



Global Fixed Income Team Views

By the Loomis Sayles Global Fixed Income Team

SECTOR	OUR CURRENT VIEW	OUR ANTICIPATED STRATEGY
CREDIT		
Global Corporates	<p>Coming into the quarter, relative credit beta had remained at the lower end of our risk spectrum on rich valuations, as highlighted by our risk premium models. While valuations improved somewhat in early April during peak tariff volatility, spreads quickly retraced lower and remain below the long term median for late cycle. Technicals remain solid, and credit fundamentals have been fine, but trade war is likely to cause pain, in our view.</p>	<p>We took advantage of the widening of early April, increasing credit beta selectively in portfolios in oversold areas like energy. We will continue to look for mispriced securities and add into further weakness.</p> <p>We remain overweight communications and tech on a combination of positive issuer specific stories and general defensive nature of the industries. Banking remains a top overweight. Underweight consumer cyclicals (e.g. retailers and autos).</p>
High Yield	<p>While forward looking loss estimates are relatively subdued, our high yield allocation has remained low given the limited risk premium available and relative value versus investment grade.</p> <p>The value proposition for high yield improved somewhat in early April but quickly evaporated and high yield risk premium has remained well below historic average overall and for this stage of the credit cycle. We remain patient and await a better buying opportunity ahead.</p>	<p>We came into the quarter with little to no high yield corporate exposure. In the first two weeks of the quarter we established some positions in select BB-rated names at wider spreads. Still, we remain low in HY corporates relative to history but will look to incrementally add as specific opportunities arise. Note, high yield exposure includes Brazil and South Africa local rates positions.</p>
Securitized	<p>A variety of factors are expected to continue driving increased rate volatility (including US fiscal dynamics, inflation and Fed path uncertainty) which is typically negative for MBS. In addition, uncertainties persist regarding regulatory changes under the new US administration.</p> <p>While housing sentiment has softened recently, underlying supply constraints and robust underwriting should support the sector, in our view.</p> <p>In ABS, select deals exhibit strong deal structures and short, attractive, high-quality carry.</p>	<p>Underweight agency MBS to free up capital for higher spread opportunities.</p> <p>Overweight high carry securitized credit, mainly in short non-agency MBS, select aircraft ABS senior bonds and EUR consumer backed ABS.</p>



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CURRENCY		
US Dollar	The dollar faces numerous headwinds: twin deficits, moderation in U.S. growth, more growth-supportive fiscal and monetary policies abroad, still expensive valuation, and fading U.S. exceptionalism.	Underweight USD.
Developed	While an infrastructure and defense spending ramp up led by Germany may be slow to materialize as an economic boost, Western Europe's resilience in the face of a dent in the global trade environment is likely to be greater than what we would have assumed coming into 2025, in our view.	Overweight EUR, JPY, AUD, SEK.
Emerging	JPY benefitting from more competitive rates globally and resilient safe-haven demand . We note that EM and global trade-sensitive economies still could struggle to attract sizable capital flows but select currencies benefit from high carry, cheap valuations and fiscal improvement (BRL). There is scope for broad Asia FX strength amidst the weak USD outlook.	Overweight BRL. Tempered CNY underweight but geopolitical risks, decline in goods exports, and risk of growth shortfall keep us underweight.
YIELD CURVES		
Duration	Rising global risks and the threat of weaker global growth associated with trade policy make us biased to be long overall duration, led by USD. However, global fiscal concerns still act as a counter to lower rates.	Long US duration. Modestly reduced later in the quarter after a US rate rally. We expect to continue range trading.
Local EM Markets	We believe select local emerging markets are currently attractive where proactive central bank tightening has resulted in high (ex-ante) real yields.	Overweight EM duration: S. Africa, Brazil, and Indonesia.
KEY RISKS		
	We believe that unexpected distortions from uncertainty and trade policy could see a rising number of stressed corporations raise risk of a broader credit cycle downturn.	As valuations adjust, we will look for opportunities to add risk in interest rates, currency and credit.
	Changes to the fiscal, trade, and immigration landscape in such a short period creates potential volatility revealing unpredictable areas of stress.	
	Geopolitics: any change (ceasefire or escalation) in the Ukraine, Middle East, or other conflicts will have market implications.	

**IMPORTANT
DISCLOSURE:**

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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.*

Commodity, interest and derivative trading involves substantial risk of loss.

Markets conditions are extremely fluid and change frequently.

Diversification does not ensure a profit or guarantee against a loss.

Any investment that has the possibility for profits also has the possibility of losses, including the loss of principal.

There is no guarantee that the investment objective will be realized or that the strategy will generate positive or excess return.

Past performance is no guarantee of future results.

OUTLOOK

- Congress may have just enacted the last significant Federal tax cut in my lifetime, maybe even in the lifetime of my younger colleagues. The main effect of the new budget is to extend current tax rates, preventing the scheduled increases in rates that were due to take effect in 2026. Minor cuts were added, including higher deductions for state and local taxes, partnership benefits, exemption for tipped wages, and benefits for older pensioners. There were also hikes for university endowment income and overseas remittances. The biggest revenue raisers are the new tariff schedules, which are still a work in progress, and outside the Congressional budget process. On net, the fiscal package is slightly stimulative, while the tariffs are slightly contractionary. The Federal deficit as a percentage of GDP may be in the approximate 7% range in 2026, up from 6.7% in the 12 months through May of this year.
- Why do we believe that this might be the last tax cut? Because the US fiscal position is in large structural deficit and the debt stock is larger. The flow deficit of about 7% of GDP combines interest expense of over 3% with a primary deficit of approximately 4% of GDP. Debt held by the public is about 100% of GDP or \$30 trillion, although the public includes the Federal Reserve, which holds approximately \$4.2 trillion. So marketable debt ex-Fed is “merely” 86% of GDP. Why worry?
- Worry seems reasonable, as each year with these deficits adds approximately 2% of GDP to the debt stock, and the interest bill will compound, in our view. Medicare and Social Security spending are rising due to demographics. We believe defense needs are more likely to rise than decline, given Chinese and Russian military ambitions. We believe within a couple of years, the US debt stock will reach an all-time high, exceeding the 106% level reached at the end of WWII. So what? Countries have run higher debt stocks and survived. Japan has a higher stock, and the United Kingdom ran debt up to 200% of GDP during the Napoleon Wars (Guillaume Vandembroucke, 2021). The reason for worry is that the US government is running an experiment on the willingness of investors to hold US government securities at current yields in the face of a trend erosion in US solvency, in our view.
- Empirical studies of the effects of debt levels on US interest rates are extensive but unsatisfactory, in our view. A recent survey and data review (Gust, Christopher, and Arsenios Skaperdas, 2024) puts the effect at about 3 basis points on US interest rates per one percentage point of increase in Debt/GDP ratio. Other observers have seen little effect until this year. In our view, we may have moved into a new regime for which debt stocks should be considered due to rising debt levels.
- We saw a sharp break in the relationship between Fed monetary policy expectations and Treasury behavior this spring, when tariff growth concerns lowered Fed policy futures yields, but ten-year Treasury yields rose rather than declined. We see a newly emerged risk premium of approximately 30-50bp in yields for long Treasuries at this time. At 3bp per point of GDP, did the market just discount the next five years of deficits, or will risk premia keep trending up? Investors will need to decide.

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OUTLOOK

- Governments can reduce debt burdens in several ways. The traditional way is to tighten fiscal policy and run a primary surplus. The British Empire ran a primary surplus for 80 years in the 19th century to cut its debt stock (Piketty, T., 2017). They did it on the gold standard, with zero inflation and bond yields of 3-4% while GDP growth ran at 2%. So R (the real interest rate) exceeded G (the real growth rate) and the British government still paid the debt down. Victorian Finance Ministers were hardcore.
- In our view, we are now soft core. There is no plan to shrink the primary deficit directly by fiscal tightening. The plan is to have G exceed R. Perhaps deregulation and AI productivity gains will accelerate GDP growth to approximately 3%. The current US administration appears to be hoping and planning for this. The US government is also aiming for lower R. Treasury that will limit duration supply by increasing T-bill issuance while Supplementary Leverage Ratio (SLR) bank capital relaxation is hoped to increase demand. In our view, both strategies appear to be very optimistic while inflation expectations are thought to be somewhat stable, with the five year forward expectation holding at 2.6%.
- In such a world, Treasury pressures on the Fed to cut rates seem unlikely to dissipate, and we remain USD bears.

Sources:

- Guillaume Vandenbroucke, "How Much Debt Is Too Much? What History Shows," St. Louis Fed On the Economy, Oct. 12, 2021.
- Gust, Christopher, and Arsenios Skaperdas (2024). "Government Debt, Limited Foresight, and Longer-term Interest Rates," Finance and Economics Discussion Series 2024-027. Washington: Board of Governors of the Federal Reserve System, <https://doi.org/10.17016/FEDS.2024.027>.
- Piketty, T. (2017). Capital in the twenty-first century (A. Goldhammer, Trans.). Belknap Press.