

Global Fixed Income Perspectives

Global Market Outlook

- Monetary policy across the globe was the focus of markets during the first quarter—mainly the pace and speed of the “normalization” of policy. The U.S. Federal Reserve (Fed) accelerated its timeline for ending quantitative easing and the pace and magnitude of interest rate hikes. It is still to be determined what the pace of balance sheet runoff will be at this time.
- Similarly, the market was caught off guard by the shift toward tighter monetary conditions in the Eurozone, which will need to be calibrated due to the impact of the Russian invasion into Ukraine.
- Russia’s military incursion into Ukraine upended markets at the end of February in addition to creating a humanitarian crisis. The response by Europe, NATO, and other nations sanctioning Russia resulted in a dislocation in asset prices and has significantly disrupted supply chains, which will cause global growth to be much slower for the balance of the year.

About this Publication

The Global Fixed Income Perspectives discusses performance and opportunities for global fixed income markets by segment.



Developed Markets

With global inflation at multi-decade highs, investors are struggling as to whether bond yields will breakout through long-term support channels. Given central banks continually sounding more hawkish, yields are poised to rise until they break the back of inflation.



High Yield

High yield bonds posted their worst quarterly returns since the outbreak of COVID-19 in Q1 2020. While previous drawdowns were largely driven by spread widening, this quarter saw significant pressure from underlying Treasury moves. Risks appear elevated, however yields look increasingly attractive.



Investment Grade

Q1 2022 was dominated by spread widening and curve inversion. While borrowing costs for IG corporates have increased, the intermediate tenured curve has risen more than the long-dated curve. There are signs of relative outperformance of IG going forward.



Emerging Markets

EM suffered negative returns during the quarter due to a back-up in treasuries and geopolitical events. Challenges ahead: Fed tightening, energy and food inflation pressures leading to risk with social unrest, and supply-chain improvement delays and lock-downs in China.



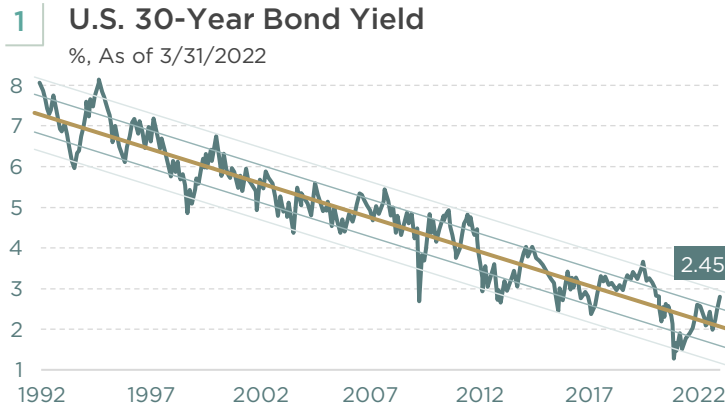
Structured Credit

Structured credit severely underperformed corporate credit in the March rally. However, we believe that solid fundamentals should enable structured credits to stage a comeback in the second quarter.

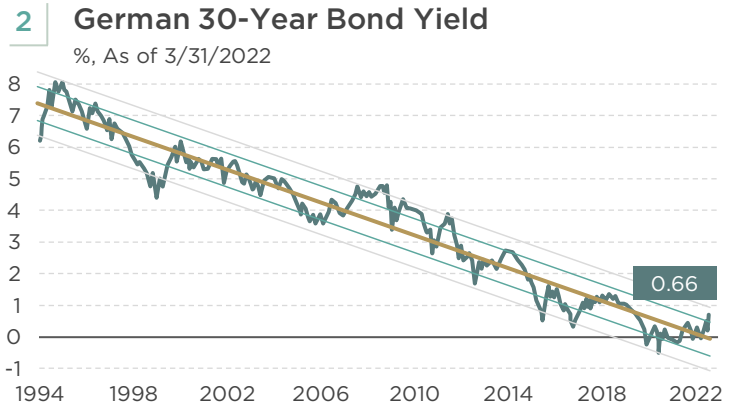


DM Developed Market Rates

- U.S. and German 30-year bond yields are at the cusp of breaking through a 30-year downward trend (FIGURES 1 AND 2). Central bank rhetoric continues to emphasize eradicating inflation as its top concern in the face of upward yields.
- Global bond benchmarks began the year with near-record high duration (WGBI at 8.71 yrs.), causing significant total return losses as interest rates rose throughout the quarter.
- Given the market backdrop of elevated duration and volatility, the team continues to advocate underweighting developed duration. However, as growth concerns become more evident, this posture could quickly change should the market correct itself quickly.



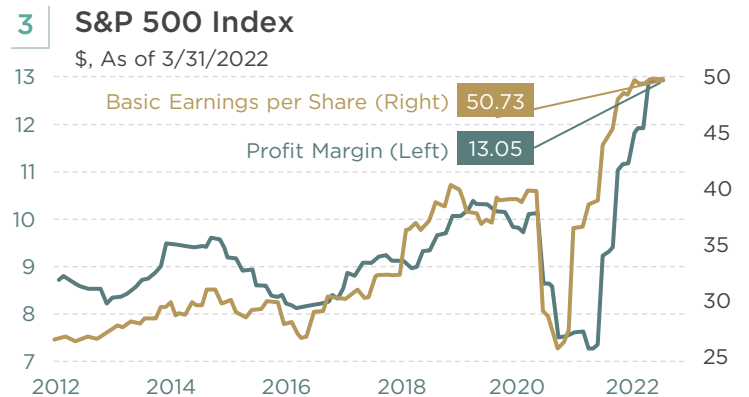
Source: Bloomberg (© 2022, Bloomberg Finance LP)



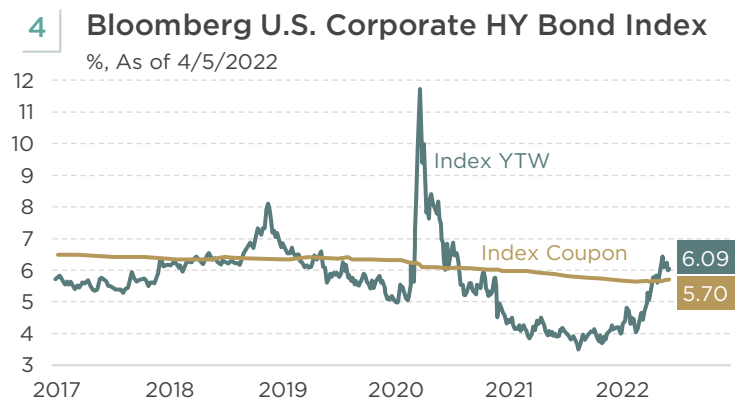
Source: Bloomberg (© 2022, Bloomberg Finance LP)

HY High Yield

- Corporate earnings and profit margins are at record highs, reflecting healthy underlying business conditions in the broader economy (FIGURE 3). Corporate cash balances are also highly elevated after record high yield debt issuance in CY 2020 and 2021.
- The majority of high yield issuers took advantage of zero interest rate monetary policies to lock in low coupons and extend debt maturities. Most high yield corporate issuers have at least 2-3 years before their first debt payments come due.
- While near-term debt payments aren't an immediate concern, the combination of higher Treasury rates and marginally wider spreads have pushed the yield on the U.S. Corporate High Yield Index above the average coupon (FIGURE 4). If this persists, when debt does need to be refinanced, an increase in cost of capital will start to deteriorate the free cash flow profiles of debtors.
- The remarkably hawkish pivot from the Fed in November 2021 has shown no signs of relenting over the first quarter, raising the odds that the index yield will continue to push higher above the average coupon.



Source: Bloomberg (© 2022, Bloomberg Finance LP)



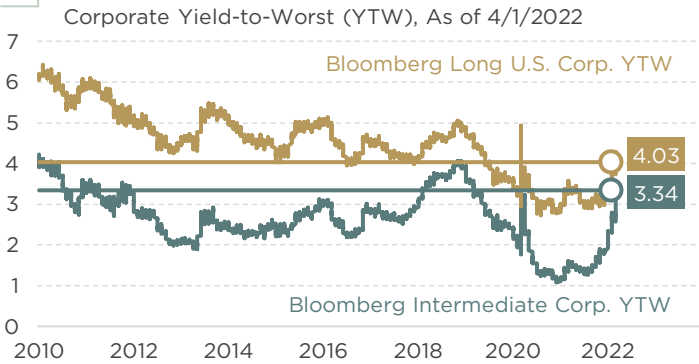
Source: Bloomberg (© 2022, Bloomberg Finance LP)



IG Investment Grade

- Q1 2022 was dominated by spread widening and curve inversion. The second half of March, however, saw some of the spread widening reverse, especially in AAA and BBB long-dated industrials, contributing to an excess return of 0.65% for the month (still an excess return of -1.77% for the quarter).
- FIGURE 5** shows that borrowing costs for corporates are markedly higher across the curve since 2021. While intermediate yield is at the top of the last decade range, longer dated yields are nearer the lower end. With the rate curve flattening, so has the corporate spread curve: long-dated spread is 1.6x that of intermediates vs. a ratio above 2x in October.
- FIGURE 6** shows the ratio of high-yield vs. investment-grade yields has compressed to 1.7x.

5 Intermediate vs. Long Term Corporate Yields



6 Ratio of High Yield vs. Inv. Grade Yields



EM Emerging Markets Debt

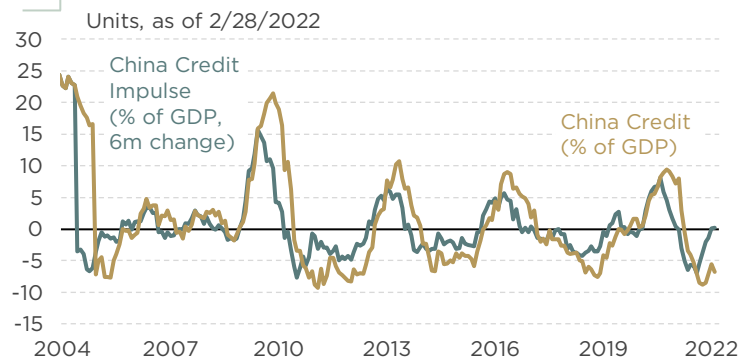
Hard currency EM was down close to 10% during the quarter. Local EM started the quarter outperforming most segments of the global bond market but reversed with Russia invading Ukraine, leading to a sell-off broadly in local EM. Going forward several challenges lie ahead:

- The Fed is moving forward with QT and rate hikes with the economy likely already slowing; this tightening of financial conditions could impact global risk markets, including EM. (**FIGURE 7**)
- Sanctions on Russia are impacting many facets of global commodity markets, including higher energy and food prices; this will affect consumer spending power and likely lead to some social unrest in some EM countries.
- China is facing another series of lockdowns, likely delaying improvement in global supply chains. We are seeing some signs of policy easing in China, which is starting to take some pressure off distressed property market, a positive development, but Fed tightening and inflation could overwhelm this. (**FIGURE 8**)

7 Rate Hiking Cycle Could Impact Global Activity



8 Signs that China Loosening Policy

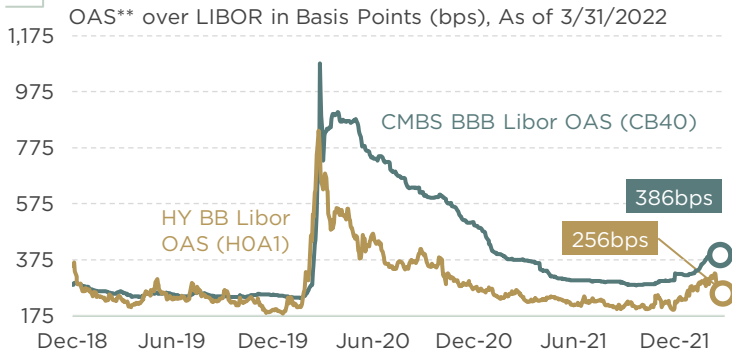




SC Structured Credit

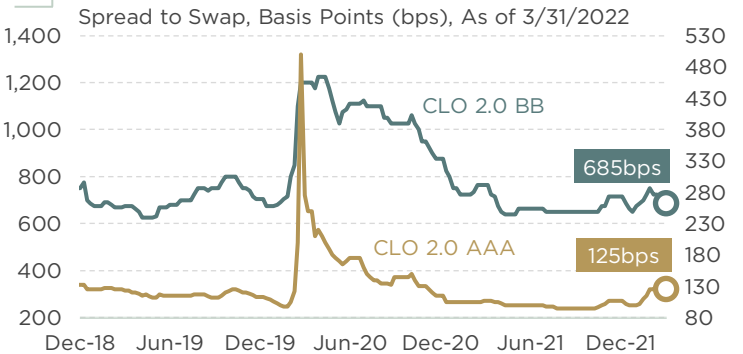
- Credit-risk transfer (CRT) bonds underperformed in the first quarter due to a sharp increase in new issue supply amid the backdrop of increased macro volatility. Nevertheless, CRT mezzanine bonds are supported by continually improving collateral credit quality and strong home price valuations. They offer a high carry profile with opportunity for spread pick-up and, as floating-rate instruments, should see increased investor demand in a rising rate cycle.
- We like BBB tranches of seasoned vintages of fixed-rate conduit commercial mortgage-backed securities (CMBS). They exhibit embedded price appreciation and amortization, spread pick-up over comparable corporates, recovery potential, and shorter duration (**FIGURE 9**). We are also constructive on Single-Asset, Single-Borrower (SASB) CMBS loans for their higher-quality collateral and floating-rate nature.
- In asset-backed securities (ABS), we prefer higher-yielding securities rated B to BBB of subprime auto and consumer loan ABS. The fundamentals should support positive returns.
- Backed by benign credit fundamentals, CLO mezzanine tranches offer some attractive opportunities in floating-rate bonds, and they may serve as a good hedge against rate hikes. (**FIGURE 10**).

9 Relative Value Comp. BBB CMBS vs. BB HY



**Option-Adjusted Spread
Source: ICE Data Indices, LLC., BofA Merrill Lynch Global Research

10 Relative Value Comp. CLO BB vs. CLO AAA



Source: BofA Merrill Lynch Global Research

The views expressed represent the opinions of Brandywine Global Investment Management, LLC (Brandywine Global), and are not intended as a forecast or guarantee of future results. All information obtained from sources believed to be accurate and reliable. Fixed income securities are subject to credit risk and interest-rate risk. High yield, lower-rated, fixed income securities involve greater risk than investment-grade fixed income securities. There may be additional risks associated with international investments. International securities may be subject to market/currency fluctuations, investment risks, and other risks involving foreign economic, political, monetary, taxation, auditing, and/or legal factors. These risks may be magnified in emerging markets. International investing may not be suitable for everyone. Brandywine Global believes that transactions in any option, future, commodity, or other derivative product are not suitable for all persons, and that accordingly, investors should be aware of the risks involved in trading such instruments. There may be significant risks that should be considered prior to investing. Derivatives transactions may increase liquidity risk and introduce other significant risk factors of a complex character. All securities trading, whether in stocks, options, or other investment vehicles, is speculative in nature and involves substantial risk of loss. Characteristics, holdings, and sector weightings are subject to change and should not be considered as investment recommendations. The ICE BAML Global Corporate Index tracks the performance of investment grade corporate debt publicly issued in the major domestic and eurobond markets. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, and a fixed coupon schedule. The ICE BAML AA Global Corporate Index is a subset of the ICE BAML Global Corporate Index, including all securities rated AA1 through AA3, inclusive. The ICE BAML Single-A Global Corporate Index is a subset of the ICE BAML Global Corporate Index, including all securities rated A1 through A3, inclusive. The ICE BAML BBB Global Corporate Index is a subset of The ICE BAML Global Corporate Index, including all securities rated BBB1 through BBB3, inclusive. The ICE BAML U.S. Corporate Index tracks the performance of U.S. dollar-denominated investment grade corporate debt publicly issued in the U.S. domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule, and a minimum amount outstanding of \$250 million. The ICE BAML Global High Yield Index tracks the performance of USD-, CAD-, GBP-, and EUR-denominated below investment grade corporate debt publicly issued in the major domestic or eurobond markets. The ICE BAML BB Global High Yield Index is a subset of the ICE BAML Global High Yield Index, including all securities rated BB1 through BB3, inclusive. The ICE BAML Single-B Global High Yield Index is a subset of The ICE BAML Global High Yield Index, including all securities rated B1 through B3, inclusive. The ICE BAML CCC & Lower Global High Yield Index is a subset of The ICE BAML Global High Yield Index, including all securities rated CCC1 or lower. The ICE BAML U.S. High Yield Index tracks the performance of USD-denominated below investment grade corporate debt publicly issued in the major U.S. markets. The ICE BAML European High Yield index tracks the performance of below-investment grade corporate bonds publicly issued in Europe. The Credit Suisse Leveraged Loan Index tracks the investable market of the U.S. dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest-rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries. The ICE BAML U.S. Mortgage-Backed Securities Index tracks the performance of U.S. dollar-denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. domestic market. The ICE BAML U.S. Fixed Rate CMBS Index tracks the performance of U.S. dollar-denominated investment grade fixed rate commercial mortgage-backed securities publicly issued in the U.S. domestic market. The JP Morgan Corporate Emerging Market Bond Index (CEMBI) Broad is a global, liquid corporate emerging markets benchmark that tracks U.S. denominated corporate bonds issued by emerging markets entities. The JPM EM Bond Index Global Diversified is composed of U.S. dollar-denominated Brady bonds, eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities. The JPM Government Bond Index-Emerging Markets (GBI-EM) Broad Diversified is a comprehensive emerging market debt benchmark that tracks local currency bonds issued by emerging market governments. The unique diversification scheme ensures that weights among the index countries are more evenly distributed by reducing the weight of large countries and redistributing the excess to the smaller-weighted countries with a maximum weight per country of 10%. All data current as of the date at the top of the page unless otherwise noted. This information should not be considered a solicitation or an offer to provide any Brandywine Global service in any jurisdiction where it would be unlawful to do so under the laws of that jurisdiction. **Past performance is no guarantee of future results.**

©2022, Brandywine Global Investment Management, LLC. All rights reserved.



Brandywine Global Investment Management, LLC

1735 Market Street
Suite 1800
Philadelphia, PA 19103

BRANDYWINEGLOBAL.COM



AROUNDTHECURVE.COM