

Global Fixed Income Perspectives

Global Market Outlook

- The fourth quarter turned in one of the strongest bond market performances ever as rates retraced the path they took the previous quarter. Ironically, the 10-Year U.S. Treasury ended 15 basis points (bps) higher than where it began the year. The debate continues around inflation, as well as around the strength of labor markets, term premia, r^* , depletion of excess savings, strength of the U.S. economy and the forthcoming supply of government bonds. We anticipate continued volatility.
- Investors have adjusted their expectations for corporate earnings in light of economic uncertainty.
- Global growth has been stronger than anticipated yet varies with monetary and fiscal policy responses, depending on country dynamics and policy goals. China remains a source of consternation as the housing market continues to struggle and the policy response remains limited.

About this Publication

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

DM Developed Market Rates

Global inflation rates continue to be above central bank targets on a year-over-year basis, which should limit how aggressively central banks can cut in 2024 outside of recessionary conditions. Given recent moves, valuation analysis, and expectations of lower inflation and growth, we are modestly constructive on duration.

HY High Yield

The combination of technical market factors, diminishing evidence of a pending recession, and an election year with additional fiscal support available make us turn more constructive on the high yield sector. While we still want to avoid CCC issuers, we're willing to extend into more idiosyncratic risk.

IG Investment Grade

Investment-grade (IG) credit rallied significantly in Q4 with a total return of 8.5%. IG breakevens are at 72 bps (yield cushion), which is in the 86th percentile. Spread curves have flattened significantly, which limits roll down opportunities. With an inverted Treasury yield curve, short-end credit is still attractive.

SP Securitized Products

As markets adjust to a higher for longer interest rate regime, we reiterate our preference to position up in credit and short in duration. We remain constructive on selective credits, particularly floating rate credit risk transfer (CRT) securities.

EM Emerging Markets

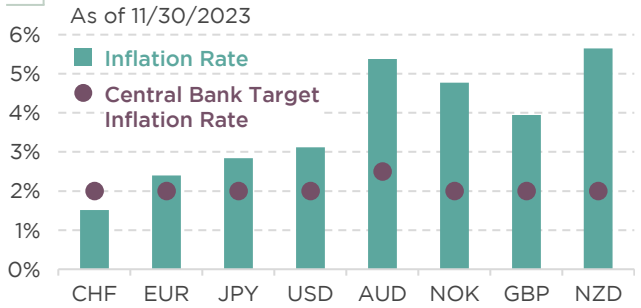
Attractive nominal and real yields still available in Latin America, remaining historically wide to the overall index. We are monitoring the policy responses from developed market central banks to project carry opportunities as well as in China where improving growth would be constructive for emerging markets.



DM Developed Market Rates

- Global inflation has fallen by over 4% on an economy-weighted metric, which has allowed central banks to halt their rate hiking cycle. Understandably, the bond market is now focused on when the rate cutting cycle will begin.
- Although inflation has come down significantly, it remains above most central bank targets, limiting how aggressive rate cuts will be in 2024 (see **FIGURE 1**).
- Remarks from multiple Federal Reserve (Fed) members have vocalized targeting real rates, thus proposing rate cuts at a parallel move equal to the drop in core inflation.
- Therefore, a further move down in rates will require either lower-than-expected future inflation or more material job losses forcing the hand of many central bankers. Brandywine Global’s view on duration has consequently changed from largely overweight to a more modestly constructive stance given the large move in yields that occurred toward quarter-end. This change is largely valuation-based as our macro views remain consistent, expecting continued lower inflation and further economic slowdown.

1 Inflation Rate and Central Bank Target

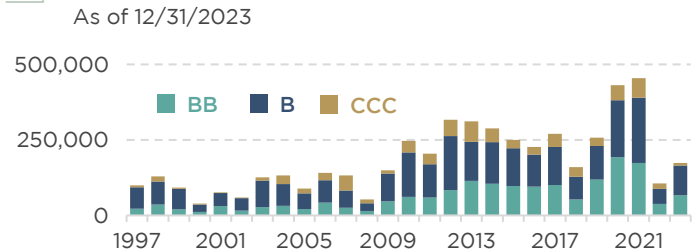


Source: Macrobond

HY High Yield

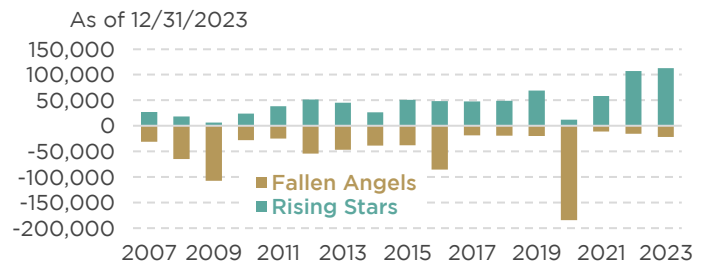
- While 2023 saw more high yield issuance than the previous calendar year, we’re still only running at roughly 65% of trailing 10-year average issuance levels (see **FIGURE 2**). This situation, coupled with a large uptick in “rising star” credits coming out of the high yield universe and into the investment-grade universe (see **FIGURE 3**), has left overall par outstanding 15% lower than the previous peak in late 2021 (see **FIGURE 4**).
- We expect this technical set up to be supportive of credit spreads as issuers will remain hesitant to lock in high coupons before the well telegraphed Fed cutting cycle begins. Any general “risk on” sentiment supported by stronger-than-expected U.S. growth prospects and looser monetary policy should keep the high yield market well bid through at least the first half of the calendar year.
- We also expect political support as the incumbent party realizes the importance of the upcoming presidential election. The current administration has done well to pass various measures of fiscal stimulus over the last two years that start to ramp domestic spending significantly over 2024. We expect this spending to be another pillar of economic stability this year, and while it may be smaller than last year, we expect government spending to be a positive contributor to 2024 GDP.

2 U.S. High Yield: Issuance by Rating



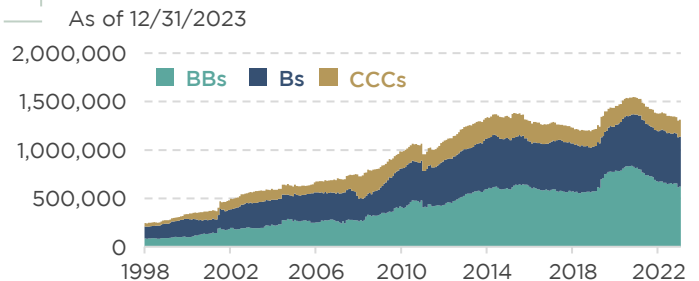
Source: BofA Global Research

3 U.S. High Yield: Fallen Angel vs. Rising Star Volume



Source: BofA Global Research

4 U.S. High Yield: Overall Market Size



Source: BofA Global Research



IG Investment Grade

- Investment-grade credit had a significant total return in the last quarter of 2023 of 8.5% on an index level basis (excess return of 2.0% over U.S. Treasuries). This return leaves the index yielding just over 5% going into 2024.
- Even after such a significant rally in Q4 breakevens, the cushion against widening by comparing yield to worst and option-adjusted duration is at 72 bps (see **FIGURE 5**), which means that the current yield offered by investment-grade credit would have to widen by over 72 bps to produce a negative total return. While this is down from the nearly 100 bps of breakeven in late October 2023, this is still in the 86th percentile since 2016 providing an attractive backdrop going forward.
- Spread curves are at historically flat levels across most sectors in investment-grade credit, which goes hand in hand with an inverted Treasury curve. Spread for the U.S. Long Corporate Bond Index vs. that of the U.S. Intermediate Corporate Bond Index has fallen to 1.2x (see **FIGURE 6**).
- The flattening has counteracted shifts in the Treasury curve, keeping the yield curve effectively flat between long- and intermediate-term paper. This situation highlights the attractive opportunity at the short end of the yield curve in investment-grade credit bar select sectors (energy and financials), resulting in limited roll down opportunities and little yield pick-up out the curve.

SP Securitized Products

- CRT securities (mortgages) remain cheaper than equivalent corporates. Collateral performance has been solid, and we expect lower gross issuance and further tendering of seasoned notes.
- Commercial mortgage-backed securities (CMBS) have priced in a lot of bad news. A decade of price appreciation and solid performance in some non-office sectors should be mitigating factors. We like select AAA to A rated notes. (see **FIGURE 7**)
- Agency mortgage-backed securities (MBS) still offer elevated spreads and their best convexity profile in history in spite of lower volatility and mortgage rates. We prefer higher-coupon bonds. (see **FIGURE 8**)
- Asset-backed securities (ABS) are seeing some normalization of delinquency rates in subprime auto loans. Solid structuring and fast deleveraging are supportive. We favor seasoned subprime auto ABS rated AAA to BBB from top-tier issuers.

5 Investment Grade Index Breakevens

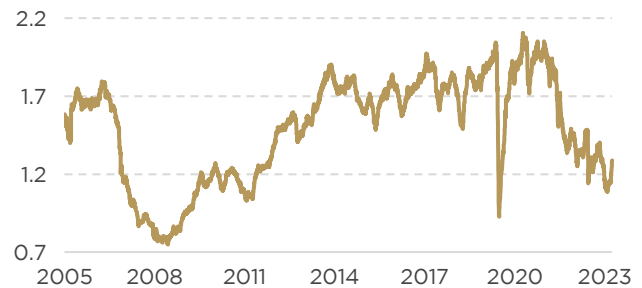
As of 12/31/2023, in Basis Points (bps)



Source: Bloomberg (© 2024, Bloomberg Finance LP)

6 Long vs. Intermediate Spread Ratio

As of 12/31/2023, Multiple



Source: Bloomberg (© 2024, Bloomberg Finance LP)

7 10-Year A-Rated CMBS Conduit vs. 7-10 Year BBB HY Corporate Credit Spreads to U.S. Treasury Curve

As of 12/31/2023, in Basis Points (bps)



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

8 30-Year MBS Spreads to 7-10 Year U.S. Treasuries vs. MOVE Index

As of 12/31/2023, in Basis Points (bps)



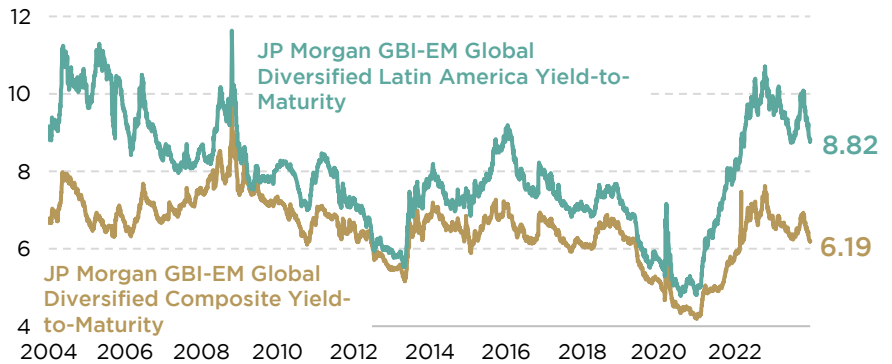
Source: Bloomberg (© 2024, Bloomberg Finance LP)



EM Emerging Markets Debt

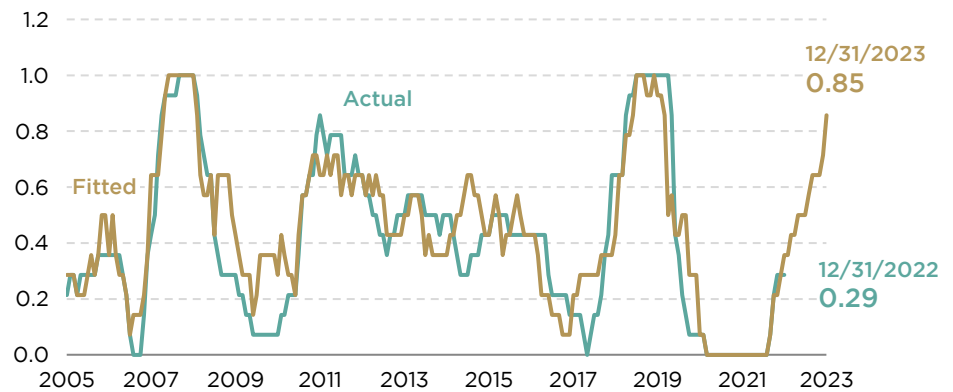
- Local currency emerging markets led the way throughout 2023 across the emerging market (EM) universe. As we have been writing for a little over a year now, we saw a significant valuation opportunity in local currency EM, driven by high nominal yields, peaking inflation following aggressive rate-hiking cycles, and elevated political risk premia in several markets.
- While the valuation gap is not as extreme as it was Q4 of 2022, we believe attractive opportunities remain in local markets offering both high nominal and real yields. This combination is particularly evident in Latin America where yields remain historically wide to the overall index (see **FIGURE 9**).
- EM central banks will initiate or continue their rate-cutting cycles over the coming months, responding to easing headline inflation and improving inflation expectations. Our diffusion index forecasts a pickup in the share of EM central banks cutting rates over the next 12 months (see **FIGURE 10**).
- As we head into 2024, we will continue to monitor the policy responses from developed market (DM) central banks, as the yield differential between EM and DM curves will be a critical driver of EM rates. As it stands today, the Fed appears done with its hiking cycle, and the debate is now focused on the pace of cuts in 2024. The other area of focus will be China; stabilizing or improving Chinese growth would be constructive for EM.

9 Latin American Yields Remain Particularly Attractive
%, As of 12/31/2023



Source: Bloomberg (© 2024, Bloomberg Finance LP)

10 Share of Countries Cutting over the Next 12 Months
Ratio, As of 12/2/2023



Source: Brandywine Global, Bloomberg (© 2024, Bloomberg Finance LP)

The chart is a diffusion index that uses Taylor rule models to forecast monetary policy in the following emerging markets: Brazil, Chile, Colombia, Czech Republic, India, Indonesia, Israel, Hungary, Malaysia, Mexico, Poland, South Africa, South Africa, South Korea, and Thailand.

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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.**

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