Global Fixed Income Perspectives

1Q 2021

GLOBAL MARKET OUTLOOK

- Vaccinating the world's population, coupled with global fiscal stimulus and accommodative monetary policy, should see a "normalization" of global growth, which in turn should allow investors to find value by positioning portfolios for a cyclical upturn.
- Restoration of confidence produced by the vaccines would turbocharge an already expanding economy. A recovery in growth and sentiment would severely test the concept of average inflation targeting and the willingness of policymakers around the world to remain accomodative.
- Going forward, fiscal and monetary policy will be quite different than throughout history. Central bankers invited politicians to a free lunch of massive deficit spending and money printing without concern for the balance sheet or how to repay ballooning debts. It is hard to overstate how exceptional these actions have been.

DM — DEVELOPED MARKETS

Our global outlook supports a spark in near-term inflationary pressures in both the U.S. and Europe. While some consolidation should occur, the general thesis of higher rates remains.

IG — INVESTMENT GRADE

Valuations are expensive, however, some lower-quality credits in the belly of the curve may lead to spread compression. Significant duration risk remains out the curve. The spread from moving from IG to HY has closed all of last year's widening, but there is potential for further tightening.

HY — HIGH YIELD

Demand for high-yield bonds is likely to remain strong, but rising rates globally may challenge this presumption later in the year. We prefer to stay towards the front end of the curve and anticipate a continuation of procyclical outperformance.

SC — STRUCTURED CREDIT

Valuations are fair, while certain COVID-19 impacted sectors and lower tranches still look cheap. Fundamentals are supported by a strong housing market, consumer balance sheets and elevated savings.

EM — EMERGING MARKETS

Valuation opportunities exist in corporates and hard currency sovereigns that would see further spread tightening on reopening. Taper tantrum risks, removal of stimulus measures and any inflationary pressures could push emerging market central banks to hike rates faster than expectations.

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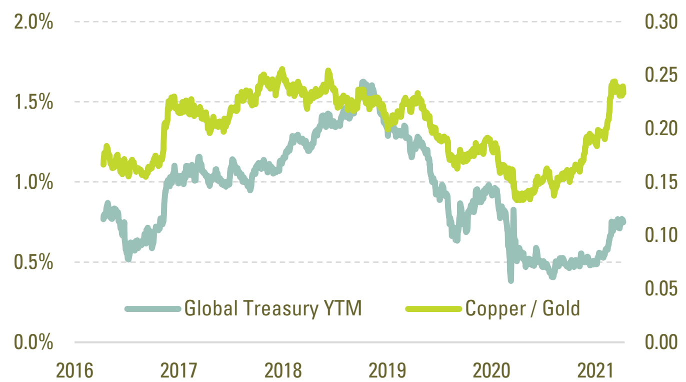
DM Developed Market Rates

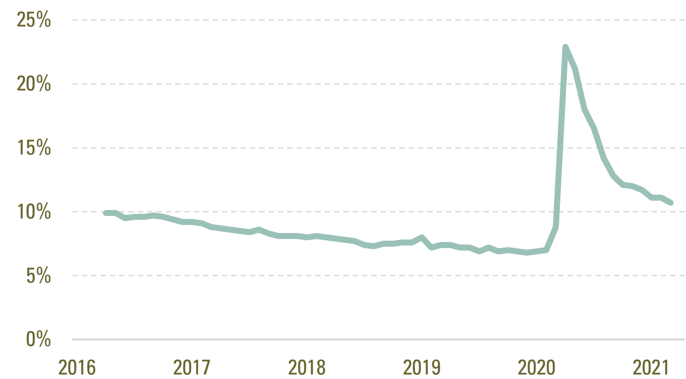
- The copper/gold ratio continues to predict higher global Treasury yields as the reflation story plays out. Some consolidation is occurring within both metrics, but the current trajectory should resume as economies reopen (Figure 1).
- Although high-quality government bonds have been used as a portfolio hedge in the past, additional thought and analysis may be required to determine whether they will provide the same ballast in this environment as they have previously.
- While job growth in the U.S. continues to come in stronger than anticipated, employment utilization rates need to improve much further prior to Federal Reserve tapering (Figure 2).

Figure 1 Global Treasury Yields vs. Copper/Gold Ratio
As of 4/1/2021



Source: Bloomberg Finance, L.P.

Figure 2 U.S. Key Unemployment Rate
As of 4/1/2021



Source: Bloomberg Finance, L.P.

IG Global Investment Grade

- Some lower-quality credits in the belly of the curve appear to offer more potential for spread compression relative to history (Figure 3).
- There are significant duration risks to being positioned far out on the curve, which may result in significant losses if Treasuries continue selling off.
- Potential pockets of value appear in lower-quality names as well as idiosyncratic, reflationary and cyclical names.
- The spread resulting from movement of investment-grade to high-yield bonds (the Baa spread) has retraced all of its pandemic widening to 200bps. However, there is still room to reach post-2008 tights of 150bps (Figure 4).
- Rating agency upgrades are expected across the asset class and with rising stars entering the investment-grade market from the high-yield market, some of which were only recently downgraded to high yield.

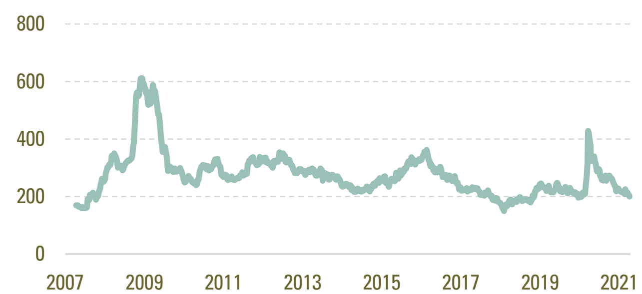
Figure 3 Percentile Ranks of Current Spreads vs. History
As of 4/1/2021

Duration Range (Years)

Credit Quality	1-2	2-3	3-4	4-5	5-6	6-7	7-9	9-13	13-18
AAA	1%	0%	1%	0%	0%	3%	1%	12%	10%
AA	1%	0%	0%	1%	0%	2%	5%	8%	5%
A	1%	0%	0%	1%	2%	11%	2%	10%	6%
BBB+	1%	0%	2%	1%	1%	6%	14%	11%	14%
BBB	0%	0%	2%	0%	1%	1%	9%	8%	13%
BBB-	4%	8%	14%	20%	8%	6%	11%	27%	

Source: DB. Each cell shows the current spread level relative to historic (since 2003) levels. Red shading indicates spreads trading tight to history, and green shading indicates trading wide to history.

Figure 4 Baa Spread
Basis Points (bps), As of 4/1/2021

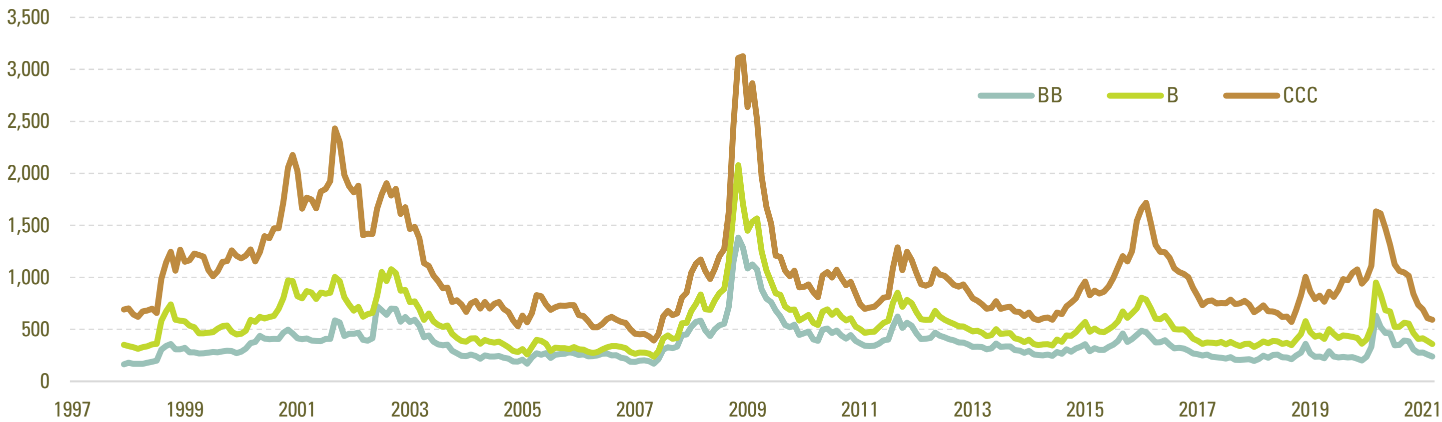


Source: Bloomberg Finance, L.P.

HY Global High Yield

- We anticipate a continuation of procyclical outperformance, favoring companies within sectors that maintain pricing power, like basic industry.
- Year-to-date 2021 issuance is at record levels. We continue to believe that the market demand for high-yield paper will be strong, but rising rates globally may challenge this thesis later in the year. We prefer to stay towards the front end of the curve in the high-yield market.
- Risks to 2021 include COVID-19 mutations, rising rates and rich valuations in the context of more debt outstanding. Additionally, the slowing China credit expansion could also weigh on risk sentiment, especially among commodity producers.

Figure 5 Global Quality OAS
Basis Points (bps), As of 4/1/2021

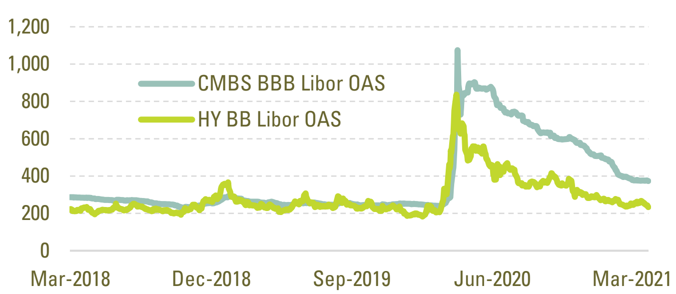


Source: ICE/BAML

SC Structured Credit

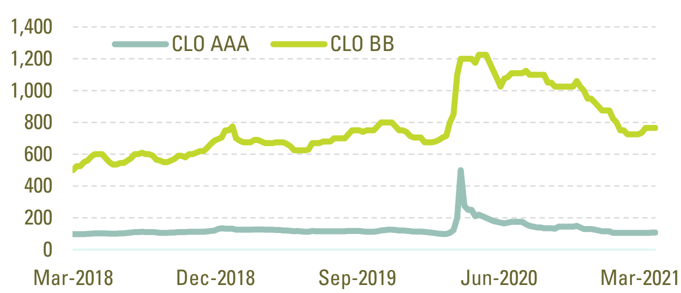
- We view this as a good entry point in CRT B1/B2s due to significant spread widening resulting from prepayment speed repricing, macro volatility and new issue supply. Single-family rental mezz also provides good value given the de minimis credit risk.
- We continue to like the catch-up trade in CMBS single-A and BBB tranches, given that the CMBS credit curve is still steep with spreads much wider than pre-COVID-19 levels (Figure 6).
- We favor lower down the capital structure in consumer ABS, supported by improving consumer credit performance, fast de-levering and short-duration nature.
- CLO BBs appear more attractive, given the recent spread widening due to refi/reset supply (Figure 7).

Figure 6 Relative Value Comparison BBB CMBS vs. BB HY
Basis Points (bps), As of 4/1/2021



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

Figure 7 Relative Value Comparison CLO BB vs. CLO AAA
Spread to Swap, Basis Points (bps), As of 4/1/2021

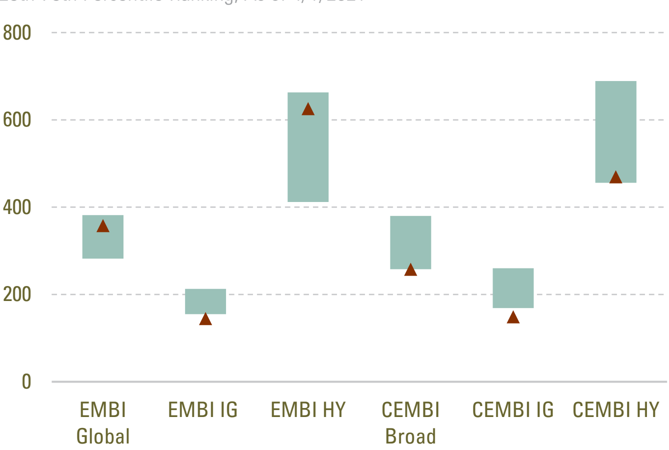


Source: BofA Merrill Lynch Global Research

EM Emerging Markets Debt

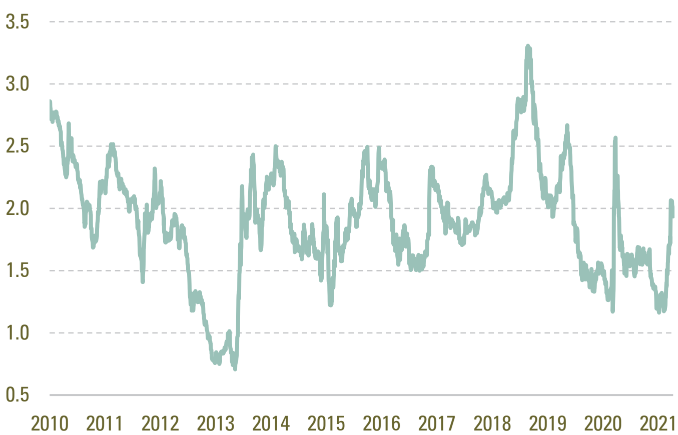
- Valuation opportunity remains in high-yield hard currency sovereigns, which are trading at 4x the spread of the investment-grade market (Figure 8). While some of these countries face challenged debt dynamics, several could see recoveries. An increase of the SDR allocation from IMF would provide needed short-term liquidity support.
- Local real yield provide opportunities in select local markets (Figure 9). Currency valuation metrics appear attractive, especially across some commodity-related currencies (Figure 10). With a handful of EM central banks starting to hike rates, we could see some support for their currencies.
- We will be closely monitoring signs that would push emerging market central banks to hike rates faster than expectations. While the China credit impulse is expected to roll over, it is unclear how aggressive credit growth reduction will be relative to past cycles.

Figure 8 Hard Currency Valuations
25th-75th Percentile Ranking, As of 4/1/2021



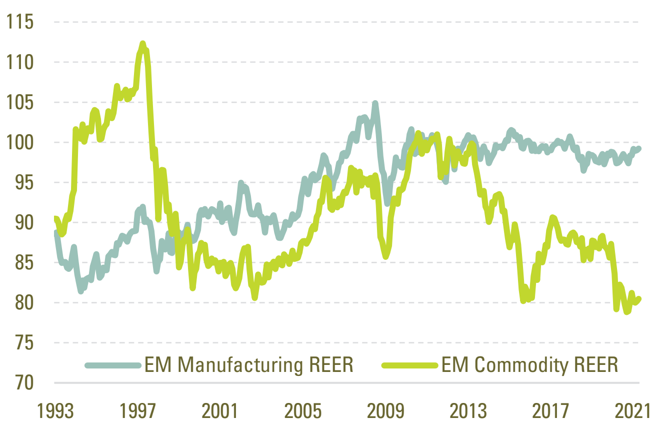
Source: J.P. Morgan

Figure 9 Local Currency EM Sovereign Forward Real Yield
%, As of 4/1/2021



Source: Brandywine Global EM Forward Real Yield Valuation model, Bloomberg Finance, L.P.

Figure 10 EM Real Effective Exchange Rate
As of 4/1/2021



Source: Bloomberg Finance, L.P.

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