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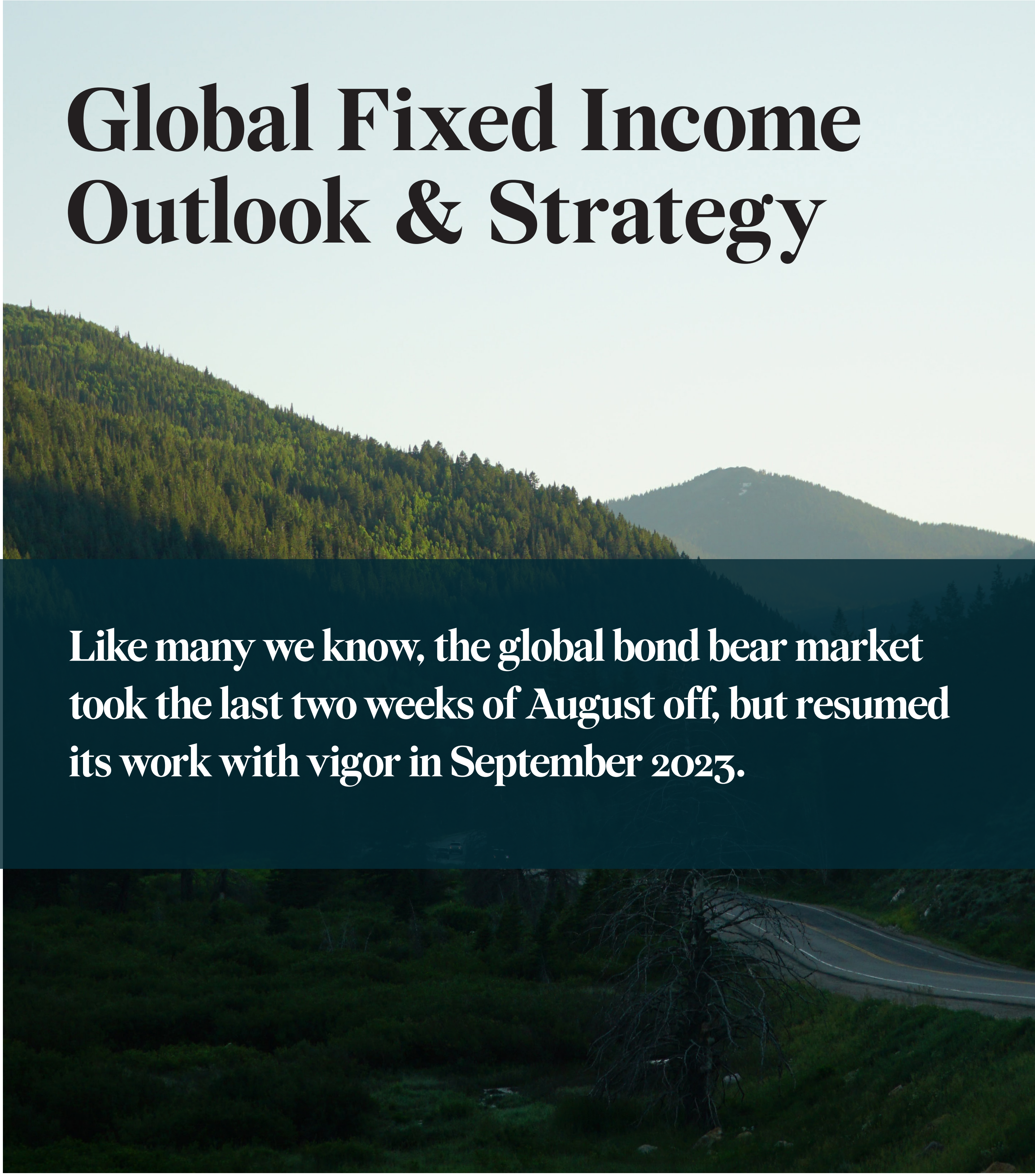
Global Fixed Income Outlook & Strategy



Like many we know, the global bond bear market took the last two weeks of August off, but resumed its work with vigor in September 2023.

Market Recap & Outlook

Ten-year US Treasury yields jumped 50bp from a range around 4.25% to stand above 4.75% by early October 2023. This has been a real yield surge. Measured inflation and wage growth continue to trend lower in most places, (the UK labor market and maybe Detroit excepted), and inflation expectations have been stable, but bond markets do not care. The market seems to be fixated on real growth trends in the short term and maybe on government deficits and supply risks in the longer term.

Two US data points stand out: September payroll gains were merely double the estimate at 336,000, plus another 119,000 in prior upward revisions. What appears to be in our opinion, a picture of robust health, the Atlanta Fed GDP Now estimate for Q3 is running at just under 5% SAAR. Chinese data is not so resilient, but seem to have bottomed, with the composite PMI now well above 50%. Not so much in the Eurozone, where the composite PMI merely managed to stop falling but remains at 47%. We believe that the summer picture of US growth exceptionalism looks intact.

A 50bp rise in long-term yields in a month is no small thing. So far, however, we have not heard of any major casualties from US bond market volatility. Maybe the regional bank damage in March of this year, served as a wake-up call. One future victim may be the US housing market. We believe that mortgage rates are high enough to have the potential to choke off demand, and may move higher. We believe that the other traditional consumer sector is the auto segment. Here the pain of higher finance charges may be amplified by "negative trade-in value". This is where the buyer finds that the residual value of his/ her old car is smaller than the remaining car loan balance. For these and other reasons, the Loomis Macro Investment Team still expects the federal funds rate tightening cycle to materially slow the pace of US spending activity, notwithstanding the perky anticipated Q3 result.

Looking ahead long-term, we believe that the US Money Supply M2 is falling (Quantitative Tightening!) while the US federal debt stock is rising. We repeat our mantra from last month that a tight money/ loose fiscal policy mix helps to increase real yields and in turn, the US dollar. Gross federal debt is now about 125% of GDP as of October 2023. Fiscal specialists can point out that the debt to GDP ratio recently fell, but that was because nominal GDP rose 17% in mid-2021 as CPI inflation hit 9%. Nominal GDP is now running at 5.9% yoy, and looks on track to converge with the ten-year yield soon. The flow deficit at full employment is now about 7%, and the Congressional Budget Office predicts 6%-7% deficits for the next decade.

Our Strategy

For our portfolios, we believe that Treasury yields are high enough to represent value in both nominals and Tips. We do not fear duration. We remain cautious on credit and expect it to potentially widen on any growth slowdown. Lastly, we suspect that the USD may be at or near a top, but are not willing to predict a dollar bear market until the current US growth exceptionalism has run its course.

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