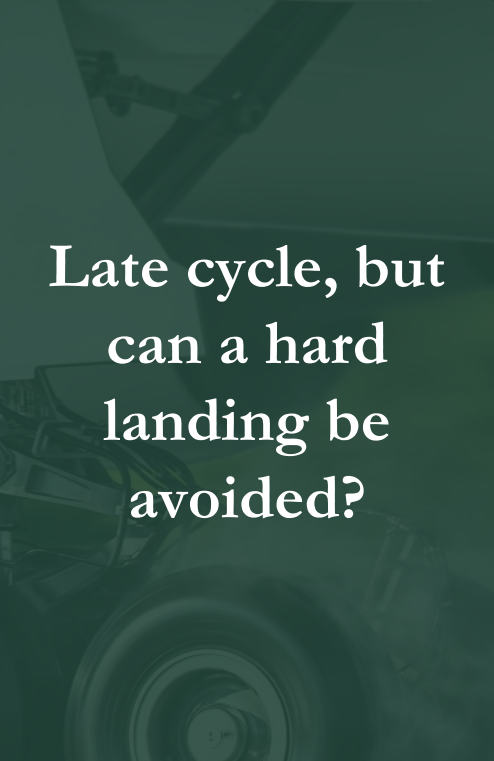


Macroeconomic outlook

Eoin Walsh

Partner, Portfolio Management



Late cycle, but
can a hard
landing be
avoided?

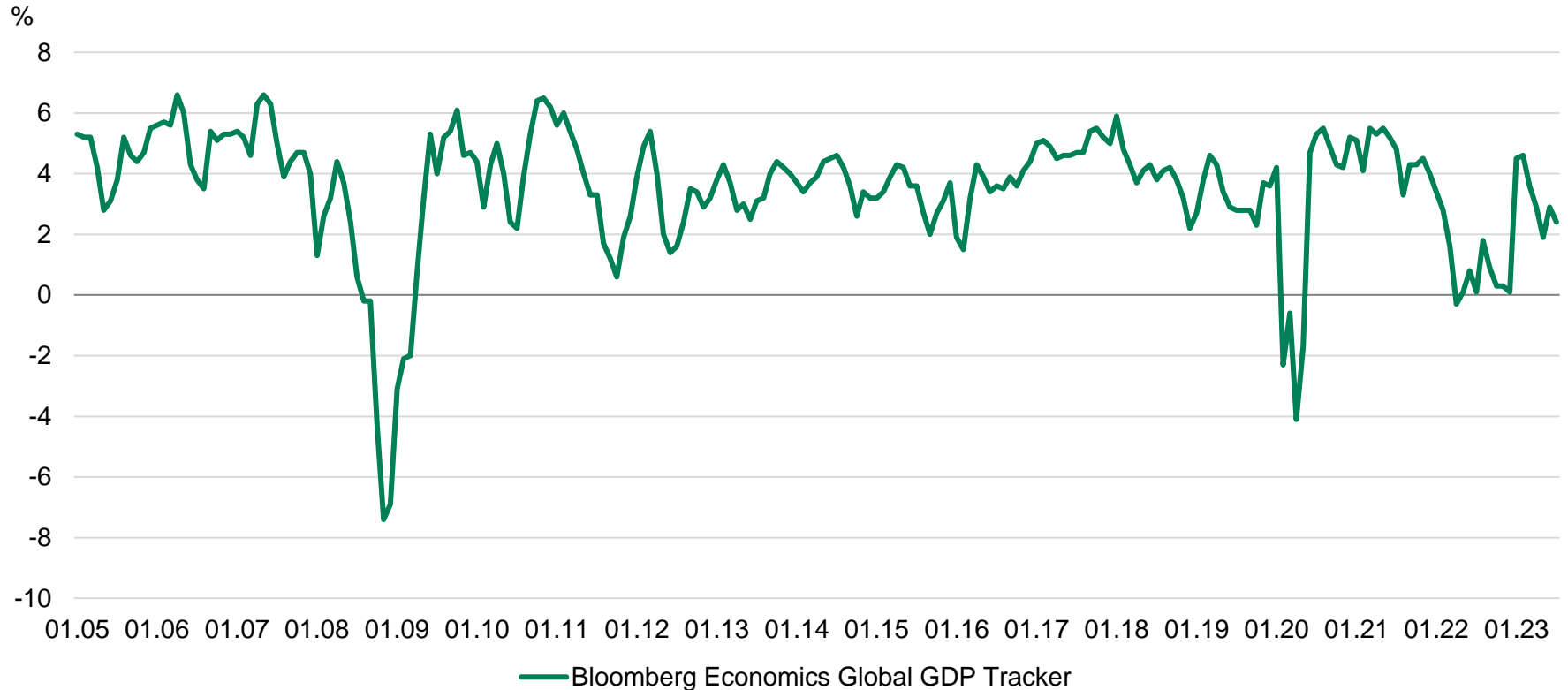
- **Economic fundamentals** have remained very strong
- **Global GDP** has recovered from close to zero 12mths ago
- **Headline inflation** is moderating, **core inflation** remains challenging
- **Unemployment rate** is **very low**, but the jobs market is weakening
- **2yr-10yr Treasury curve has been inverted** since July '22 – this doesn't offer a guide to the severity of a downturn however
- Extent of the “**lag**” since hikes began is **difficult to quantify**
- **Geopolitical risks** also remain **elevated**

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Global GDP has rebounded in 2023

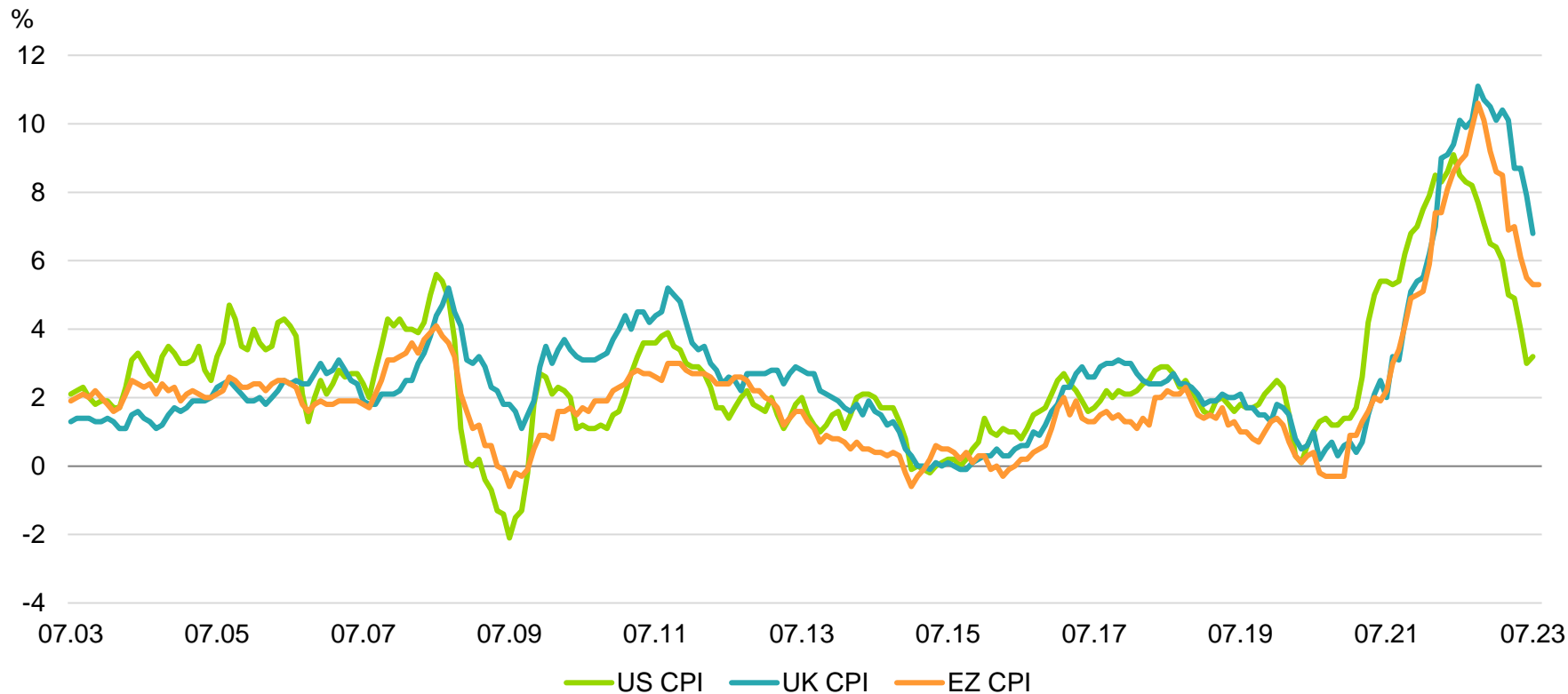


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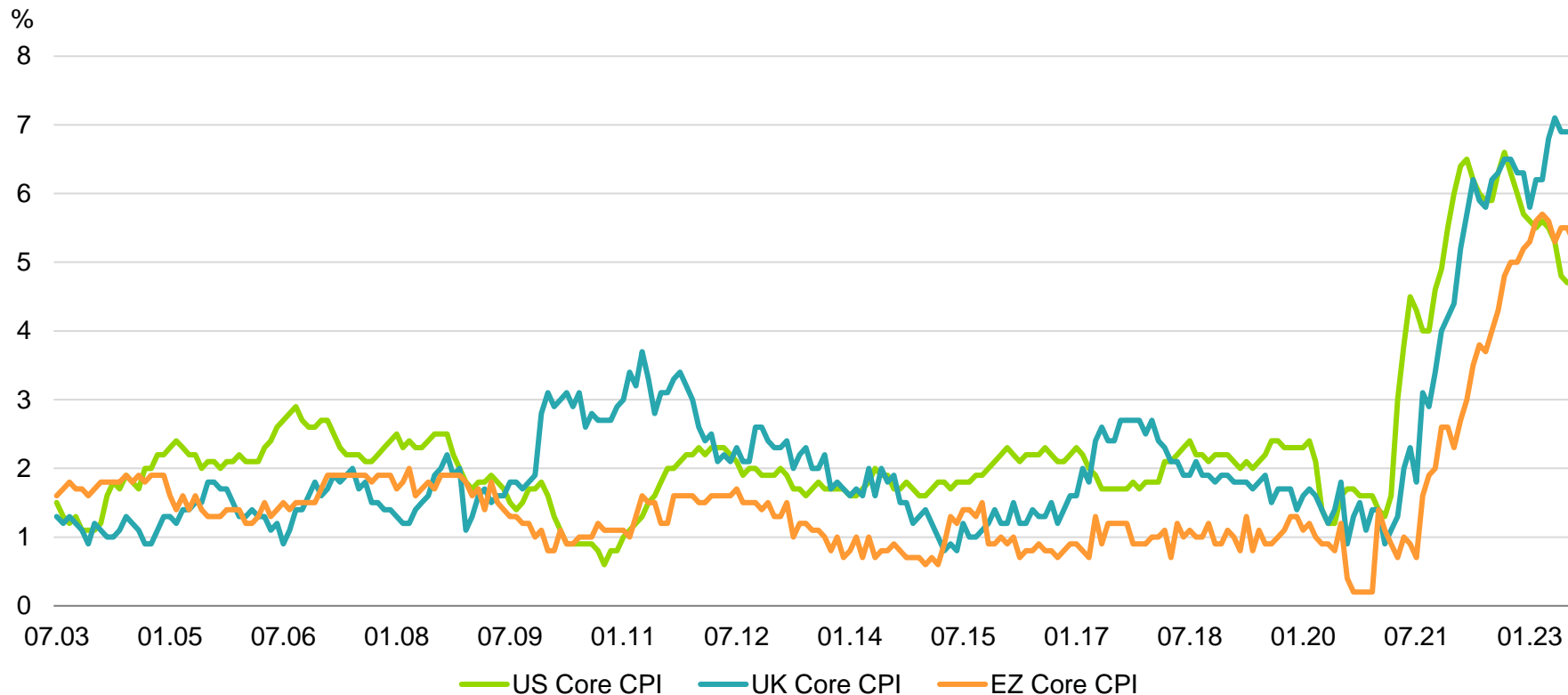


Source: Bloomberg; 31 July 2023

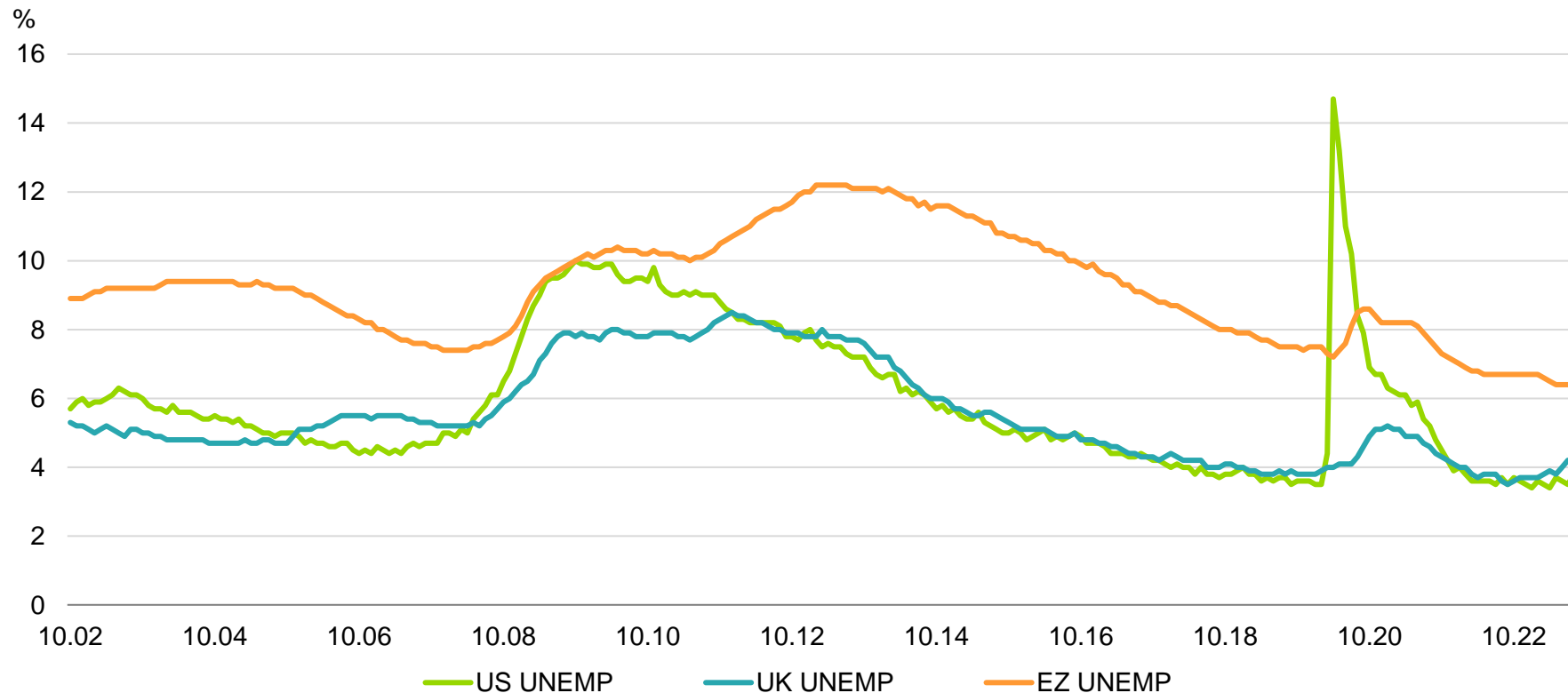
Headline inflation seems to have peaked



Core inflation is proving more persistent

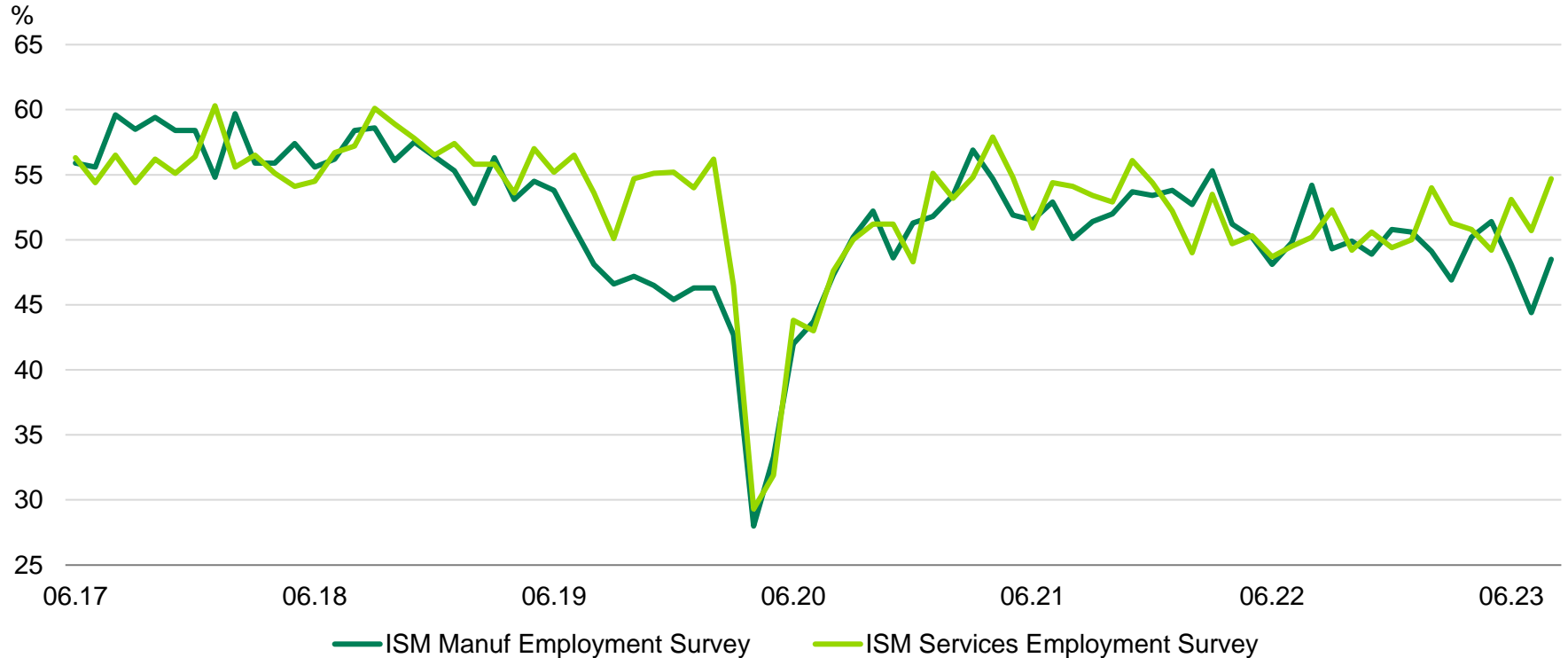


Unemployment has been very resilient so far



Employment sentiment is mixed, however

ISM Employment Reports

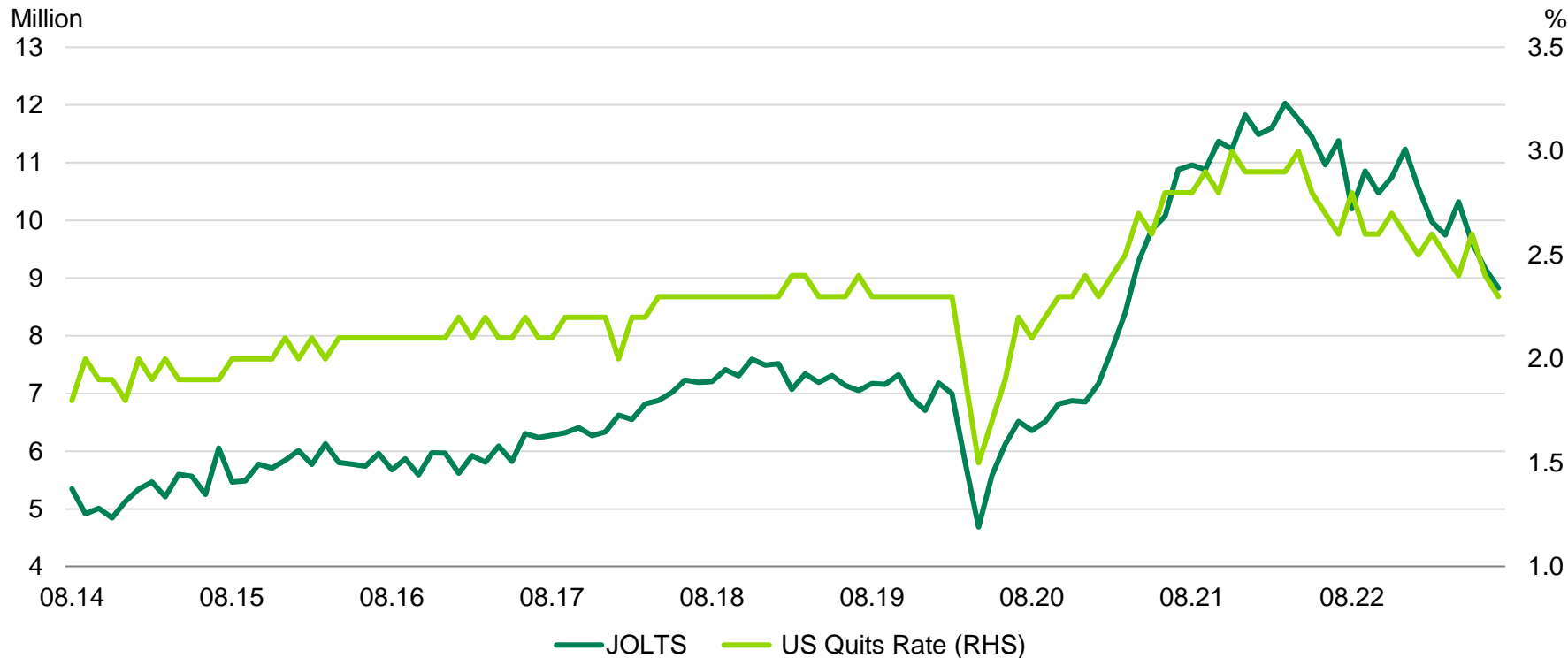


Fewer jobs available and quit rate is falling



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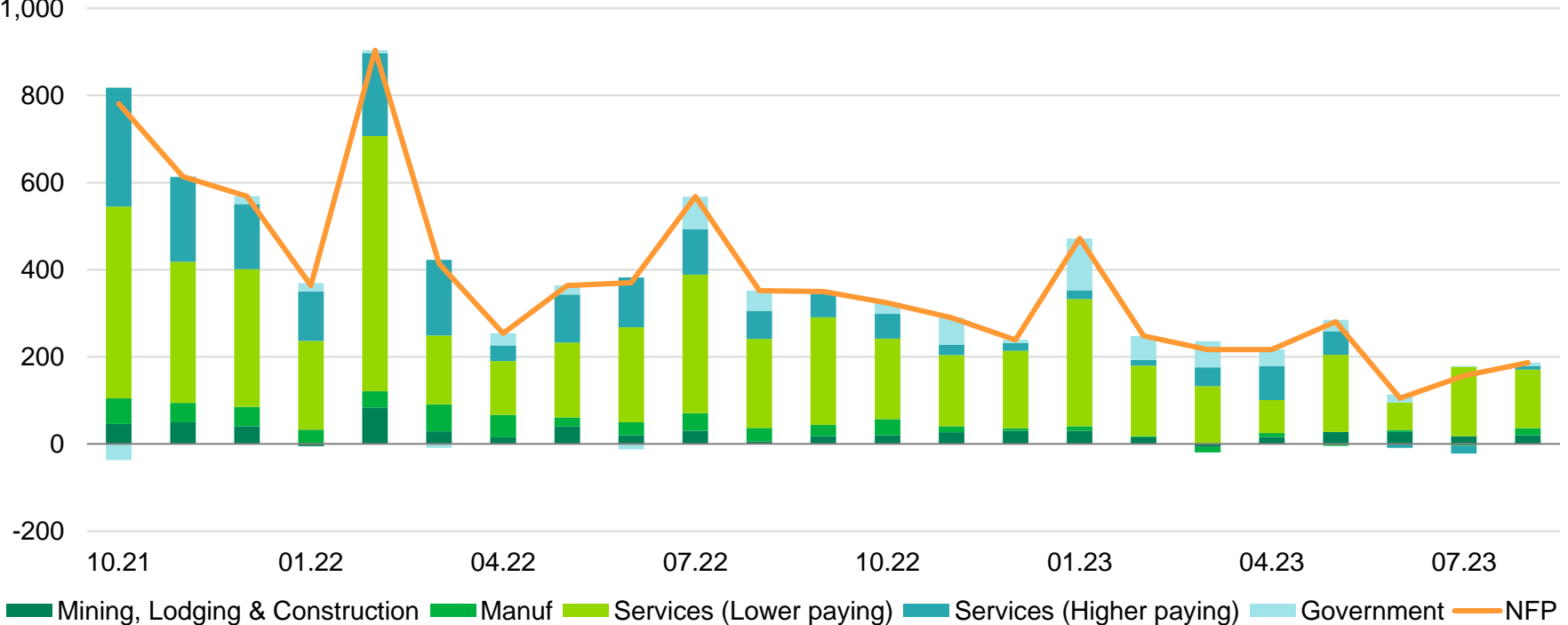
Jolts & Quits



Fewer jobs being created, and they are less well paid

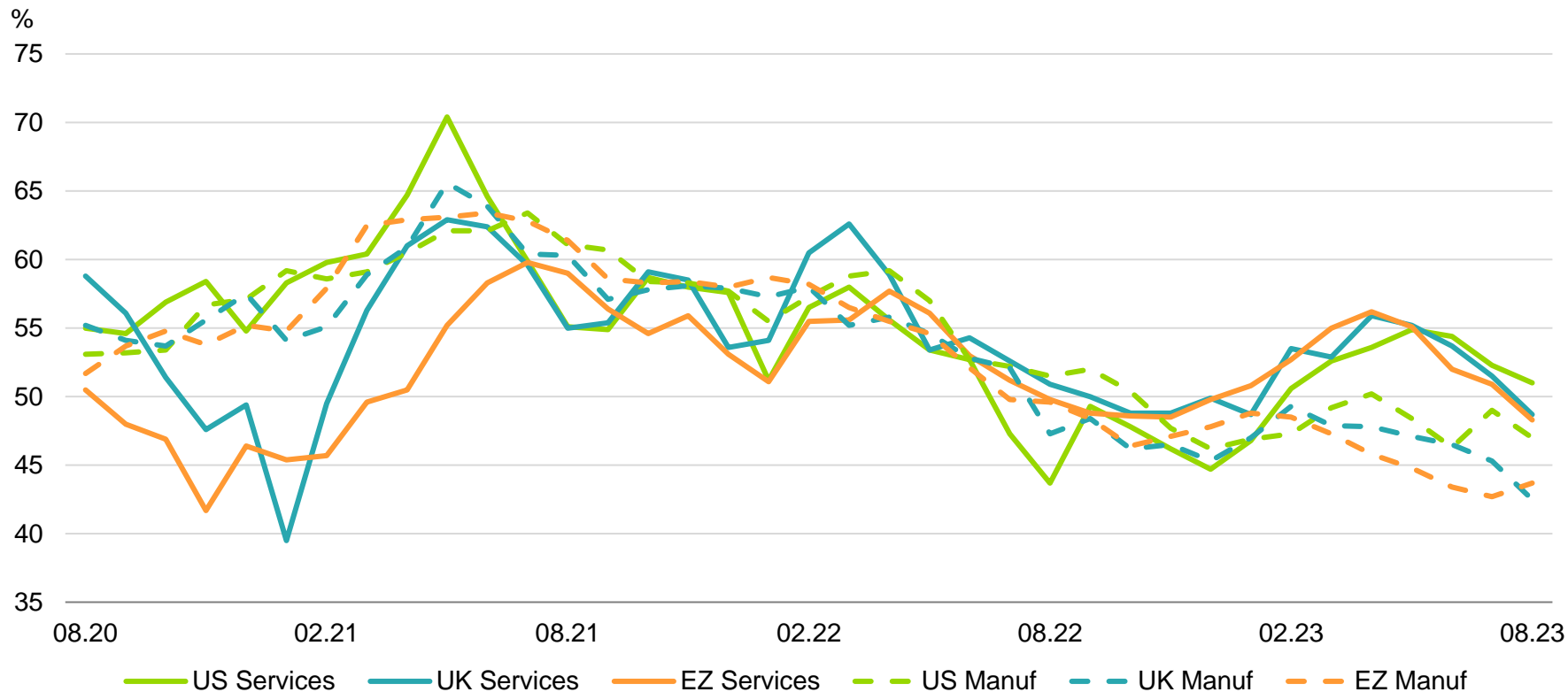
Non-farm payrolls

Thousand
1,000



Source: Bloomberg; 31 August 2023

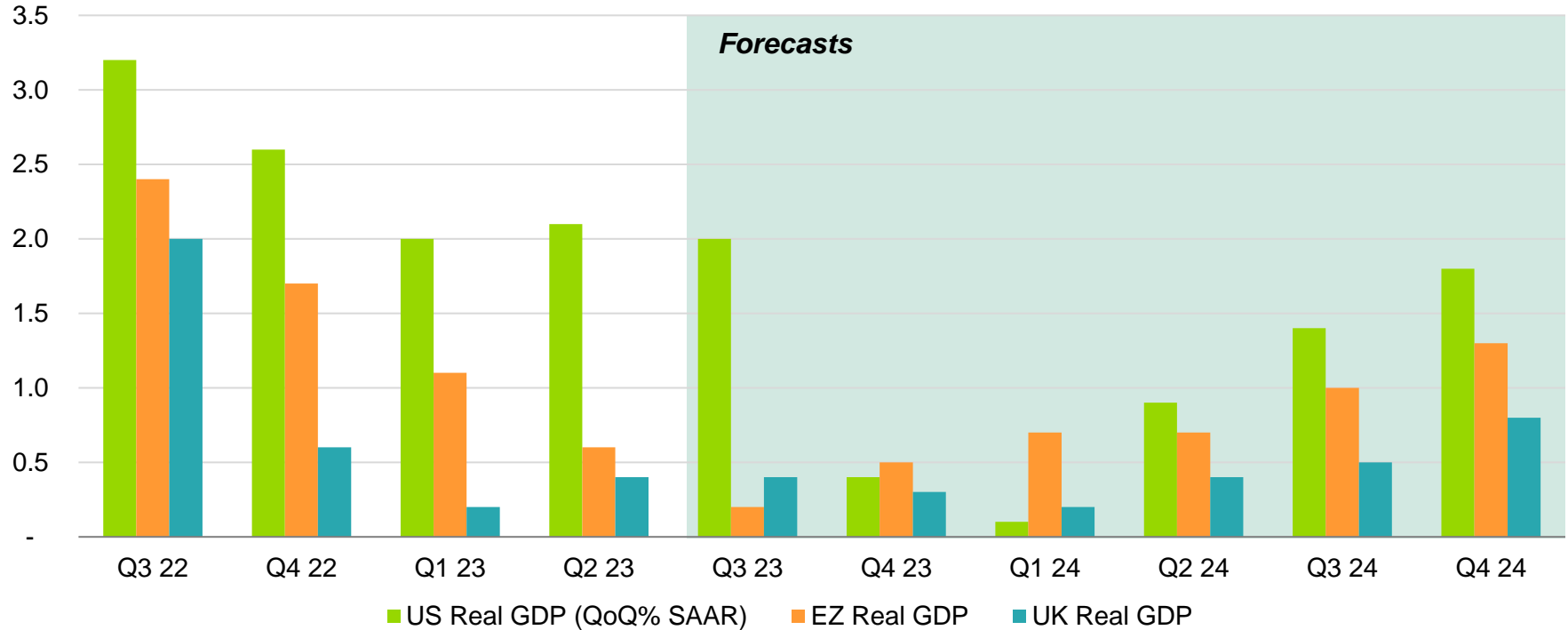
PMIs either weak or weakening



Source: Bloomberg; 31 August 2023

Despite this, “soft landing” expectations are growing

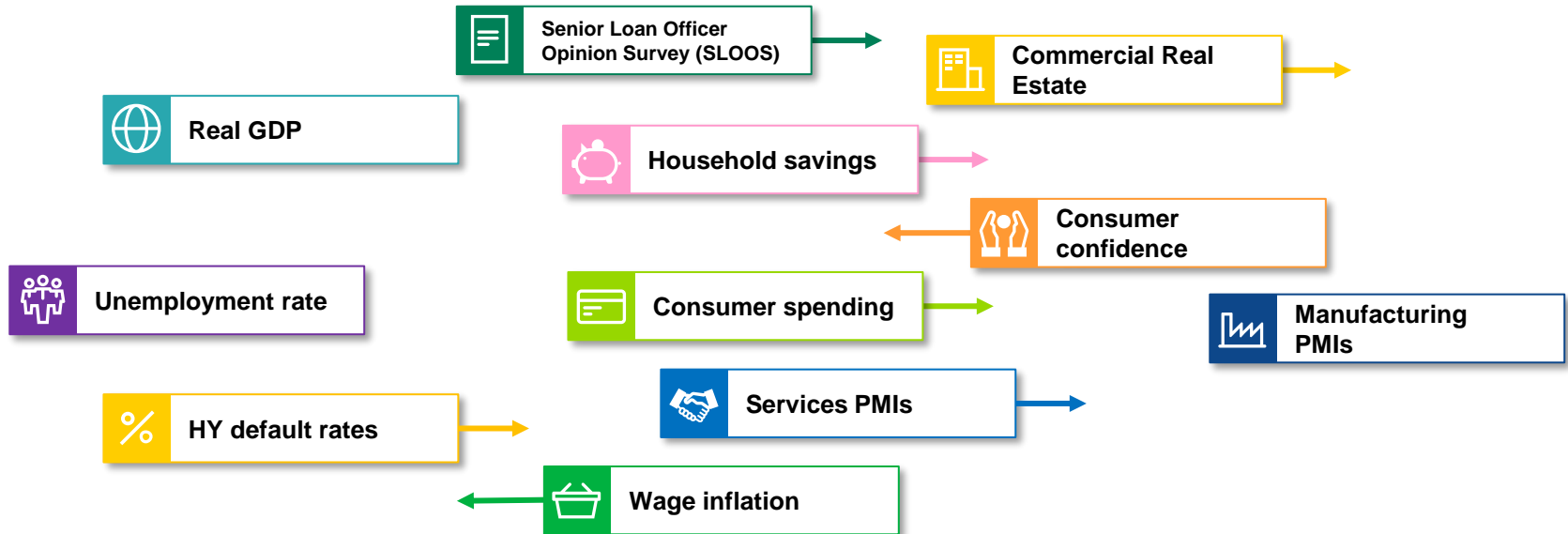
Real GDP expectations – Contributor Composite



Where will the economy “land”

Soft landing

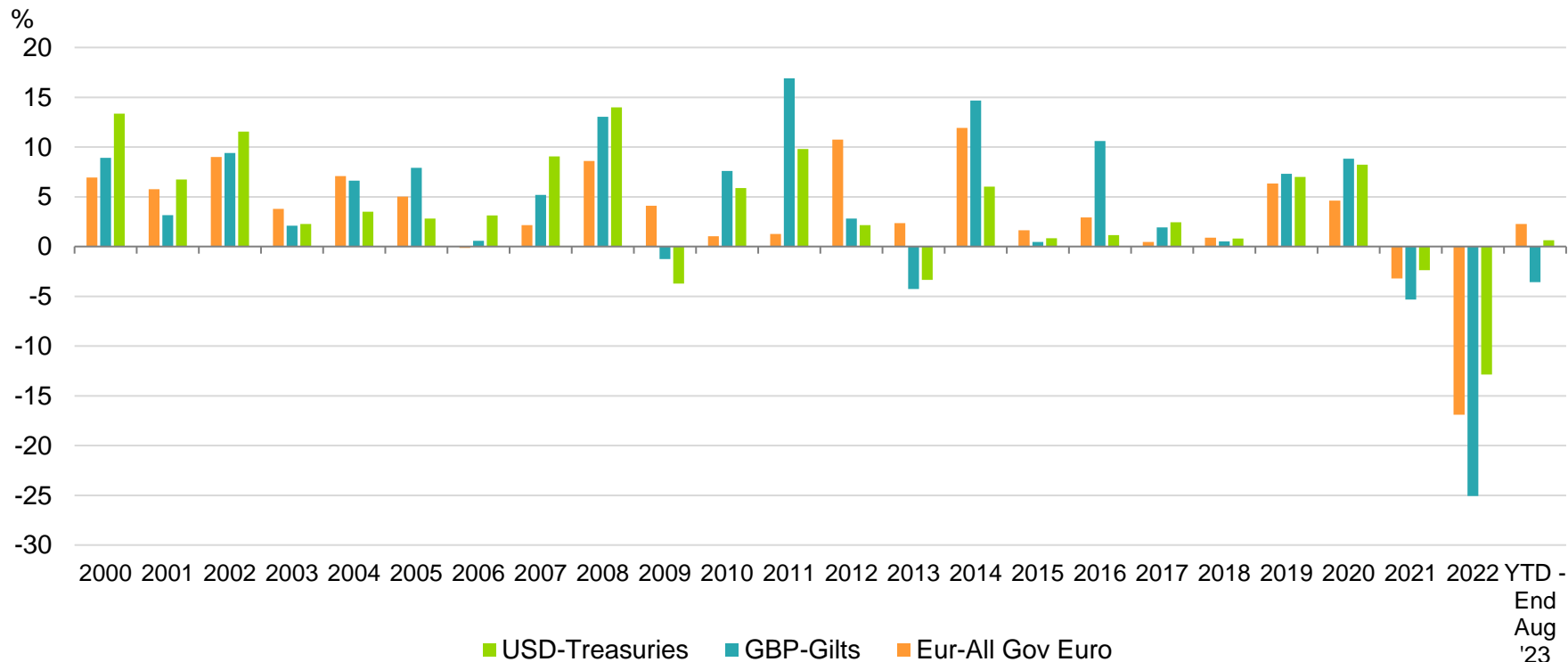
Hard landing



We are not yet half-way through yield curve lag – too soon to call

Government Bond indices – total returns (\$, £, €)

Total return (local ccy)

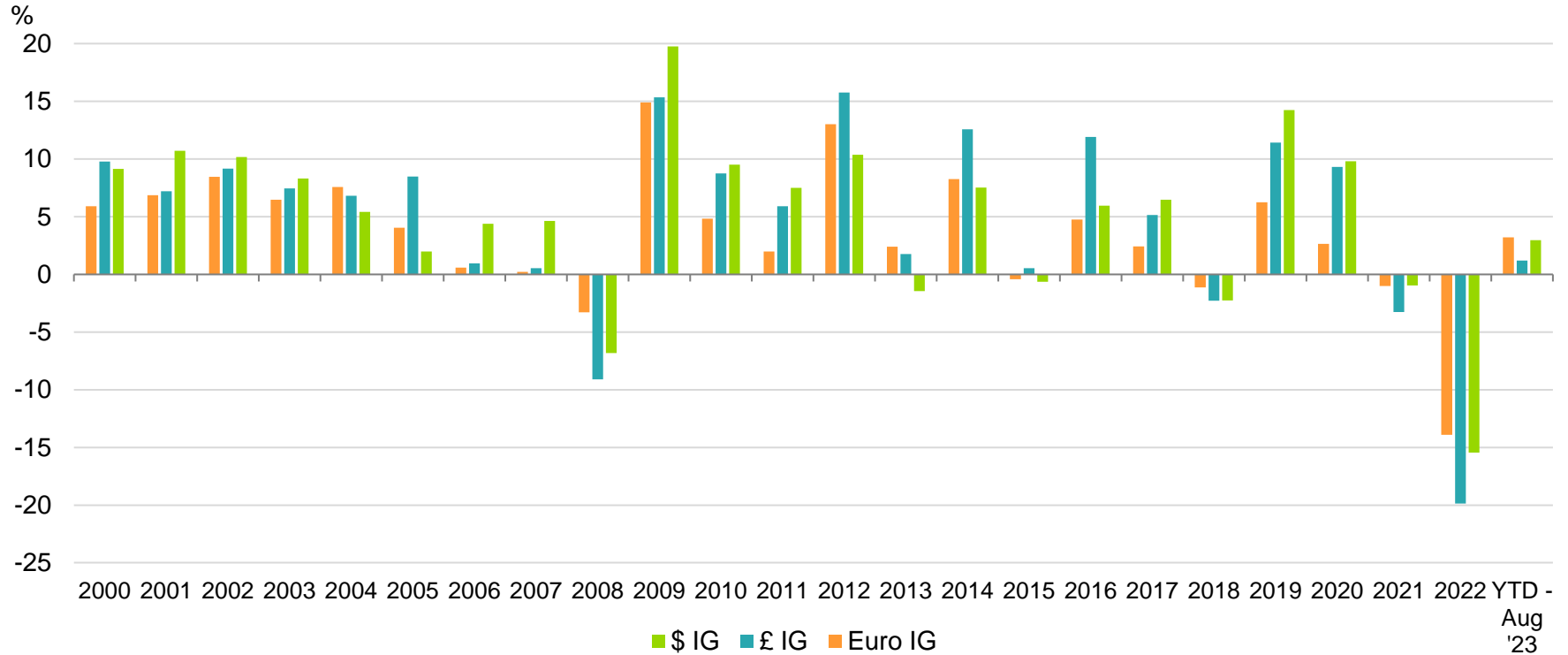


Past performance is not a reliable indicator of current or future performance. It is not possible to invest directly into an index and they will not be actively managed.

Source: Bloomberg; 31 August 2023

Investment Grade indices – total returns (\$, £, €)

Total return (local ccy)



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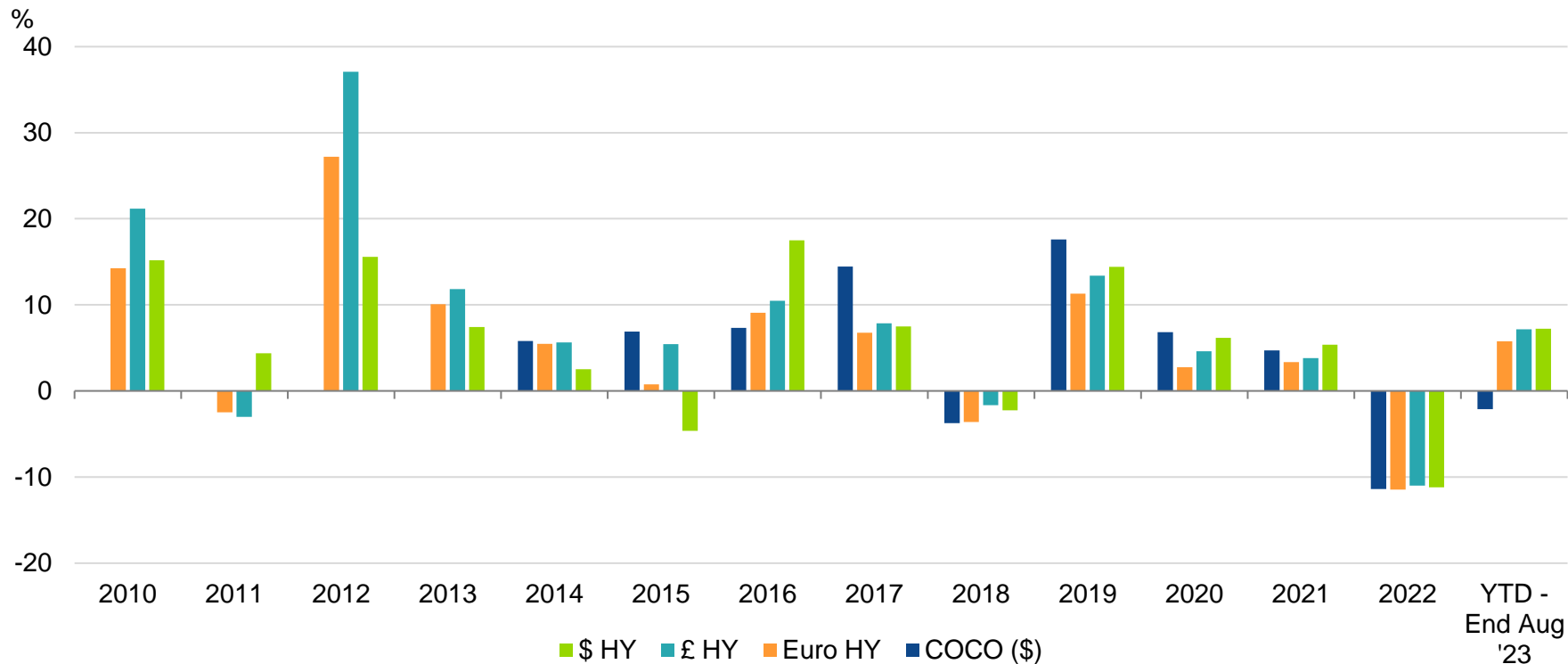
Source: Bloomberg; 31 August 2023

High Yield and COCO indices – total returns (\$, £, €)



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Total return (local ccy)



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Source: Bloomberg; 31 August 2023

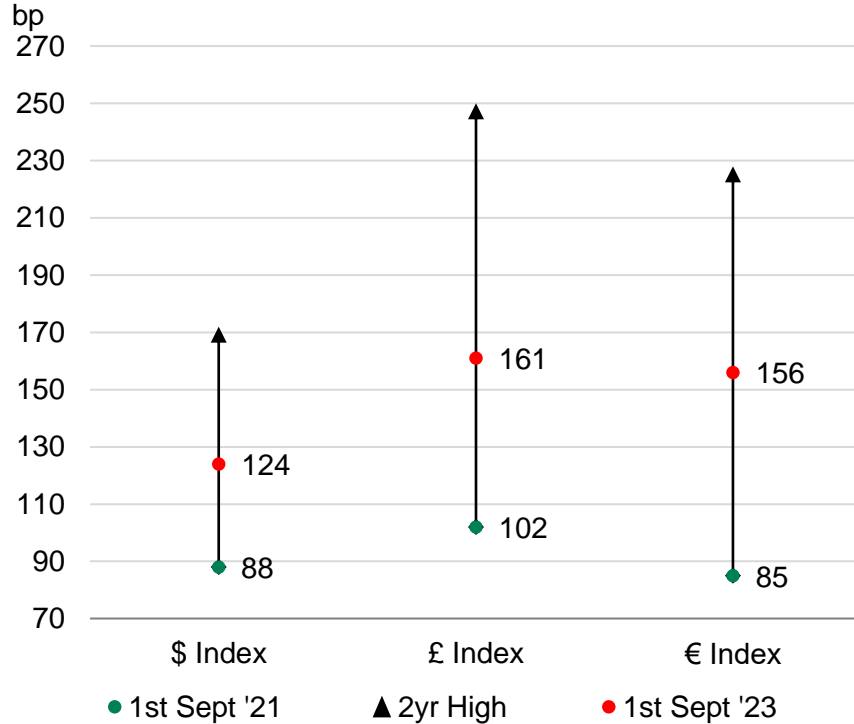
Fundamentals justifying performance?

- Resilience of the Fixed Income market, particularly HY, has surprised some investors this year
 - > Despite rates headwinds, US regional bank collapses, the collapse of CS and continuing geopolitical risks
- So far, helped by low refinancing requirements, HY markets have delivered attractive returns
 - > Rating agencies have remained constructive; the upgrade:downgrade ratio in Europe is positive for credit and only slightly negative in the US
- European banks have lagged, due to Rates headwinds and AT1 volatility following the CS collapse
- However, bank fundamentals and earnings have remained strong
 - > The Moody's upgrade:downgrade ratio is over 4x this year for Euro banks, compared to 0.5x for US banks

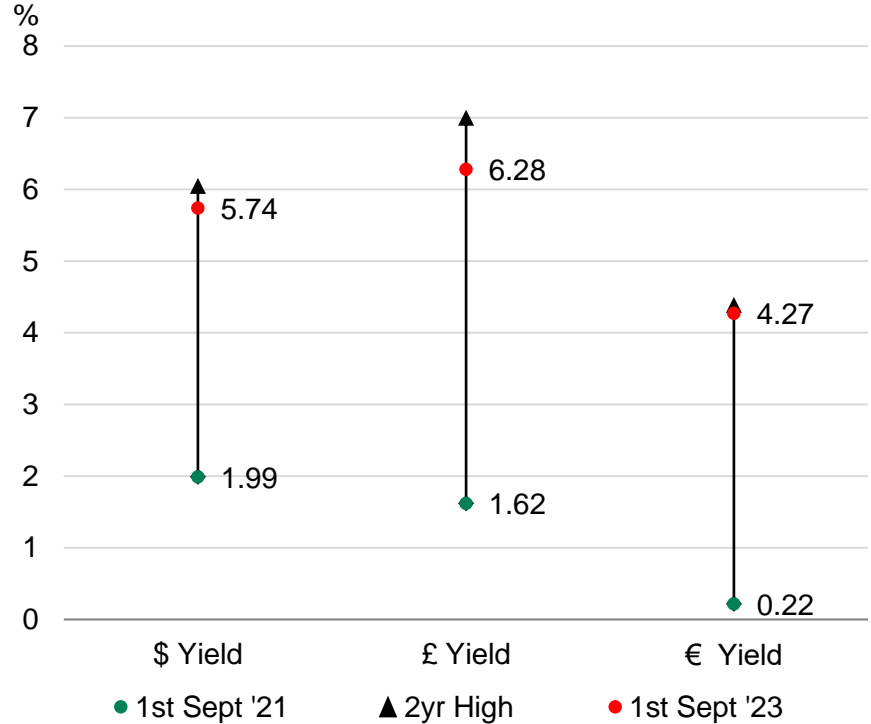
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IG spreads have tightened, yields remain very attractive

IG spread to worst



IG yield to worst

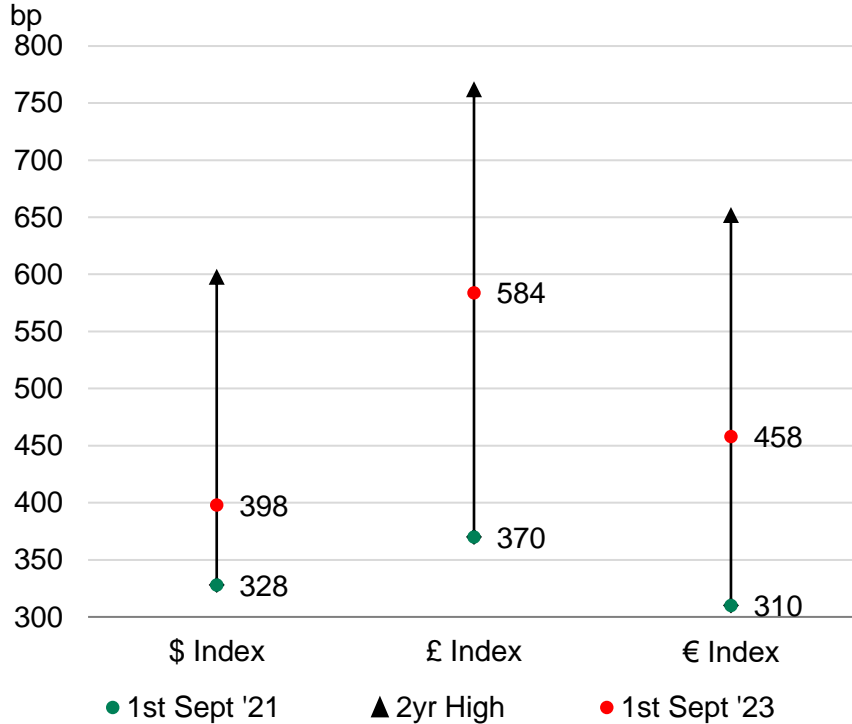


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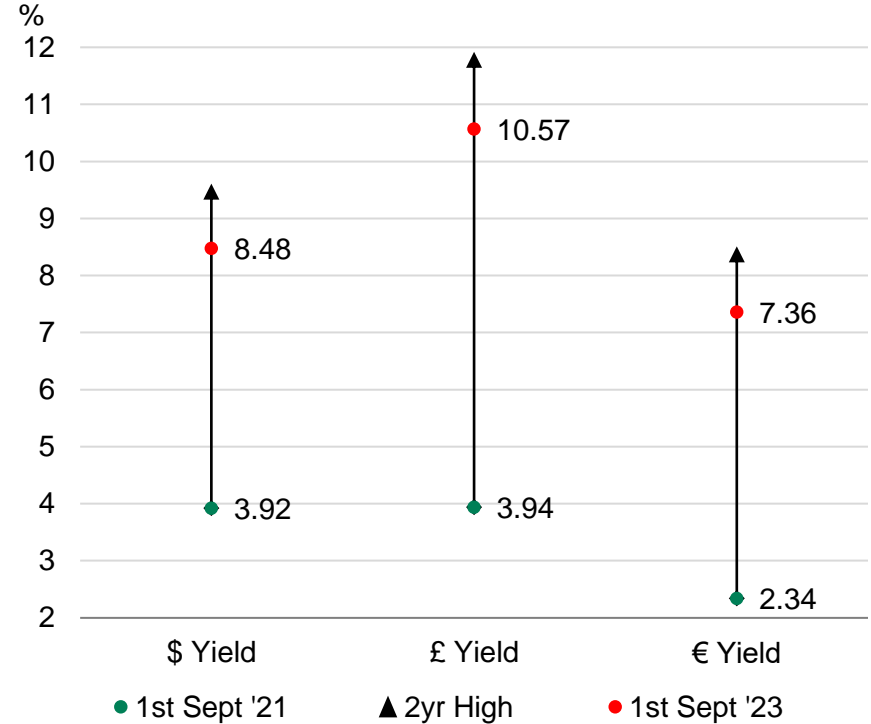
Data source: ICE Indices

Similar moves in High Yield

HY spread to worst



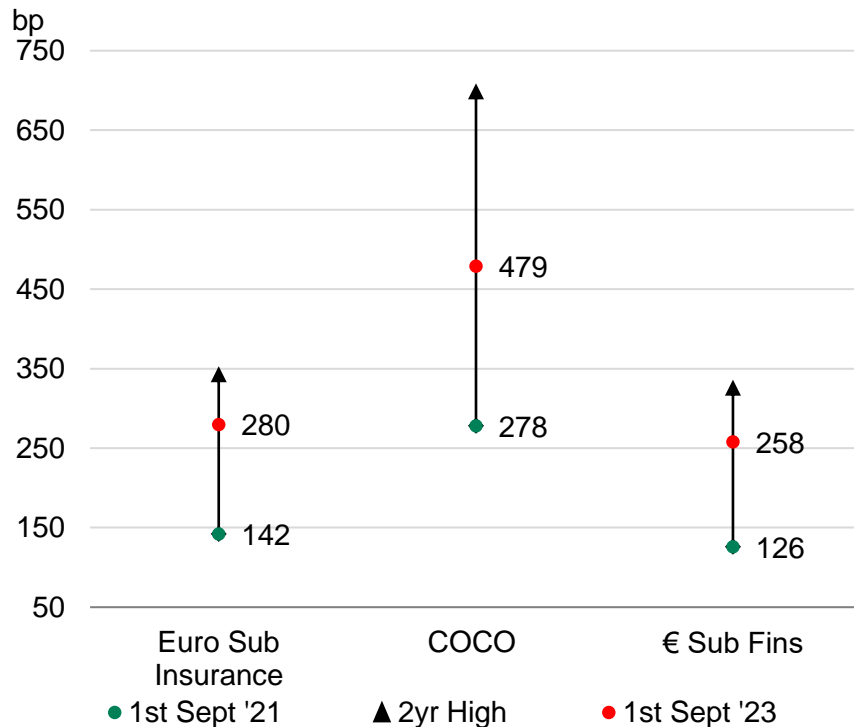
HY yield to worst



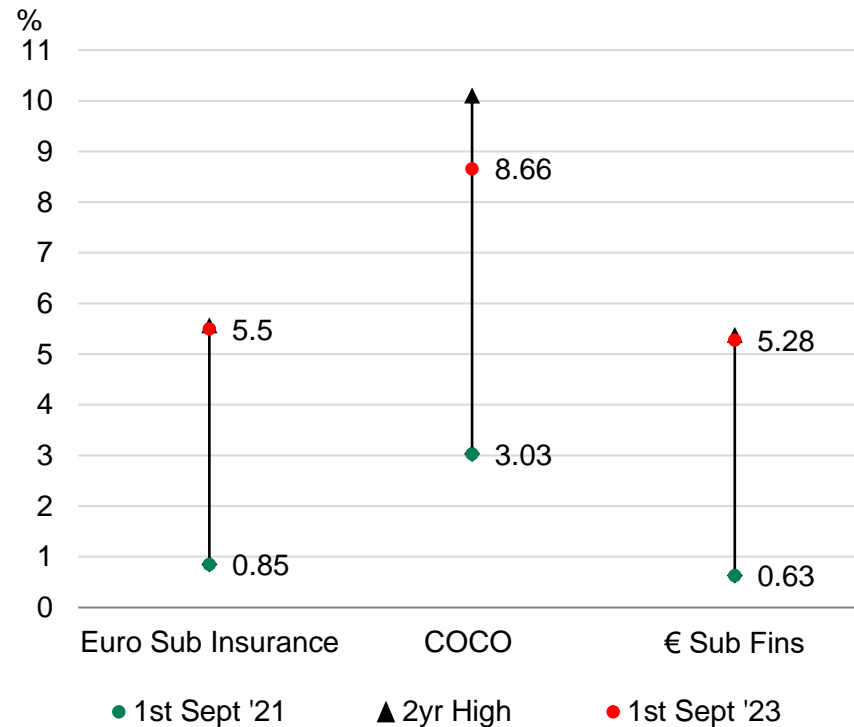
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Data source: ICE Indices

Banks and Insurance spreads and yields remain attractive

Financials spread to worst



Financials yield to worst

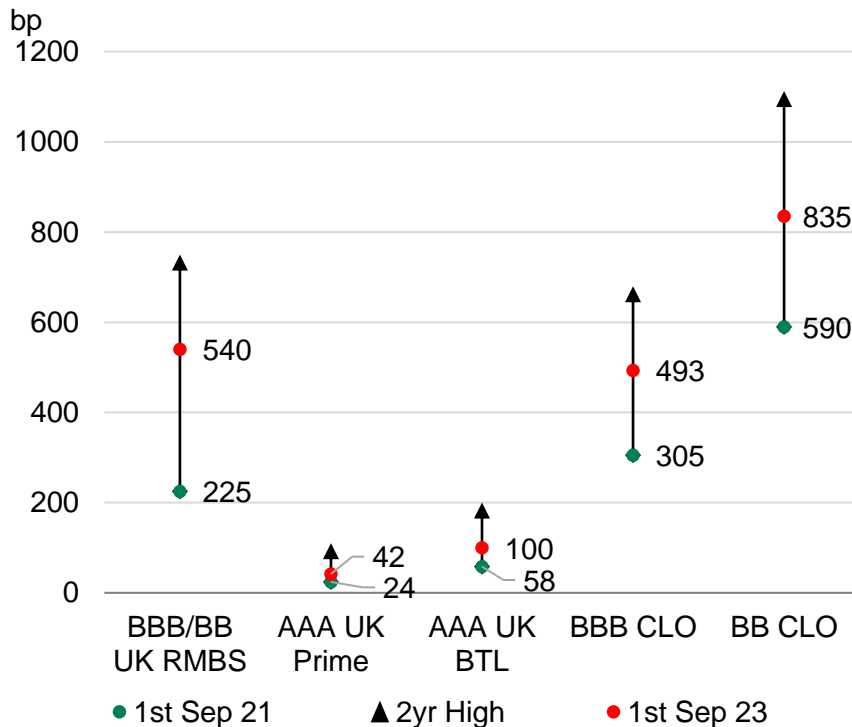


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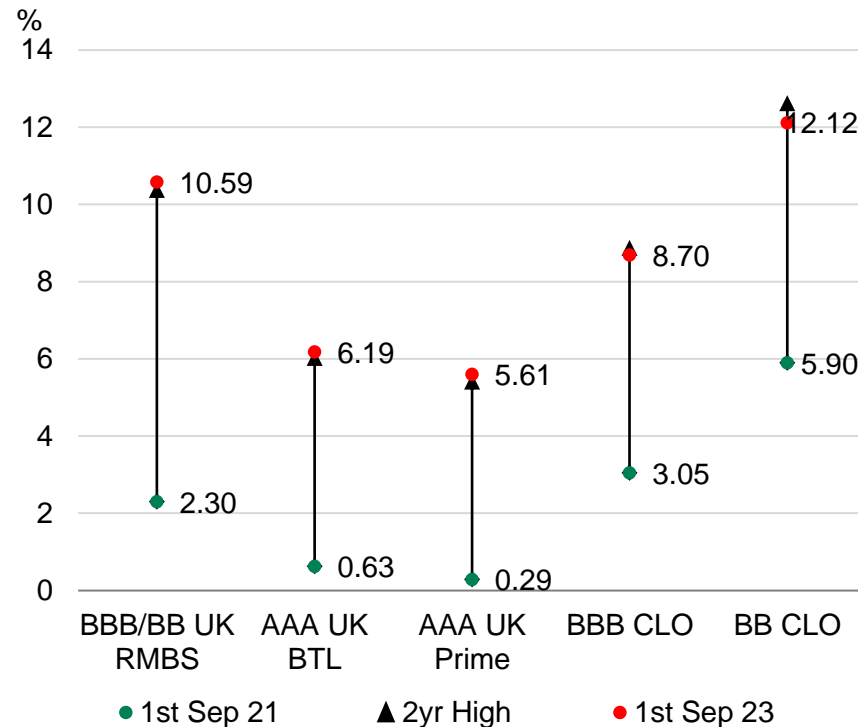
Data source: ICE Indices

Similar story in ABS & CLOs

ABS/CLOs spread



ABS/CLO yield

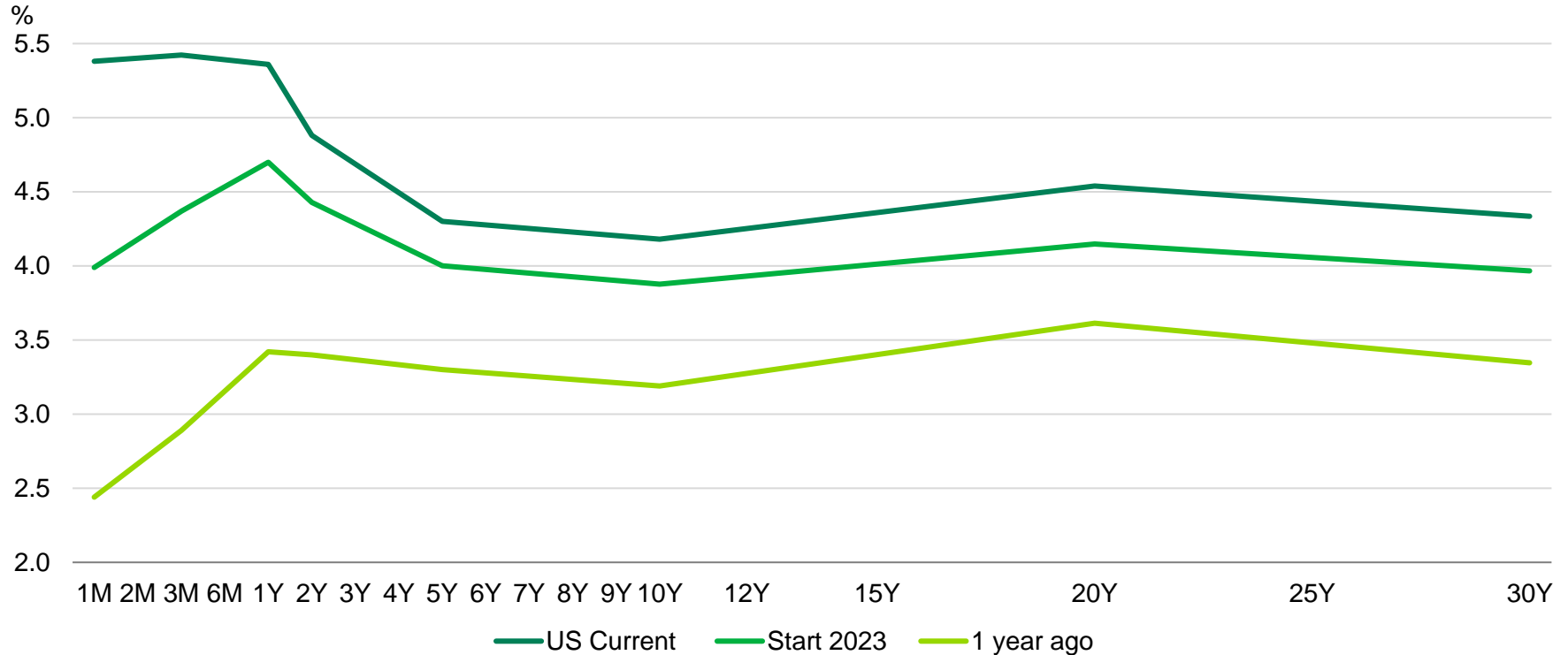


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Data source: Morgan Stanley Spread Data & CitiVelocity

Treasuries have continued to be a headwind

Treasury yield curve

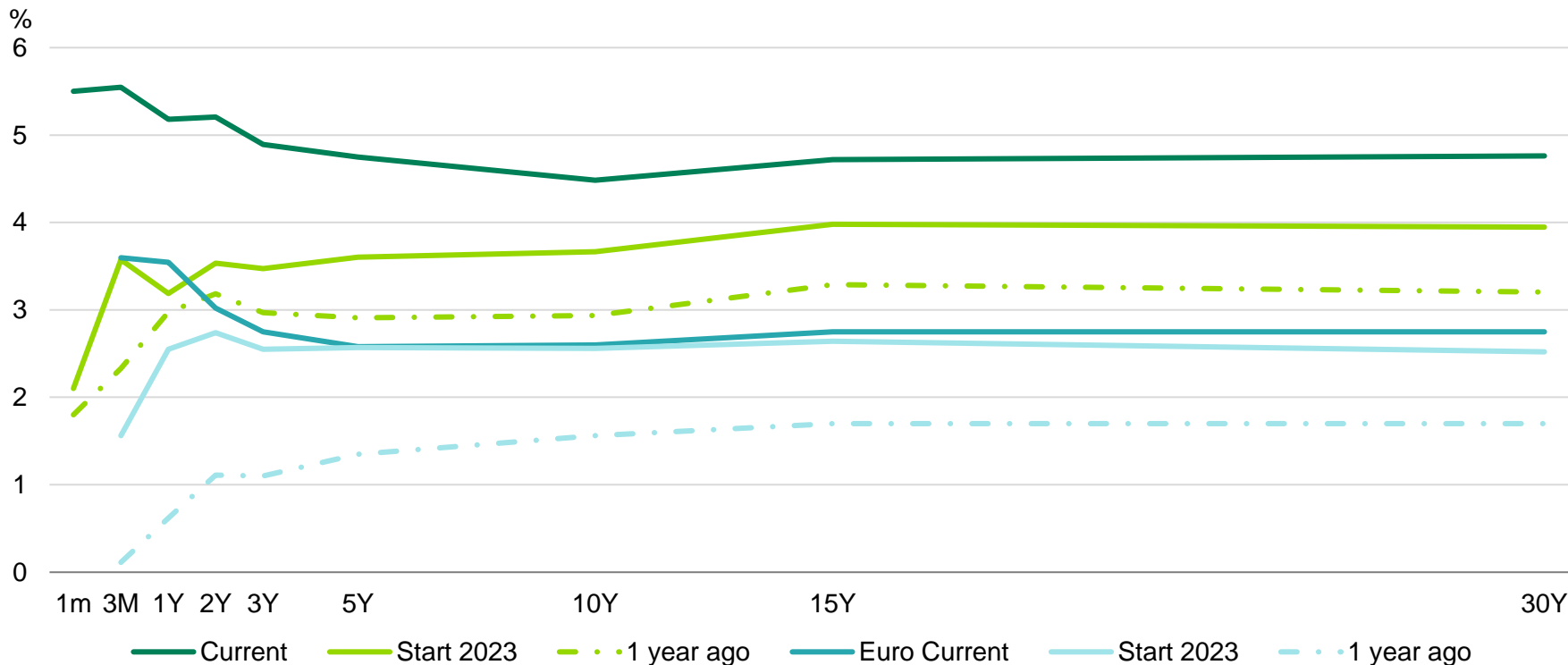


Gilt curve continued aggressive move higher this year



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UK and German curves

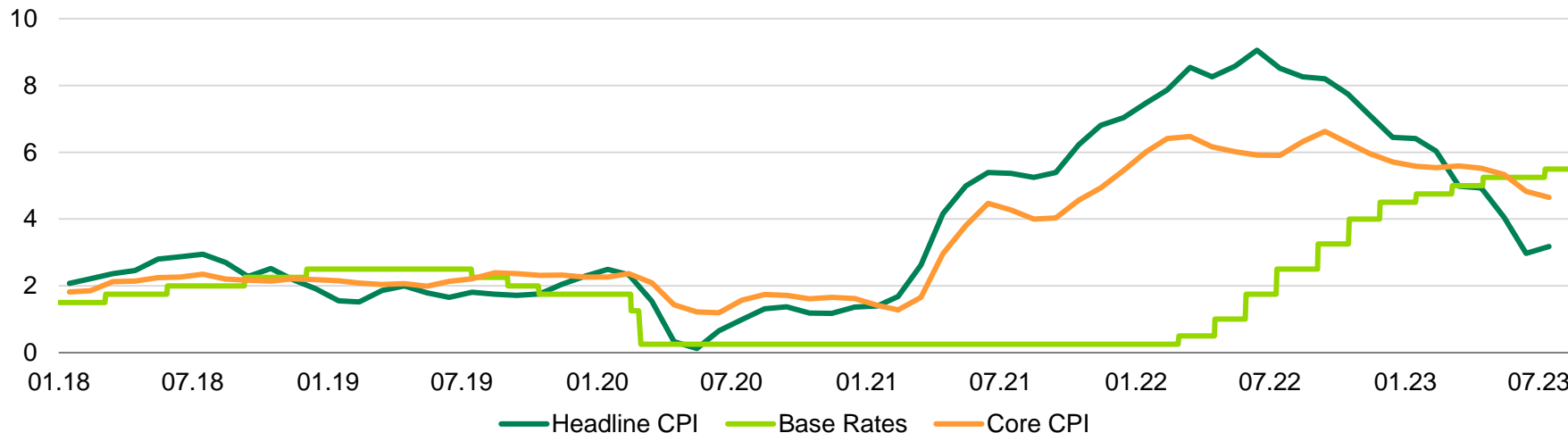


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Source: Bloomberg; 5 September 2023

Has the Fed been too hawkish?

- Inflation peaked 12 months ago, but the Fed has maintained their hawkish stance
- The “lag” seems to have been longer than in previous cycles, however, looking at previous hiking cycles, only in one instance would a recession have started by now
- The hawkish stance kept markets on side, and “higher for long” has been achieved



Quantifying the “lag”

- Excess US household savings were over \$2tr in mid 2021, now estimated to be closer to \$500bn
- Wage inflation has helped to protect workers, but it's beginning to soften in the US
- HY maturity wall is not impacting default rates significantly, but it is getting closer
- Most US mortgages are 30yr fixed rate, slowing the impact of rate hikes. Similar in the UK, but fixed rate mortgages are shorter term
- Only 20-30% of business debt in the US is floating rate, compared to approx. 70% in Eurozone, where rate hikes impact quicker
- Consumer facing businesses in the US are beginning to report falling sales numbers
- Credit card delinquencies are increasing, especially for smaller US banks
- Leverage loan default rates in the US and Europe remain low, at ~1.5%

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Macro drivers

01

Base rate hikes in the US should pause in our view – but how much damage has been done?

02

Markets are hopeful that the ECB is also close to ending its hiking policy – however, Core CPI is too high and seems very sticky

03

China has emerged from its Zero-Covid policy much slower than expected – this has had a negative impact on global demand and growth

04

Low unemployment and wage increases have helped to protect the consumer – is this ending?

05

Weakness in Commercial Real Estate could impact US regional banks – which could negatively impact lending

06

The resilience of the US economy has surprised, but it looks vulnerable to a negative shock

07

The length of the lag between policy and economic impact will become clearer

Positioning and outlook

- 01** We continue to **expect a “softish” landing**, but it's too early to completely discount a harder landing
- 02** At current yields, **Treasuries** provide **cheap insurance** against external shocks or negative surprise
- 03** Although spreads are not outright cheap in some sectors, **yields remain very attractive**
- 04** **Moving up the credit quality** curve as we enter late cycle **seems prudent**
- 05** **European banks’ bonds**, from Senior to Subordinated, look **attractive** on both a **spread** and **yield** basis
- 06** **ABS**, despite strong performance this year, continue to offer **very attractive risk-adjusted yield** opportunities
- 07** With the path of the global economy uncertain, **flexibility and liquidity remain essential**

Fixed Income yields offer a compelling value opportunity for investors

What could the future hold?



**Yields are attractive in
Fixed Income**



**Close to peak base rates, we
expect cuts in 2024**



**We expect inflation to continue
to move towards target**



**Late cycle economy
is vulnerable to an
external shock**



**We expect below trend GDP
growth, but not a hard landing**



**Ultimately, high starting
yields should reward
medium term investors**

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