LOOMIS | SAYLES

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Global Fixed Income Outlook & Strategy

Global bond markets are not having a happy new year. US Treasury sentiment turned distinctly bearish in the first two weeks of January, amplified by a blow-out US payroll release. The US economy apparently produced a quarter of a million new jobs in December. US growth exceptionalism persists.

Market Recap & Outlook

Stepping back from the payroll data, the bond markets seem to be pricing two different risks, in our view. Core inflation has lately plateaued in the US, and with buoyant underlying growth, prospects for future Federal Reserve policy cuts have faded into the distance.

Separately, US fiscal policy has become less predictable, but very possibly more stimulative, in our view. The incoming Trump administration has a majority in both houses of Congress, and we typically see most policy initiatives announced in the first three months of an incoming administration. We believe that immigration deportation could affect low end labor markets as well as potential deregulatory initiatives, tax cuts, and tariff hikes. Risk markets seem most concerned about tariffs, but the scale, scope, and timing of these are all unknown for now. The incoming administration inherits a difficult fiscal position, with close to full employment and a federal budget deficit that is 7% of the GDP. We believe that at least some of the recent back-up in yields is the result of a higher fiscal risk premium.

Two longer term trends are supportive of bond valuations, however. US productivity seems to have increased post-pandemic, and the quits rate continues to fall. We believe this has been a good leading indicator of wage growth and that nominal wage inflation still looks likely. This is supported as well by ongoing declines in wage inflation measured by the Atlanta Fed Wage Tracker and the Employment Cost Index. The next Fed policy move may still be a cut, but maybe not for a while, in our view.

Elsewhere, European growth is negligible, and policy is paralyzed by governance instability in Germany and France. Chinese domestic growth has remained weak, but we note that a weakening Chinese yuan (CNY) is coexisting with a trillion-dollar trade surplus. With local bond markets reflecting deflation risks, or even Japanification of the economy, we look for a significant increase in debt monetization of local government liabilities over time.

US credit spreads have benefited from credit ETF inflows attracted by yields, not spreads. At these higher yields, this looks set to continue unless equities fail to cooperate, in our view. The principal threat to credit spreads, in our view, would seem to come from earnings disappointments, either via tariff damage or yield- driven increases in capital costs.

Our Strategy

We are broadly neutral USD duration as current 10-year yields of about 4.75% may balance fiscal risks with the inflation outlook for now. However, we may see more short term USD strength and credit weakness. We suspect that initial tariff headlines will be more unsettling for risk markets than current pricing suggests.

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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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