real US yields look attractive. Bank of Japan policy shift could pressure Japanese government bond yields higher.	Overweight 10-year USD, underweight 10-year JPY. Extended US duration overweight via TIPS. 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

- Like many we know, the global bond bear market took the last two weeks of August off, but resumed its work with vigor in September. Ten-year US Treasury yields jumped 50bp from a range around 4.25% to stand above 4.75% by early October of this year. This has been a real yield surge. Measured inflation and wage growth continue to trend lower in most places, (the UK labor market and maybe Detroit excepted), and inflation expectations have been stable, but bond markets do not care. The market seems to be fixated on real growth trends in the short term and maybe on government deficits and supply risks in the longer term.
- Two US data points stand out: September 2023 payroll gains were merely double the estimate at 336,000, plus another 119,000 in prior upward revisions. What appears to be in our opinion, a picture of robust health, the Atlanta Fed GDP Now estimate for Q3 is running at just under 5% SAAR. Chinese data is not so resilient, but seems to have bottomed, with the composite PMI is now well above 50%. Not so much in the Eurozone, where the composite PMI merely managed to stop falling but remains at 47%. In our view, the summer picture of US growth exceptionalism looks intact.
- A 50bp rise in long-term yields in a month is no small thing. So far, however, we have not heard of any major casualties from US bond market volatility. Maybe the regional bank damage earlier this year in March served as a wake-up call. One future victim may be the US housing market. We believe that mortgage rates are already high enough to have the potential choke off demand and may move higher. In our view, the other traditional consumer sector that responds to higher interest rates is the auto segment. Here the pain of higher finance charges may be amplified by "negative trade-in value". This is where the buyer finds that the residual value of his/ her old car is smaller than the remaining car loan balance. For these and other reasons, Loomis Sayles Macro Strategies Team still expects the federal funds rate tightening cycle to materially slow the pace of US spending activity, notwithstanding the perky anticipated Q3 2023 result.
- Looking ahead long-term, we believe that the US Money Supply M2 is falling (Quantitative Tightening!) while the US federal debt stock is rising. We repeat our mantra from last month that a tight money/ loose fiscal policy mix helps to increase real yields and in turn, the dollar. Gross federal debt is now about 125% of GDP as of October 2023. Fiscal specialists can point out that the debt to GDP ratio recently fell, but that was because nominal GDP rose 17% in mid-2021 as CPI inflation hit 9%. Nominal GDP is now running at 5.9% yoy, and looks on track to converge with the ten-year yield soon. The flow deficit at full employment is now about 7%, and the Congressional Budget Office predicts 6%-7% deficits for the next decade.
- For our portfolios, we believe that Treasury yields are high enough to represent value in both nominals and Tips. We do not fear duration. We remain cautious on credit and expect it to potentially widen on any growth slowdown. Lastly, we suspect that the USD may be at or near a top, but are not willing to predict a dollar bear market until the current US growth exceptionalism has run its course.