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 still remain cautious given the current volatile macroeconomic backdrop. Credit fundamentals, while fairly resilient to this point, have been weakening as evidenced by higher interest costs, declining margins and elevated leverage. We think the full impact of tighter financial conditions is yet to be realized. Global demand for yield has driven credit spreads tighter and the risk/return profile for credit is unattractive.	We are waiting for a better opportunity to increase credit risk with valuations unattractive at current levels. Overweight communications and consumer non-cyclical on a combination of positive issuer specific stories and general defensive nature of the industries. While we have reduced credit beta in banking it still remains a top overweight given embedded safeguards of capital requirements mandated by regulators. Underweight more cyclical industries like transportation and basic industries.
High Yield	Our high yield allocation still remains low as we continue to be cautious on credit. The significant central bank rate hikes and tighter lending standards indicate lower access to capital and a growth slowdown forthcoming, in our view. We remain patient and await a better buying opportunity ahead, considering current valuations and expectations for volatility to remain high.	We have minimal high yield corporate exposure across accounts. Where we do, investments are largely idiosyncratic, issuer specific potential "rising star" candidates. We are at or near all time lows in terms of utilization of our high yield risk budget. Note, high yield exposure includes Brazil and South Africa local rates positions.
Securitized	In Agency MBS, valuations are attractive but technical headwinds still remain (lack of Federal Reserve (Fed) and bank buying). Residential real estate performance should be contained given a structural lack of supply, record home equity and conservative underwriting, in our view.	Overweight in securitized credit, mainly in short non-agency MBS, and select aircraft ABS senior bonds. Overweight Agency MBS on valuation and positive convexity profile.

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CURRENCY		
Dollar view	We expect eventual dollar weakness as clarity emerges around the timing of the highly anticipated Fed cutting cycle. We believe Further evidence of disinflation will be key in supporting cuts. In the meantime we remain patient, with positioning subdued, as we recognize the possibility of a safe haven bid amid mounting geopolitical risks.	Roughly neutral USD for now.
Developed	Eurozone economies still stagnating with soft manufacturing and global trade. Stubborn wage inflation and extremely loose monetary policy support Bank of Japan (BoJ) policy shift. Combined with expectations for a global growth slowdown we see eventual strengthening of the yen.	Underweight EUR vs JPY as valuations, cyclicals and technicals favor the yen..
Emerging	Emerging Markets (EM) local currencies that we favor have limited external financing needs and high carry. The Mexican Peso (MXN) has the additional tailwind from nearshoring and favorable labor market dynamics.	Overweight Brazil Real (cheap valuations, supportive external flows) and MXN (lower political risks, exposure to resilient US). We reduced MXN exposure a bit post quarter end on valuation, but still maintain some and still remain positive long term. Underweight Chinese Yuan on geopolitical risks, decline in goods exports, and risk of growth shortfall.
YIELD CURVES		
Duration	Despite the sharp fourth quarter bond yield rally and falling inflation, with challenged global growth, and relatively high real yields (compared to recent history) we still find US duration appealing. We believe eventual BoJ policy shift should pressure Japanese Government Bonds yields higher. In our view, the German Manufacturing Purchasing Managers' Index (PMI) suggest Eurozone economic weakness may have found a bottom. With the European Central Bank (ECB) seemingly less dovish than the Fed, 10yr UST / 10yr bund spread looks too wide.	While we have reduced, we still remain overweight 10-year US duration. Remain underweight 10-year Japanese Yen. We are underweight Euro duration.
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: South Africa, Brazil, Mexico, and Indonesia.
KEY RISKS		
	In our view, the lagged effects of monetary policy may experience more severe than expected U.S. and global growth repercussions. We believe elevated service inflation and wages may require a sharp repricing of central bank policy paths and of risk assets. U.S. fiscal wrangling and election politics could unleash volatility well above that embedded in market pricing, in our view. We believe US-Russia-China-Middle East dynamics pose an ever present source of angst and catalysts for additional volatility. 2024 US presidential election along with many other global elections we believe could be incremental drivers of market volatility.	As valuations adjust, we will look for opportunities to add risk in interest rates, currency and credit.

Important Disclosures

Key Risks: Credit Risk, Issuer Risk, Interest Rate Risk, Liquidity Risk, Non-US Securities Risk, Currency Risk, Derivatives Risk, Leverage Risk, Counterparty Risk, Prepayment Risk and Extension Risk. Investing involves risk including possible loss of principal.

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OUTLOOK

- The first quarter was a bear market for US Treasuries and a bull market for the US dollar. Behind both moves, we believe, a resurgence in US growth exceptionalism. US economic surprise indices have been strong all year, notably in the labor markets. The 303,000 jump in March payrolls was echoed by similar strength in the ADP release and in the household employment survey. February was nearly as strong. The Atlanta Fed's GDP-Now tracker is currently posting a 2.5% growth estimate for Q1, slightly above the full-employment trend.
- As the real US economy looks to be in rude health, there is no reason for the Federal Reserve to rescue it by cutting policy rates, in our view. We believe the key to rate cuts is therefore the path of core inflation, and particularly the labor cost-driven services sectors. Here underlying wage inflation is likely to determine Fed timing, in our view. Wage gains are slowing, whether they are measured by average hourly earnings (4.1% year-over-year), the Atlanta wage tracker (5.0%), or the employment cost index (4.2%). But they are slowing at a decreasing rate. We have observed that this has reduced the odds of a near-term cut in policy rates as well as the expected total number of cuts this year. Loomis Sayles Research still looks for the first cut in June or July, and three in total before the end of this year.
- We believe the biggest immediate threat to this generally bullish policy outlook may be the March spurt in the price of oil. West Texas Intermediate is up 20%, or $15/bl since the beginning of this year. This seems to reflect both prior supply restrictions from Russia and Saudi Arabia, as well as separate cuts in exports from countries such as Mexico. We find that oil prices can have an exaggerated impact on consumer inflation expectations, probably because of their visibility at the gas pump, and this market bears watching.
- The Euro-zone has also seen positive surprises, but the growth trend is not nearly as strong as in the US. Markets are highly confident that the ECB will cut in June.
- Japan's micro rate hike may not be the end of the story there, as the Rengo trade unions claim to be receiving 5% pay hikes. This degree of wage inflation is still a coming attraction, in our view, and is not in the national data, where nominal wage growth still lags inflation. Japanese Government Bonds have echoed the US rates sell-off this quarter.
- With Treasury yields higher and US growth robust, we see the US bond market as better-valued, and are inclined to add duration on sell-offs rather than sell on rallies. This view is still conditioned by our expectation that policy rates, yields and the USD will all be lower by year-end.
- We must warn that any US Treasury bull market, absent genuine recession, is likely to be limited by the fiscal backdrop. The US government is running a 6% of GDP deficit at full employment atop a debt stock of about 100% of GDP. Congressional policy is expected to remain paralyzed in a presidential election year. The most likely tax hike we might expect in 2025 may be an import tariff, which would likely increase inflation directly, more than offsetting any fiscal relief from an improved revenue and deficit outlook. We see no serious fiscal reforms in prospect until a Treasury buyer's strike forces a change in policy. We will likely need to see a market panic before policy progress.

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