PIMCO

# Fixed Income: Investing in Volatile Markets

Mutual Fund Directors Forum

September 2022

**IMPORTANT NOTICE**
Please note that the following contains the opinions of the manager as of the date noted and may not have been updated to reflect real time market developments. All opinions are subject to change without notice

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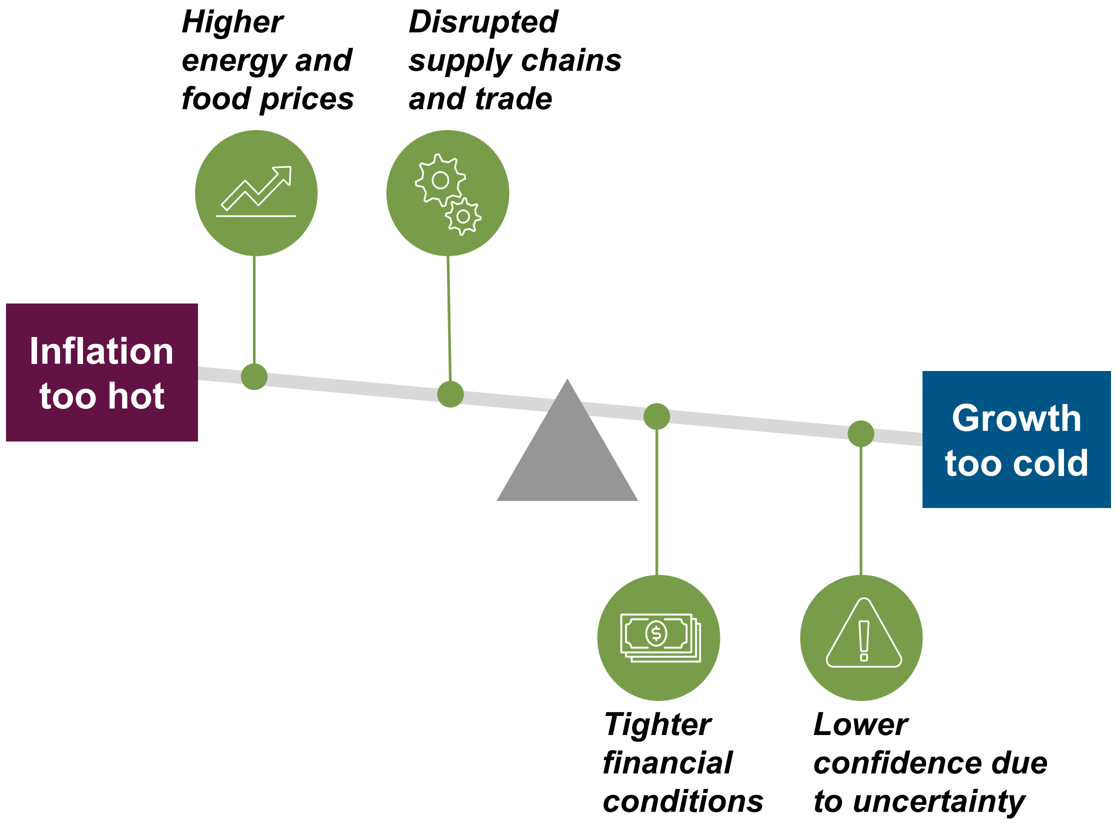
# Market Environment

# *Cyclical Outlook:* Anti-goldilocks

A global economy where inflation becomes “too hot” and growth “too cold”




## Key Highlights

- Uncertainty clouds the outlook
- Expect greater dispersion
- Central Banks focused on fighting inflation over supporting growth
- PIMCO strategies favor portfolio flexibility and liquidity

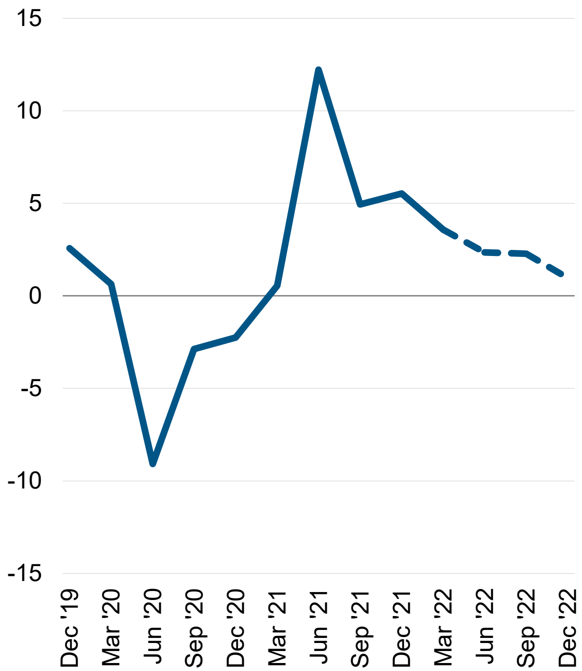
***Active management may help investors navigate an economy where inflation becomes “too hot” and growth “too cold”***

**For illustrative purposes only.** Source: PIMCO.
Refer to Appendix for additional outlook and risk information.

# Cyclical Outlook: “Anti-Goldilocks” backdrop and elevated recession risks

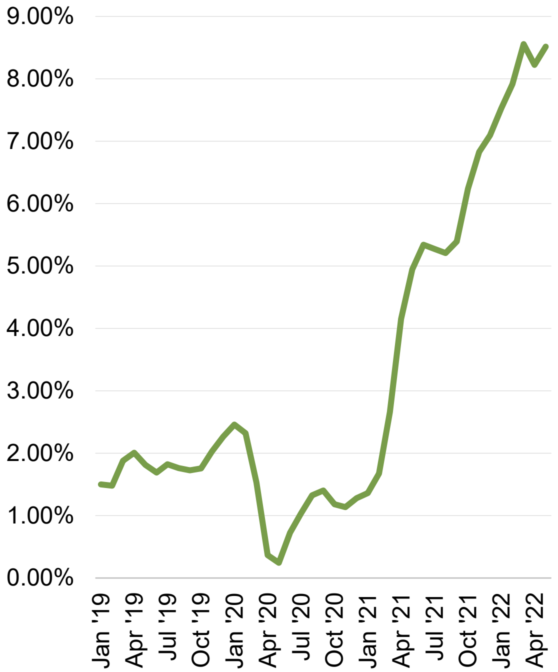
**Activity too cold**

US real GDP



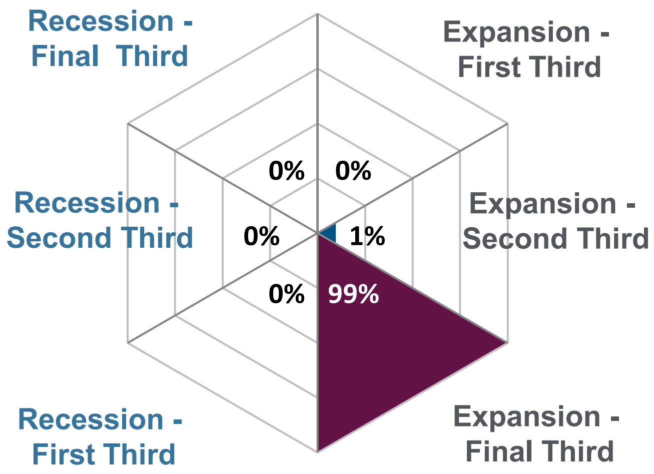

**Inflation too hot**

US headline CPI y/y




**Recession risk elevated**

Stylized business cycle model

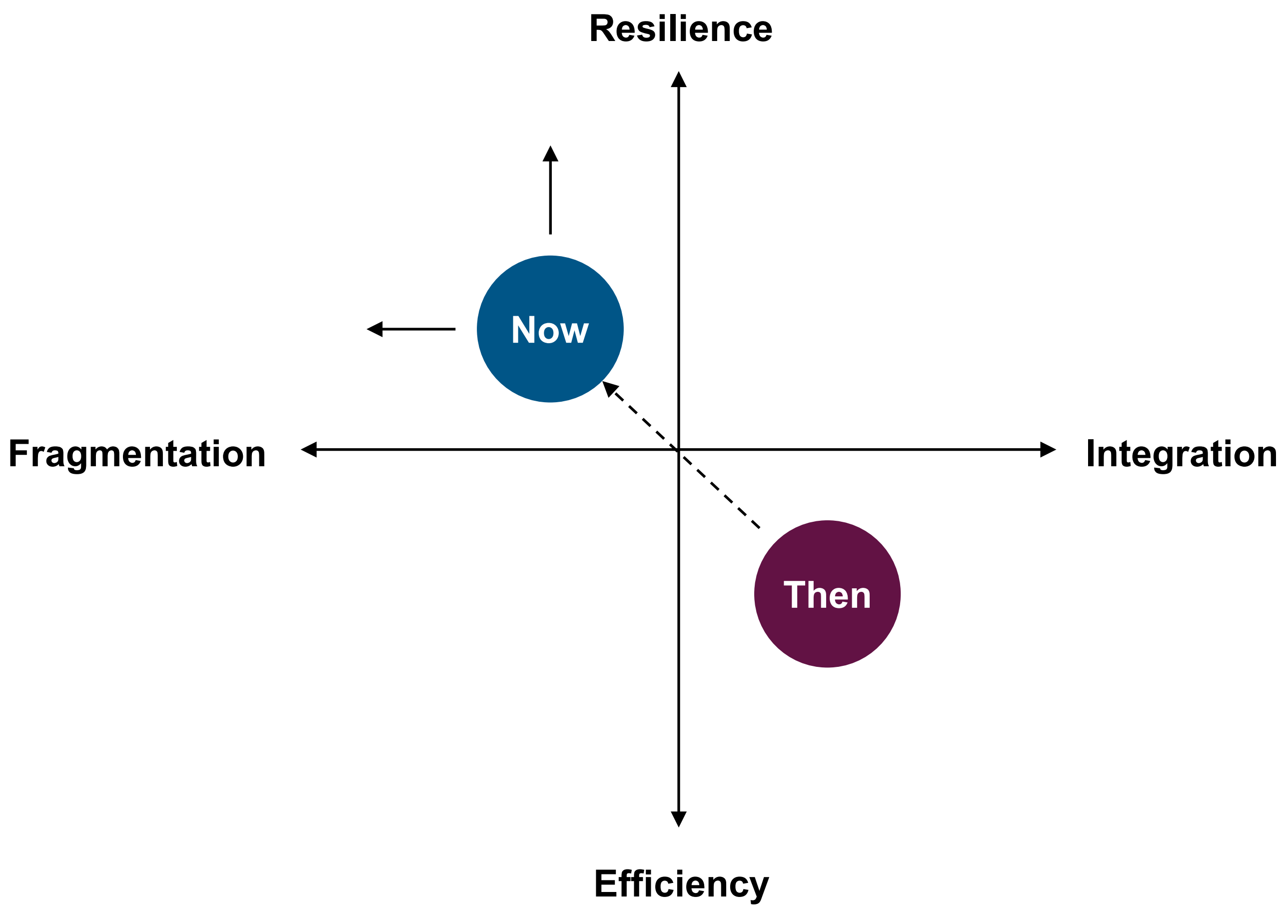



**For illustrative purposes only.** As of June 2022. SOURCE: PIMCO

The dynamic factor model (DFM) divides the business cycle into six phases; for example, 2T (second third) expansion is the mid-cycle expansion phase. The model incorporates a set of underlying factors with the potential to drive economic growth and assumes various economic time series are realizations of these factors with varying time lags. We estimate these factors based on 750 U.S. time-series variables covering a wide range of phenomena, including growth and its components, inflation components, labor market data, surveys, housing statistics, banking data, interest rates, asset price series, and more.

Refer to Appendix for additional outlook and risk information.

# 2022 Secular Outlook: Reaching for Resilience



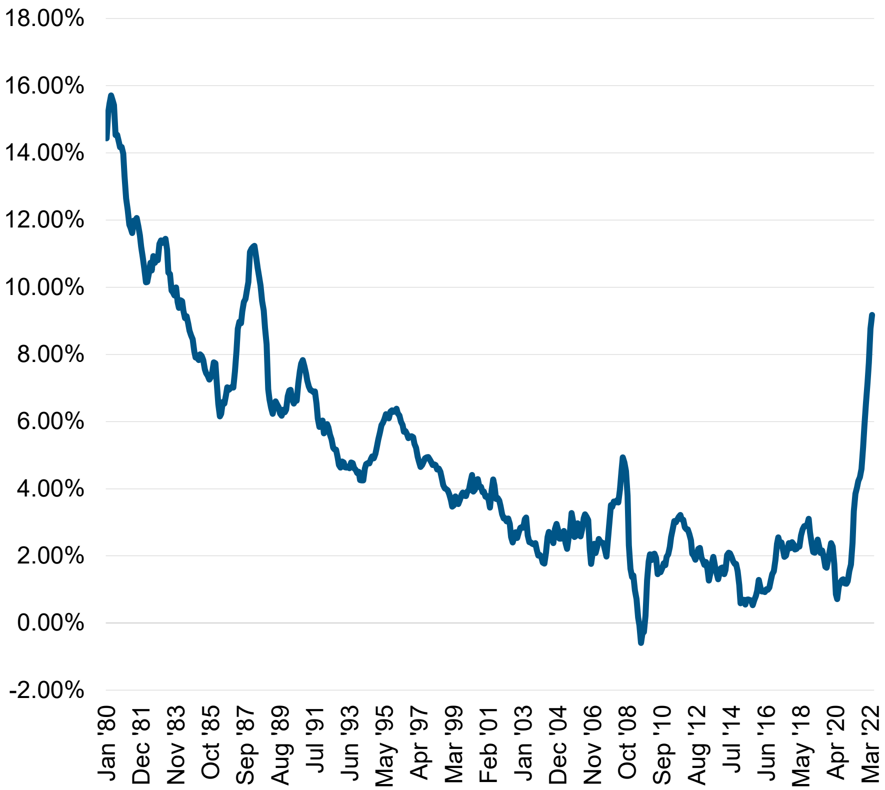

| We believe: |
| --- |
| Risks of deglobalization and fragmented capital markets are heightened |
| Volatility, inflation, and geopolitical strain have countries and businesses focusing on defense |
| There is an elevated risk of recession over the next two years |
| Investors should reach for portfolio resilience instead of reaching for yield |
| Fixed income investments, will play an important role for diversification |

As of June 2022. Source: PIMCO
Refer to Appendix for additional outlook and risk information.

# Expect a different monetary and fiscal policy response in the next downturn

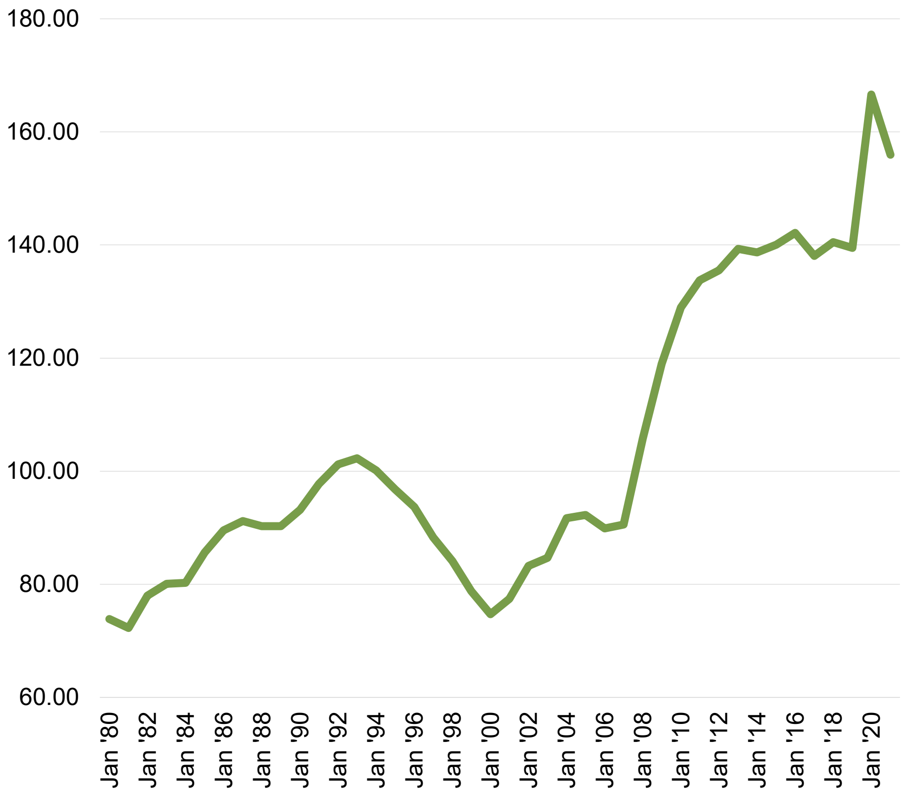
**High inflation may make policymakers hesitate to revisit fiscal tools in the next downturn**

**OECD CPI Y/Y**




**Government debt levels and central bank balance sheets are bloated**

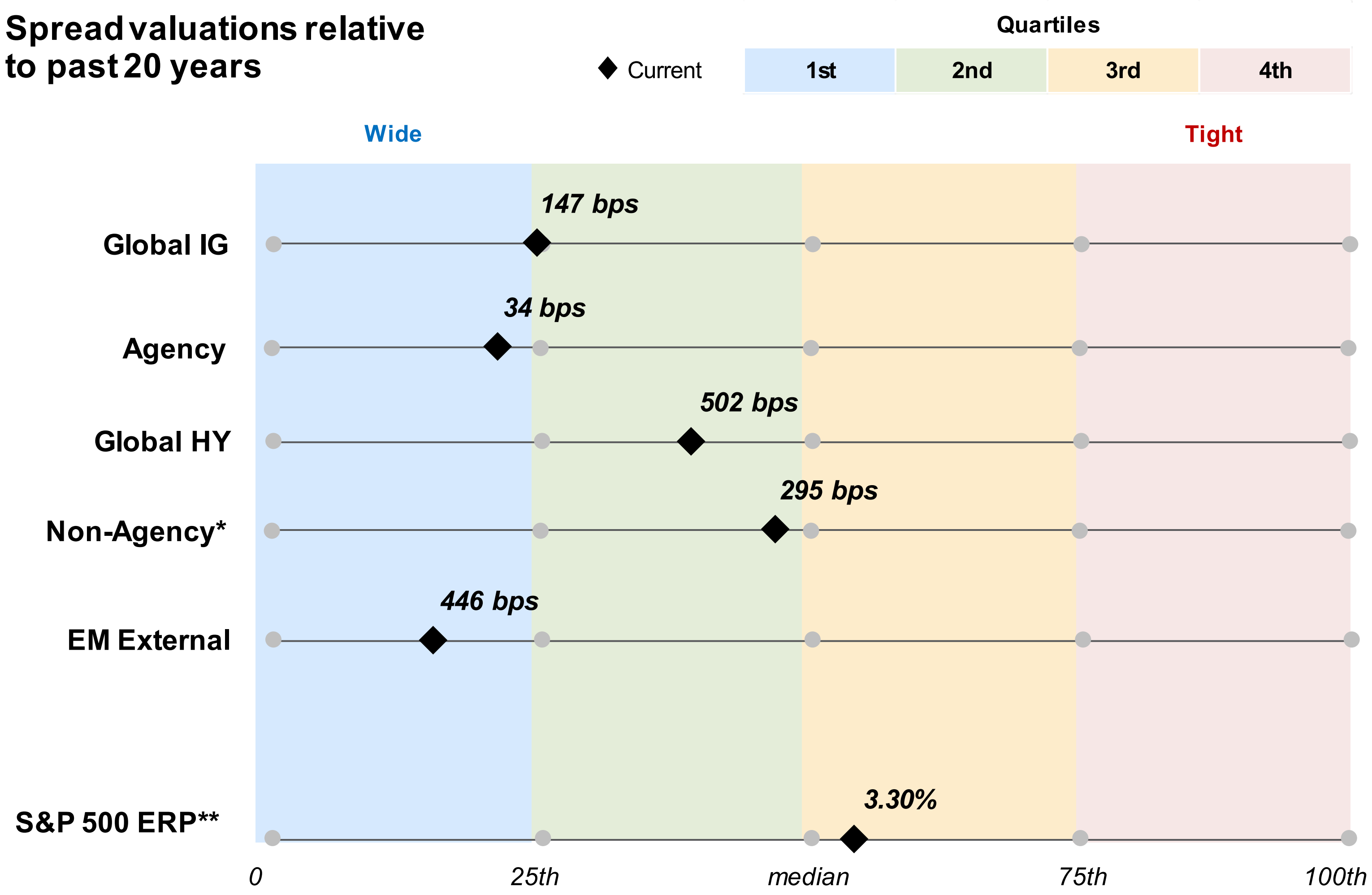
**US Debt to GDP (%)**




As of June 2022. Source: Haver.
Refer to Appendix for additional outlook and risk information.

# Why Now

# Dispersed valuations reinforce the importance of active management and selection




As of 31 July 2022. SOURCE: PIMCO, Bloomberg

Valuations using data over last 20 years or relative to the period from index inception to as of date. Global IG = BBG Global Agg Credit Avg OAS, Global HY = Ice Bofa DM Constrained Index, EM External = JPM EM Bond Index Global Sovereign Spread, Agency MBS =PIMCO Current coupon Rich/Cheap

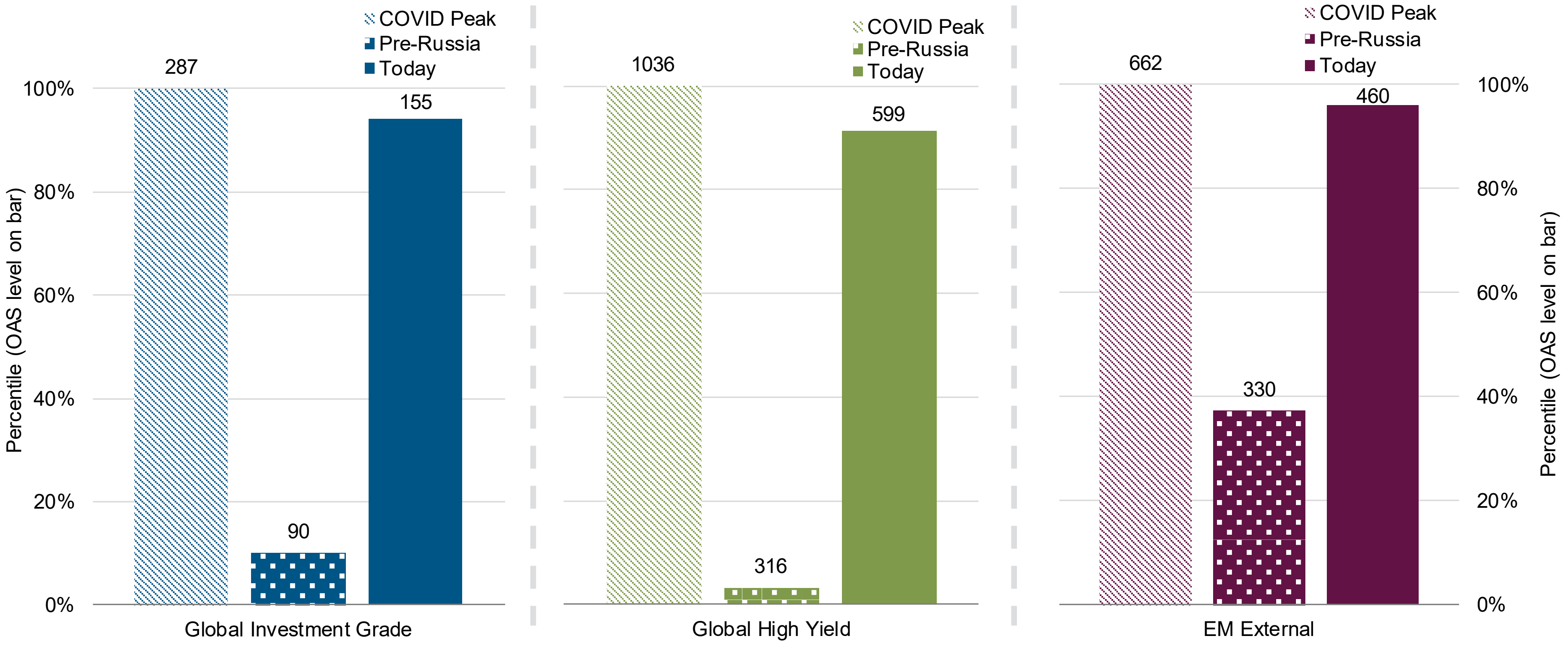
*Non-Agency data goes back to the start of 2011 and is LCF subprime data from ICE BAML US Securitized Products Spreads.

**The S&P 500 Equity Risk Premium (ERP) is 10y Cyclically Adjusted Earnings Yield (1/ CAPE) minus the 10y real yield.

Refer to appendix for additional index, OAS, and risk information.

# Spreads are above their post-pandemic tights

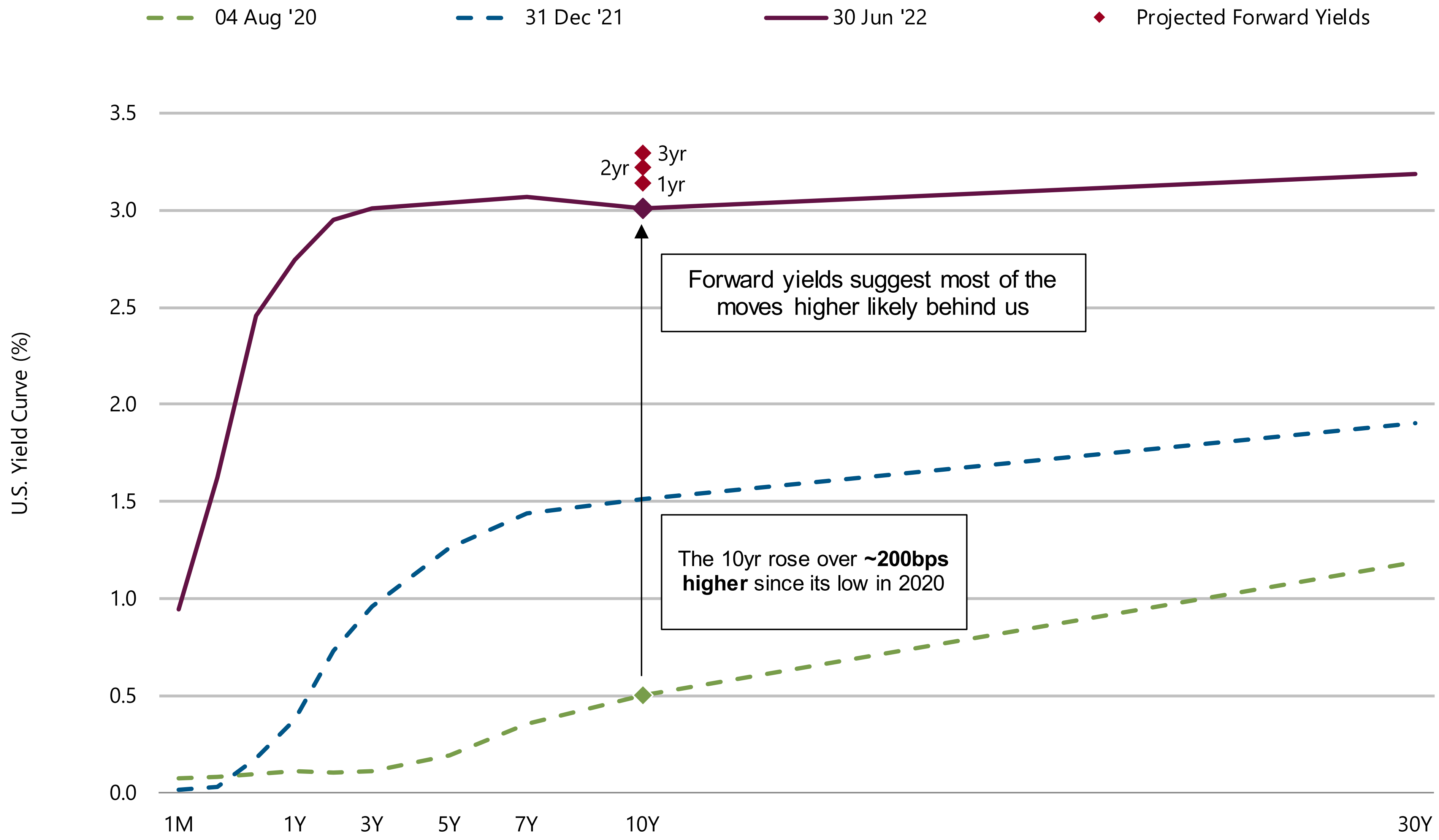
## Current Spread Percentile relative to the last ten years




As of 30 June 2022. SOURCE: Bloomberg, ICE BofA Merrill Lynch, JP Morgan. **For illustrative purposes only.**
Historical levels based on last ten years of daily data (starting April 2012). Spread refers to Option Adjusted Spread (OAS). OAS shown is versus treasuries
Benchmark: Global IG is represented by the Bloomberg Global Aggregate Credit Index, Global High Yield is represented by the ICE BofA ML Developed Market High Yield Index (HYDC), EM External is represented by the JPM EMBIG Index
Refer to Appendix for additional index, OAS, and risk information.

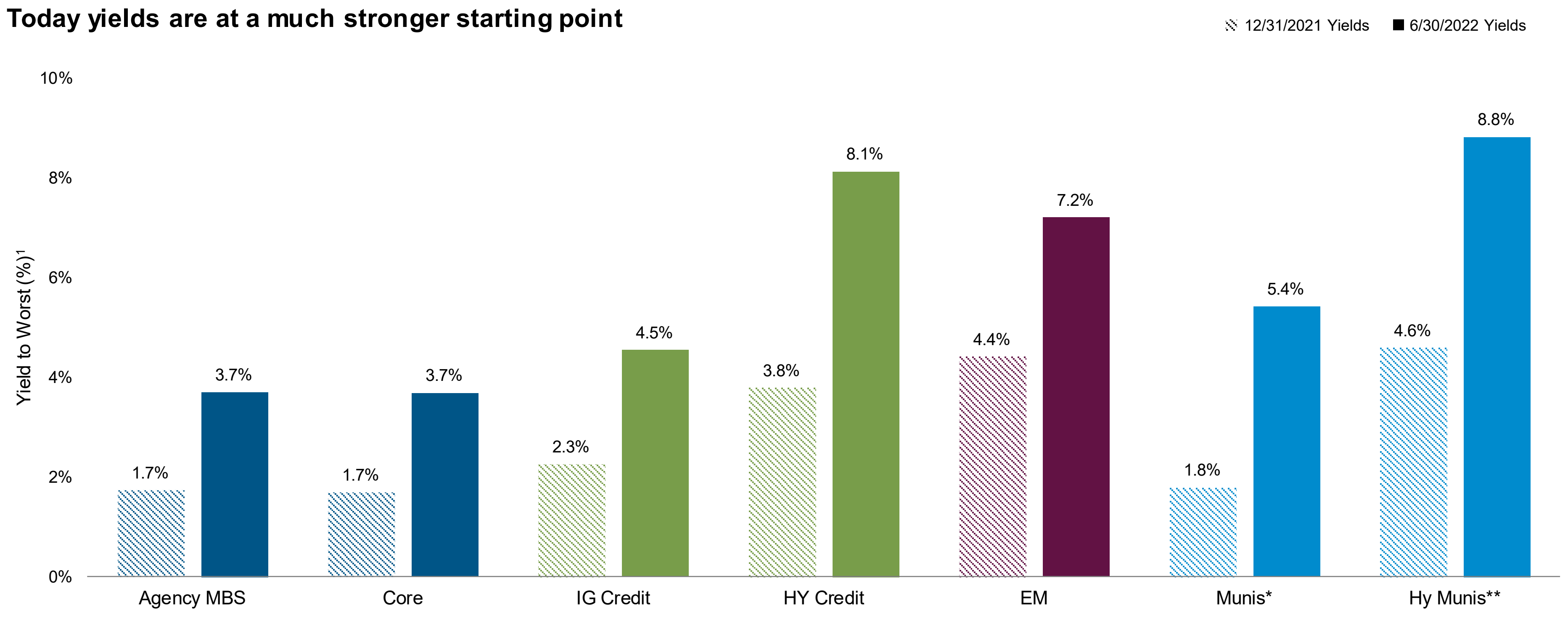
# Dramatic rise in the yield curve, but projected forward yields suggest moderation at the long-end

## Improving forward-looking total return potential for portfolios




As of 30 June 2022. Source: PIMCO, Bloomberg.
Refer to Appendix for additional forecast, outlook and risk information

# Starting yields across asset classes look more attractive after the recent repricing of the yield curve



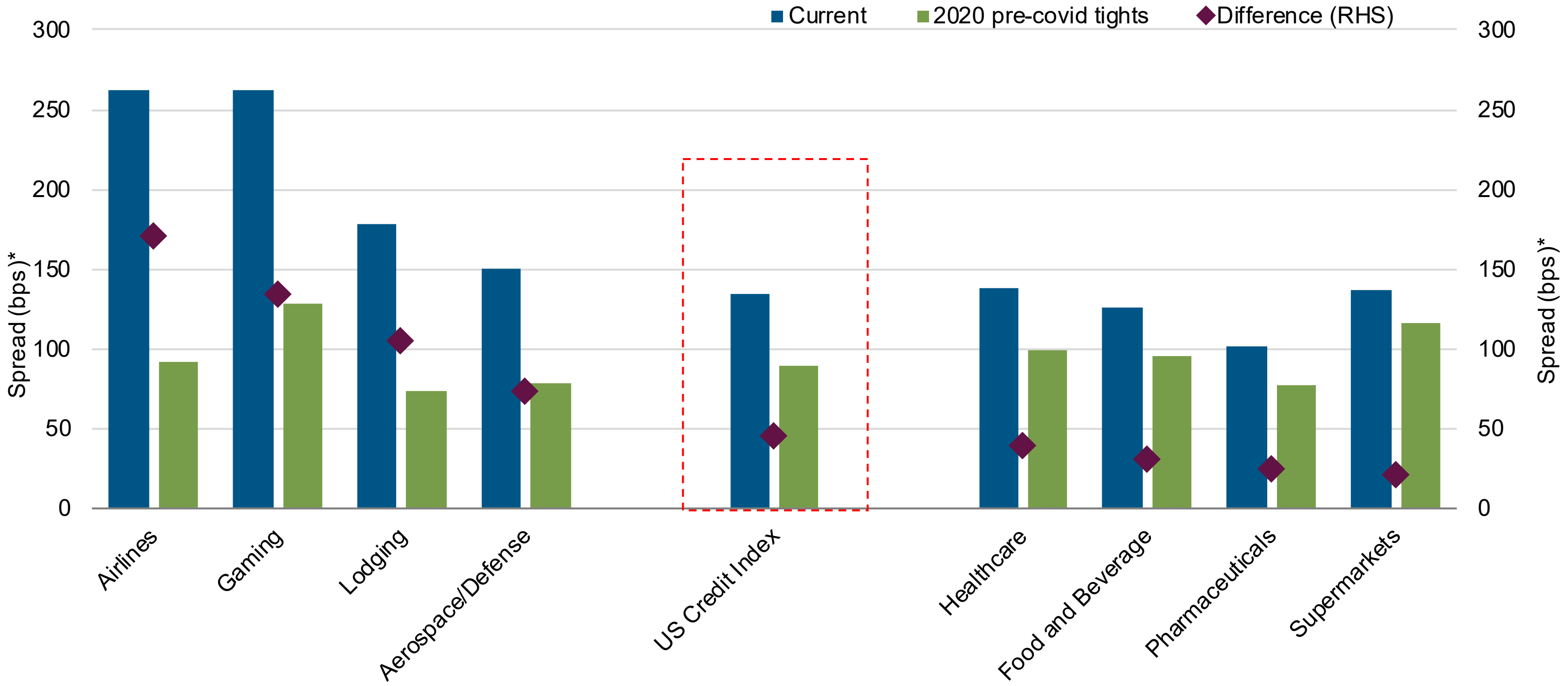

**YTD Change in Yields (bps)**

| Agency MBS | Core | IG Credit | HY Credit | EM | Munis* | Hy Munis** |
|---|---|---|---|---|---|---|
| +196 | +200 | +229 | +435 | +279 | +363 | +424 |

As of 30 June 2022. SOURCE: Bloomberg, PIMCO.
Index proxies for asset classes displayed are as follows: Bank Loans: CS Leveraged Loan Index (incept: 12/31/91 ), Agency MBS: Bloomberg MBS Fixed Rate Index (incept: 1/30/76), Munis: Bloomberg Municipal Bond Index (incept: 1/30/80), HY Munis: Bloomberg HY Muni Bond Index (incept: 5/22/03), Core: Bloomberg U.S. Aggregate (incept: 1/30/76), HY Credit: ICE BofA US HY BB-B Rated Index (incept: 12/31/96), EM: JPMorgan EMBI Global (incept: 12/31/93), IG Credit: Bloomberg US Credit Index (incept: 1/31/73), US Prefs: ICE BofA ML Fixed Rate Preferred Index (incept: 3/31/89)
* Municipal yields are the taxable equivalent yield, adjusted by the highest marginal tax rate (40.8%). Unadjusted IG Muni index yield is 3.2% with a YTD change of 210 bps, the unadjusted HY Muni Index yield is 5.3% with a YTD change of 219 bps. ** HY Muni index data starts in 6/30/2003.
[1] The yield to worst is the yield resulting from the most adverse set of circumstances from the investor's point of view; the lowest of all possible yields.
Refer to Appendix for additional index, outlook, and risk information.

# The recovery trade in corporate credit: Select resilient credits in travel & leisure have further upside to a reopening of the economy

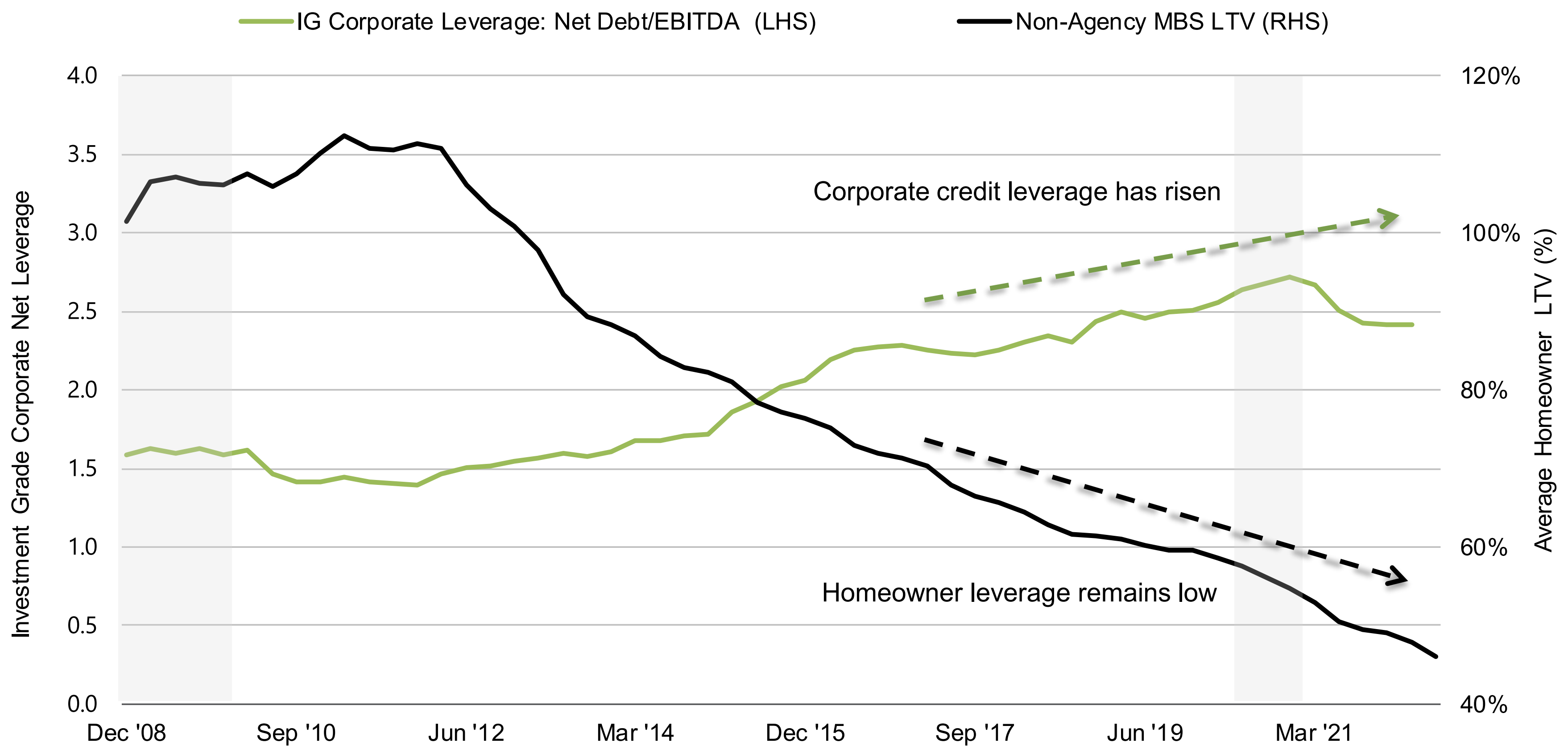
- Investment grade credit indices have largely recovered from the COVID-19 sell-off, but sector dispersion remains high
- Hardest-hit sectors may be poised to outperform and offer further upside, particularly among more resilient issuers that have ample liquidity




As of 31 July 2022. Source: Barclays.
* Option Adjusted Spread relative to treasuries.
**Past performance is not a guarantee or reliable indicator of future results.**
The continued long term impact of COVID-19 on credit markets and global economic activity remains uncertain as events such as development of treatments, government actions, and other economic factors evolve. The views expressed are as of the date recorded, and may not reflect recent market developments.
Pre-COVID tights refers to the period prior to March with the tightest spread in each respective sector.
US Credit Index is represented by the Bloomberg US Credit Index. Sector level data is represented by the respective sector within the Bloomberg US Credit Index.
Refer to Appendix for additional index, investment strategy, OAS, outlook and risk information.

# Corporate leverage remains high, while homeowner leverage remains low

**Leverage: Corporate debt vs. Non-Agency mortgages**

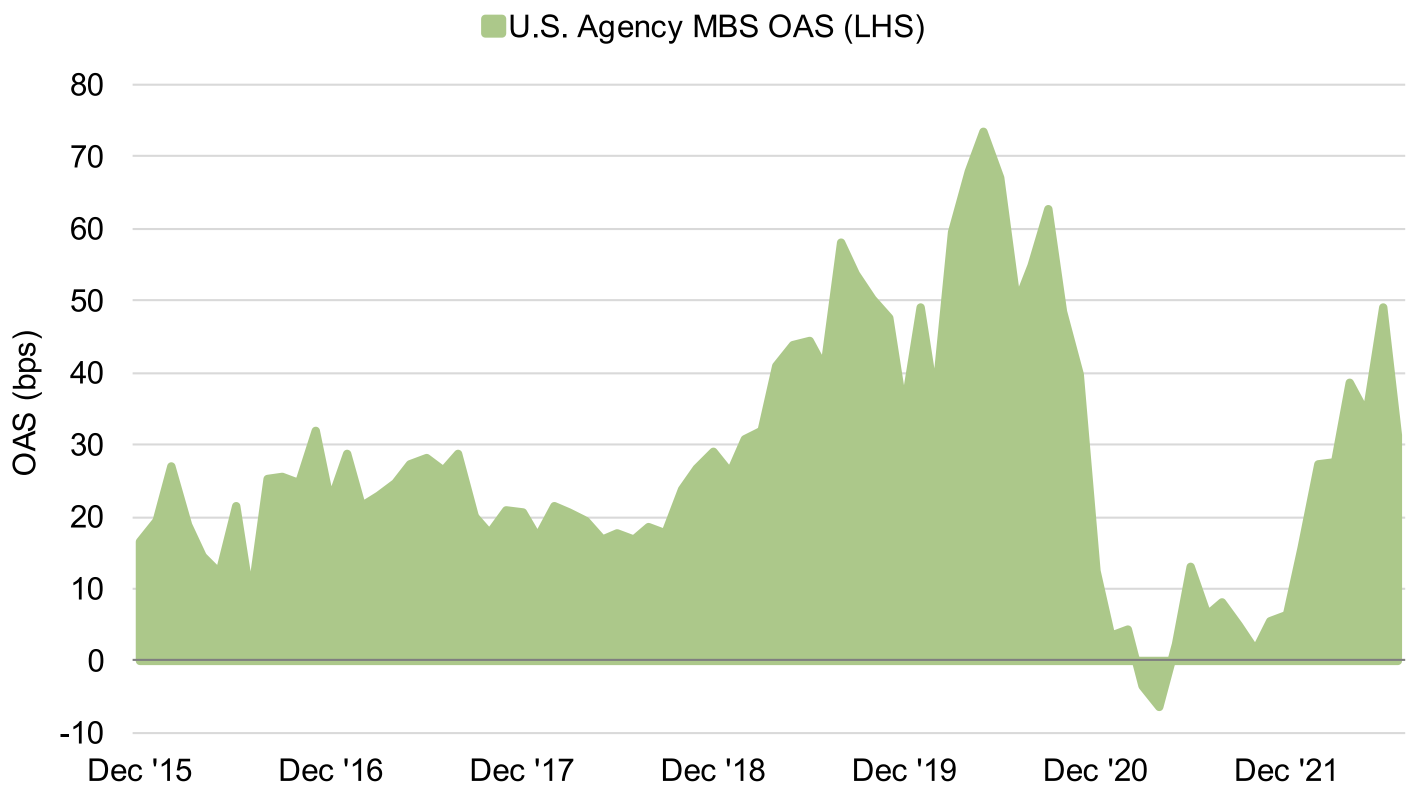



Non-Agency MBS LTV is as of 30 June 2022 and IG corporate leverage is as of 31 March 2022
Source: PIMCO, Bloomberg Finance LP, JP Morgan
Grey Bars indicate recessionary periods in the U.S. This includes the recession from December 2007 to June 2009 and the COVID-19 shock starting February 2020.
Net Leverage is defined as net debt (company's interest bearing debts less cash or cash equivalents) divided by EBITDA: earnings before interest, taxes, depreciation, & amortization
Refer to Appendix for additional forecast, index, investment strategy. and risk information.

# Agency MBS: A decrease in demand from the Fed has raised mortgage rates and cheapened valuations

Agency MBS spreads have widened since the Fed announced its intention to taper MBS purchases, back to its cheapest levels in 2 years

**Agency MBS: Spreads vs. PBE**




As of 30 June 2022. Source: PIMCO, Bloomberg.
Agency MBS: PIMCO Current Coupon OAS
Refer to Appendix for additional index, OAS and risk information.

# Appendix

**Past performance is not a guarantee or a reliable indicator of future results.**

**FORECAST**
Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fees, and/or other costs. In addition, references to future results should not be construed as an estimate or promise of results that a client portfolio may achieve.

**INVESTMENT STRATEGY**
There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. No representation is being made that any account, product, or strategy will or is likely to achieve profits, losses, or results similar to those shown.

**INDEX**
It is not possible to invest directly in an unmanaged index.

**OUTLOOK**
Statements concerning financial market trends or portfolio strategies are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest for the long term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

**OPTIONS ADJUSTED SPREAD (OAS)**
The option adjusted spread (OAS) measures the spread over a variety of possible interest rate paths. A security's OAS is the average return an investor will earn over Treasury returns, taking all possible future interest rate scenarios into account.

**RISK**
Investing in the **bond market is** subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Investing in **foreign-denominated and/or -domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Mortgage and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and their value may fluctuate in response to the market’s perception of issuer creditworthiness; while generally supported by some form of government or private guarantee there is no assurance that private guarantors will meet their obligations. **High-yield, lower-rated, securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. Income from **municipal bonds** may be subject to state and local taxes and at times the alternative minimum tax. Equities may decline in value due to both real and perceived general market, economic, and industry conditions. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. **Diversification** does not ensure against loss.

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