

Webcast Summary



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4Q24 Market & Strategy Update

Our base-case investment thesis is coming closer to fruition as the US economy remains resilient, with a moderate slowdown expected that should avoid a recession. This aligns with the ongoing trend of global disinflation, which continues to progress. Together, these developments set the stage for further central bank rate cuts later this year. The upcoming US presidential election adds more uncertainty to the global outlook, with market impacts hinging on the outcome. Despite tight spreads in various credit sectors, robust fundamentals suggest potential stability. Given this environment, our emphasis is on maintaining exposure to sectors offering attractive relative value. Consequently, we currently favor higher-quality high-yield bonds, bank loans and local currency EM debt.

Global Economic Outlook

- Global disinflation is ongoing, with developed market (DM) central banks easing monetary policy to normalize interest rates. We believe this shift provides a favorable environment for fixed-income investors.
- Following a period of policy tightening, emerging market (EM) central banks have now begun easing, providing a constructive backdrop for local yields. We anticipate this trend will continue, benefiting EM local currency bonds as inflationary pressures abate.
- In the eurozone, industrial production is expected to remain weak, and service inflation is likely to decline, leading to further European Central Bank rate cuts and potentially better performance for 5- and 10-year German government bonds. In the UK, we expect the Bank of England to cut another 25 bps in November, and likely cut further at consecutive meetings thereafter.
- China's recent comprehensive support package aims to stabilize growth, but deeper secular and cyclical headwinds like demographics and housing remain unaddressed, suggesting only a moderate impact on long-term growth.
- In Australia, the loosening job market has seen wage growth turn and the improved labor balance should give the Reserve Bank of Australia some scope to ease policy by mid-2025.
- Japan's structural labor shortages and demographic challenges are likely to persist, driving continued wage growth and inflation, which should see the Bank of Japan continue to tighten policy.

US Economic Outlook

- US inflation is approaching the Federal Reserve's (Fed) 2% target, with recent data showing a significant decline in goods inflation and a gradual easing in service sector inflation.
- The unemployment rate is trending higher primarily due to an expansion in the labor force rather than an increase in layoffs, suggesting a soft-landing scenario is more likely than a recession.
- The Fed has room to cut rates further as inflation continues its decline—and if the economy starts to stumble or if unforeseen events create more volatility and economic headwinds.
- The US dollar has weakened modestly, which will have implications for trade balances and the competitiveness of US exports in global markets. This can potentially improve the US trade balance by increasing export volumes.

2024 US Presidential Election Outlook

- Despite betting odds and market expectations, the outcome of the US presidential election remains very uncertain, making it difficult to build portfolios contingent on a specific result.
- Both presidential candidates are likely to pursue agendas that lead to further fiscal expansion.
- The major differences between the candidates lie in their approaches to regulation and tax policy, with Trump favoring deregulation and Harris favoring more regulation.
- Both candidates have used tariffs, but Trump is expected to be more aggressive with them. The president has the authority to issue tariffs unilaterally if imports are deemed a threat to national security, which could impact markets regardless of the election outcome.

Investment Themes

- **Overall Risk Assets:** Despite tight spreads, we are maintaining exposure to spread sectors for their income carry advantage, supported by strong fundamentals and a favorable central bank policy environment.
- **Credit Sectors:** We are focusing on higher-quality investments within credit sectors to build resilient portfolios, given the strong fundamental backdrop and potential for unforeseen economic headwinds.
- **Investment-Grade Credit:** Fundamentals remain supportive with positive revenue growth and low leverage, making investment-grade credit attractive despite tight spreads. We are selectively trimming exposure but maintaining a focus on quality.
- **High-Yield Credit:** The high-yield market is benefiting from low default rates and strong fundamentals, particularly in higher-quality segments. We are migrating toward higher-quality high-yield bonds to mitigate risks.
- **Structured Products:** US agency mortgages are favored due to limited supply and attractive spreads relative to high-quality, short-dated corporate bonds. We are also increasing exposure to commercial real estate, particularly in sectors like retail and industrial, while being cautious with office properties.
- **EM Debt:** EM local yields are expected to continue rallying as EM central banks ease policy. We see value in local EM debt in the larger EM economies and are also exploring opportunities in frontier markets.
- **Geopolitical and Economic Risks:** Current events such as Middle East tensions and the US dockworkers strike are being closely monitored for potential inflationary impacts.

Q&A Highlights

- Oil prices are uncertain due to conflicting signals from the Saudis' stance on not defending higher prices and the inflationary impact of Middle East tensions; we prefer investing in companies with lower production costs to mitigate risks.
- The US dockworkers strike is inflationary, and its impact depends on how long it lasts; we are closely monitoring the situation to understand its potential economic effects.
- We are maintaining sector exposure for the carry advantage, supported by a strong fundamental backdrop, which we believe will keep spreads relatively anchored despite their tight levels.
- Overall, our investment concerns include the rapid growth and potential stress in private credit, and the bifurcated office real estate market, which requires selectivity and a focus on higher-quality properties to find opportunities amid potential high-profile stress pockets.

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