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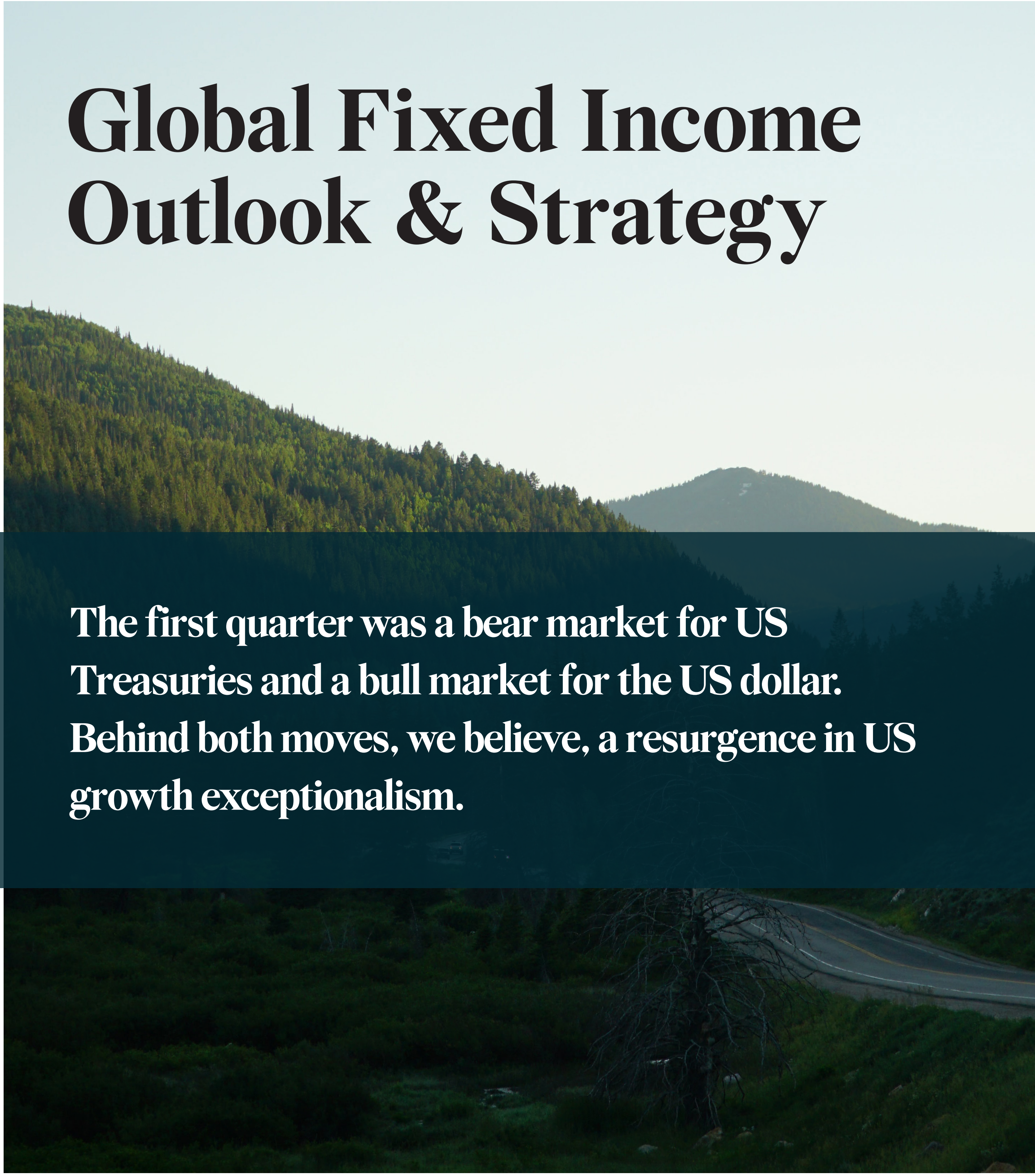

Global Fixed Income Outlook & Strategy

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.

Market Recap & Outlook

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 Federal Reserve's (Fed) 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.

Our Strategy

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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Important Disclosures

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