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 and rich valuations. Credit fundamentals are mixed in the US and remain weak in Europe. Earnings have stabilized, leverage remains high and defaults are increasing, but still well contained. 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, in our view. We are 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 consumer cyclicals (e.g. retailers and autos).
High Yield	Our high yield allocation still remains low as we continue to be cautious on credit. While forward looking loss estimates are relatively subdued, the available risk premium is very thin. We think there is more stress to come from the lagged effects of the recent tightening cycle with lower quality, more interest sensitive companies the most vulnerable. We remain patient and await a better buying opportunity ahead.	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). We believe residential real estate performance should be contained given a structural lack of supply, record home equity and conservative underwriting.	We are overweight high carry securitized credit, mainly in short non-agency MBS, and select aircraft ABS senior bonds. We are overweight Agency MBS on valuation and positive convexity profile.

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CURRENCY		
US Dollar view	Higher relative rates in the US and still stronger growth than many peers are supportive of a stronger US dollar. The potential investment opportunity in bid for US dollars amid geopolitical turmoil is supportive as well. However, as further evidence of disinflation mounts and the path of Fed interest rate cuts becomes more clear, the likelihood of a weaker dollar increases.	We are modestly overweight USD for now.
Developed	Eurozone economies are still stagnating with soft manufacturing and global trade. Vulnerability to a weak China poses a risk as well.	We are underweight EUR.
Emerging	Emerging Markets (EM) local currencies that we favor have limited external financing needs and high carry. Political uncertainty has tempered our optimism toward previously favored currencies (Mexican Peso - MXN, Brazilian Real - BRL). BRL – Recent actions and narrative from President Lula's administration has had a major impact on volatility. MXN – the surprisingly decisive Morena political party legislative victory introduces potential for a worsening fiscal picture and subdued growth.	We are overweight BRL (cheap valuations, supportive external flows), although we have reduced on recent volatility. We recently hedged our MXN overweight and will be patient in reestablishing as clarity forms around the political landscape. We are underweight CNY on geopolitical risks, decline in goods exports, and risk of growth shortfall. We are overweight IDR on favorable carry and contained inflation and sovereign risk.
YIELD CURVES		
Duration	Still restrictive real rates and continued global disinflation leaves central banks poised to reduce rates. While evidence continues to justify cuts, services inflation still remains sticky and risk of commodity shocks also remains. Interest differentials and Bank of Japan (BoJ) policy shift has strong potential to move Japanese Government Bonds (JGB) yields higher.	We believe the 10yr US Treasury Securities (UST) will be range bound and we look to add on sell offs. We are currently modestly overweight 10-year US duration. We still remain underweight 10-year Japanese Yen (JPY). Small underweight EUR duration offset by small long exposure to higher yielding Danish Krone (DKK).
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.	Overweight EM duration: S. Africa, Brazil, Mexico, and Indonesia.
KEY RISKS		
	The lagged effects of monetary policy may be more severe than expected. Credit stress from commercial real estate, private credit, or lower income household borrowers may become potent in aggregate. Elevated services inflation and wages may require a sharp repricing of central bank policy paths and of risk assets. Change in Ukraine and Middle East dynamics will impact markets. Global political landscape could elevate fiscal concerns for many economies. Concentration risk in US large cap tech equities.	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

- US growth exceptionalism appears to be over, in our view. After a 1.4% GDP growth first quarter, the Atlanta Fed GDP-Now indicator is assessing 1.5% for Q2. This agrees with both recent payroll and consumer expenditure data, which are also showing slowdowns. Citibank's US Economic Surprise indicator, which was buoyant through mid-April, has plunged steeply negative.
- Slower growth has helped the Federal Reserve approach its inflation goal. Inflation as measured by the Federal Reserve's preferred metric, the core personal consumer expenditure price index, has slowed to 2.6% year-over-year, matching the headline PCE. This is still above the Fed's 2.0% target but not by much. We expect labor markets to continue to soften slowly, gradually reducing wage inflation and service price momentum. With the unemployment rate edging up to 4.1%, we believe that the path is clear for an interest rate cut at the Fed's September meeting.
- Last year, a predicted growth slump failed to occur, in large part because of the strength of fiscal stimulus. From May to July, the US federal deficit as a share of GDP jumped to 8%, up from 6%. This has not occurred this year, at least not yet, as the May deficit of 6.1% is in line with the year to date trend. Barring a repeat of an unexpected fiscal injection, we look for two policy cuts by year-end.
- With former President Trump leading in the polls, markets have begun to speculate on the policies of a Trump Presidency. Much of course will depend on the composition of Congress, but a Republican sweep might favor the Trump policy goals of tariff hikes and tax cuts.
- On the face of things, tax cuts at near full employment with still-unresolved inflation issues and a structural primary deficit of 3% of GDP may not seem like wise macro policy, but the same was said of the 2017 Trump tax cuts. These slashed corporate income tax rates, also at full employment, with little impact on the CPI. This was, we believe, largely due to what companies did with the bulk of their windfall. They did not jump to hire more workers or expand capital expenditures; they bought back shares. The inflation was in equity prices. Maybe the same will be true in 2025, but we are skeptical that more fiscal insouciance will prove to be benign. Pandemic spending has left the debt to GDP ratio vastly higher than eight years ago. Interest costs are also far higher, given higher yields for Treasuries. The current slowdown in both growth and inflation is yield friendly, but forward markets are pricing a floor for Federal Reserve policy rates at about 3.0%. In our analysis, we believe there is strong potential for positive term premia and a near-term floor for the 10-year yield. We have already trimmed our USD duration overweight as the current rally has progressed.
- Elsewhere, the French elections have produced a hung parliament with a left, rather than populist right, tilt. Both political wings would like to spend money France does not have, so coalition politics may be about fiscal symbolism. The UK elections predictably returned a massive Labour majority, which will seek ways to recharge UK growth that also do not cost too much. Japan is looking at quantitative easing taper, and markets expect at least one more micro rate hike this year.
- We have trimmed our USD duration overweight, while remaining cautious on credit and currency factors. We remain underweight Japanese duration, and look for yields to gradually edge higher there by autumn.

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