Global Fixed Income Perspectives

2Q 2021

GLOBAL MARKET OUTLOOK

- A Federal Reserve (Fed) that was more hawkish than anticipated, coupled with inflationary pressures and labor and supply chain bottle necks, led to lower yields in the developed worlds' treasury markets following their first quarter ascent. Over the next several weeks, more than half the U.S. states are eliminating the extended unemployment benefits, and the results will guide policy going forward.
- Nothing has led the global economic cycle more consistently since the Great Financial Crisis than the global credit impulse. China has been the high-beta source of both global growth and the global credit impulse. As China's credit cycle continues to contract, the global impact will be substantial.
- Variants of COVID-19 continue to raise concerns for the pace of reopening the global economy. The reopening remains on pace albeit at varying speeds.

DM DEVELOPED MARKETS

Elevated Global PMI's and historically high savings rates provide a robust backdrop for outsized GDP growth and steeping yield curves. Unprece-dented liquidity is expected to significantly boost GDP and to increase savings levels.

IG INVESTMENT GRADE

IG yields are off their year-end lows cased by moves in the Treasury market. Spreads, however, are still near their all-time tight. Dispersion in net leverage between select sectors is significant with leveraging declines in energy driven by oil price increases and increased leverage in communications fueled by M&A.

HY HIGH YIELD

High yield spreads continue to tighten to historic records through all quality ranges of the universe. Although spreads are tight, we continue to favor the yield pick up in this sector as we don't see a material catalyst in the near future that would send spreads significantly wider.

EM EMERGING MARKETS

Hard currency corporate and sovereign credit valuations continue to trade toward the tighter-end of historical ranges. We are following developments in a number of distressed situations in Chinese credit as well as uncertainty in local markets' Fed policy reaction, local hiking cycles, and upcoming elections.

SC STRUCTURED CREDIT

A strong housing market, healthy consumer balance sheets, and supportive supply-demand technicals should continue to create an environment for further spread compression. We remain focused on sectors that have lagged the recovery and favor positions down in the capital stack for select segments.

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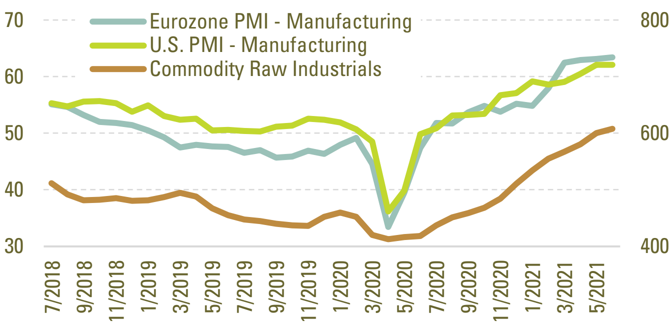
DM Developed Market Rates

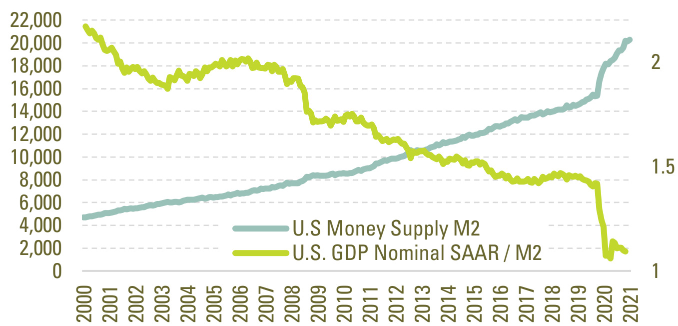
- Strong Global PMI's and high commodity prices point toward increased sovereign yields (Figure 1).
- Unprecedented liquidity supplied by central banks and capital markets leave individuals and corporations with significant ammunition to spend (Figure 2). We estimate nominal GDP could increase by upwards of 15% of the money spent on goods/services and capital expenditures, returning saving levels to pre-COVID-19 volumes.
- Far from a U.S. phenomenon, central banks globally have increased money supply significantly since March 2020 (Eurozone +23.4%, China +9.4%, Japan +11.%).

Figure 1: Signs Point Toward Further Global Growth
As of 6/30/2021



Source: Markit & Commodity Research Bureau, Bloomberg (© 2021, Bloomberg Finance LP)

Figure 2: Spending Remains the Key
Left $billion, right $, As of 5/31/2021

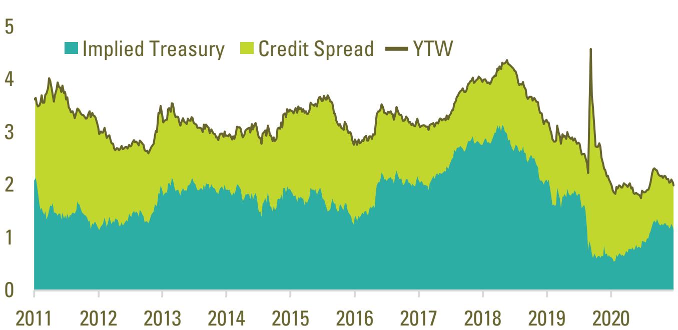


Source: Bloomberg (© 2021, Bloomberg Finance LP)

IG Global Investment Grade

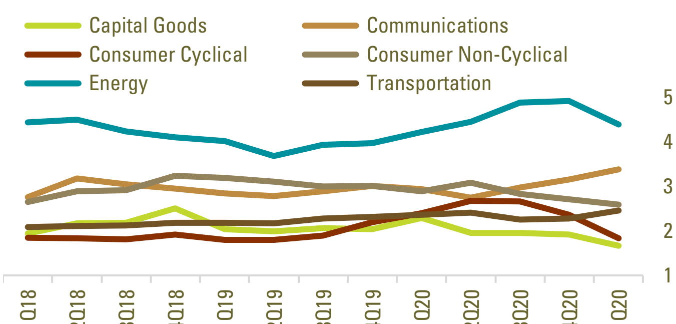
- IG yields have backed off their all-time low at the end of December 2020 due to Treasury moves. Spreads, however, are still low by historical standards (Figure 3). In previous periods, 2013 for example, where Treasuries have backed up significantly, spreads have remained more subdued for some time looking forward.
- There have been fundamental changes in net leverage between select sectors in the investment grade universe (Figure 4). Energy is coming off its near-term historical peak of 5x as a sustained increase in oil prices have allowed companies to generate cash flow and reduce net debt incurred during the pandemic. Communications, however, is seeing an increase in net leverage caused by massive debt-fueled M&A in the sector. Whilst consumer cyclicals and capital goods are deleveraging due to increases in demand caused during the pandemic and the reopening.

Figure 3: Investment Grade YTW by Component
%, as of 6/30/2021



Source: Bloomberg (© 2021, Bloomberg Finance LP)

Figure 4: Net Leverage for Selected Sectors
Turn of leverage, as of Q1 2021

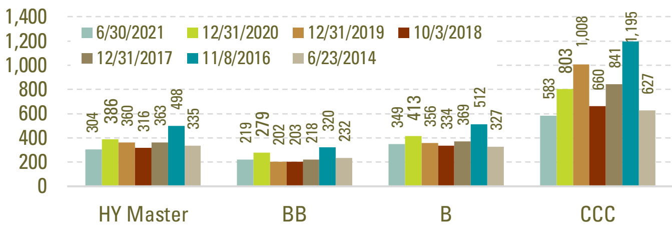


Source: Bloomberg (© 2021, Bloomberg Finance LP)

HY Global High Yield

- The Fed shows no signs of easing accommodative monetary policy in the near future. A growing balance sheet and commitment to keep short-term rates at zero will be supportive enough to keep spreads at compressed levels. (Figure 5)
- Consumers are beginning to draw down savings accumulated as a result of accommodative fiscal policies enacted during the pandemic. While we originally witnessed increased spending on goods, we're starting to see the transition to services which will help sectors like retail, leisure, and travel continue their recovery. (Figure 6)
- Risks for the remainder of the year include increased vaccine penetrations from COVID-19 variants, as well as an easing credit impulse from China which may weigh on elevated commodity prices.

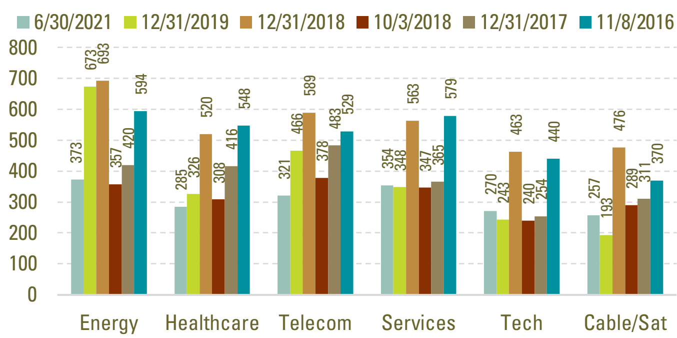
Figure 5: U.S. HY Spread Changes from Key Dates



	Current Level	From					
	6/30/2021	12/31/2020	12/31/2019	10/3/2018	12/31/2017	11/8/2016	6/23/2014
HY Master	304	(82)	(56)	(12)	(59)	(194)	(31)
BB	219	(60)	17	16	1	(101)	(13)
B	349	(64)	(7)	15	(20)	(163)	22
CC	583	(220)	(425)	(77)	(258)	(612)	(44)

Source: CreditSights, ICE BofA/ML Indices data through 6/30/2021

Figure 6: A Cross-Section of Traditional HY Bellwethers and Diversified Services

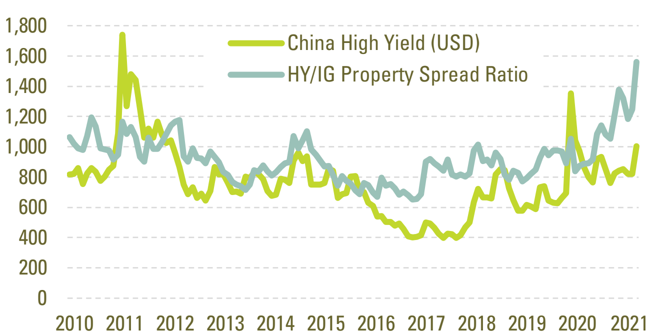


Source: CreditSights, ICE BofA/ML Indices

EM Emerging Markets Debt

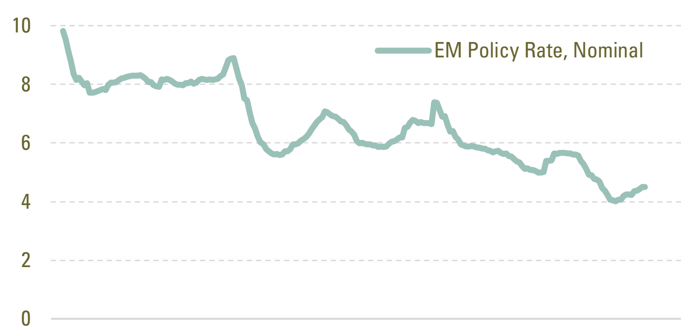
- Hard currency corporate and sovereign credit valuations continue to trade toward the tighter end of historical ranges. One notable exception is the China high yield bond market currently trading at distressed levels with spreads just over 1,000 bps and HY property spreads 5x that of IG property (Figure 7). Markets are following developments around Huarong, Evergrande, and Suning.com for clues around the future of moral hazard and how a restructuring of offshore bonds may look in the future.
- Local markets rallied during the quarter following a challenging first quarter. A number of central banks have begun raising rates on higher inflation, however, policy remains close to record lows (Figure 8). In addition to Fed policy uncertainty, many emerging markets will be heading to the polls for elections. Peru was the most recent example where we saw Castillo come from nowhere in the primaries and ultimately win. The pandemic has pushed the poverty rate up in many emerging markets and a push back toward populism will be a risk.

Figure 7: China High Yield Credit at Distressed Levels
As of 6/30/2021



Source: USE ICE BAML Index Disclosure.

Figure 8: EM Central Bank Rate Hiking Cycle Starting
As of 6/30/2021

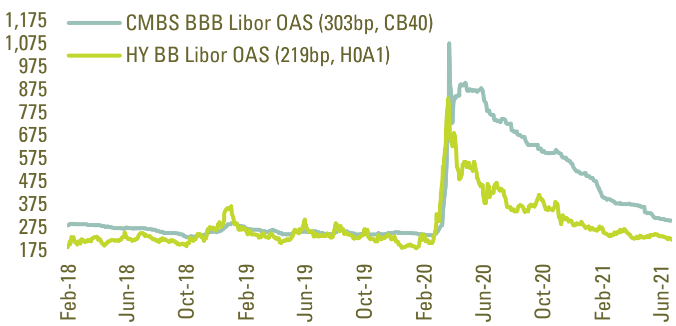


Source: Bloomberg (© 2021, Bloomberg Finance LP)

SC Structured Credit

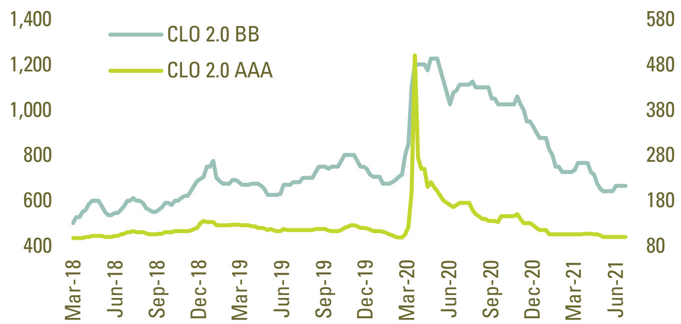
- We view credit-risk transfer (CRT) notes as the best way to gain exposure to the U.S. housing boom. Forbearance programs are levelling off and prepayment speeds are accelerating, benefiting underlying collateral performance. Notes down in the capital stack should benefit from fast de-levering of the deal structures and call upside.
- We see good relative value in the CMBS market compared to high yield corporate credit, with risk premiums compensating for the uncertainties in the sector. Opportunities can be found in some single-A and BBB- tranches of CMBS conduits, especially in seasoned deals that have de-levered due to amortization. Seasoned CMBX indices also possess decent spread-tightening potential (Figure 9).
- We also like consumer credit asset-backed securities (ABS), including BB-rated subprime auto ABS and marketplace lending ABS. These are supported by healthy household credit, high used car prices, fast de-levering, and short duration.
- Unlike other credit sectors, CLO spreads have yet to revert to pre-COVID-19 levels, and we believe CLO BB tranches offer very attractive value. (Figure 10).

Figure 9: Relative Value Comparison BBB CMBS vs. BB HY
Basis Points (bps), As of 6/25/2021



Source: ICE Data Indices, LLC., BofA Merrill Lynch Global Research

Figure 10: Relative Value Comparison CLO BB vs. CLO AAA
Spread to Swap, Basis Points (bps), As of 6/25/2021



Source: BofA Merrill Lynch Global Research