Global Fixed Income Perspectives

Global Market Outlook

- With the start of the easing cycle this year for most developed market central banks, the macro environment is generally favorable for bonds. As the world heals from the pandemic and monetary and fiscal policy normalizes, investors continue to assess the probability of various outcomes from a hard-landing to no-landing scenarios.
- China does not appear to be following previous responses to financial crisis, which may weigh on global growth. The National People's Congress just put forth its plan that continues it near-term focus on internal goals.
- Corporations remain disciplined with their balance sheets and fourth quarter earnings generally met expectations. Spreads have come in, but yields still offer some value. We prefer short-dated credits and are being selective, looking to take additional risk on an individual, idiosyncratic basis where opportunities arise.

About this Publication

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

DM — Developed Market Rates

Growth differentials amongst developed market economies have been high in recent quarters. Thus far, these gaps have not equated to large dispersion in bond returns. If this growth divergence continues, it should create alpha-generating opportunities.

HY — High Yield

We continue to favor allocations in the high yield space as macroeconomic data supports a stronger U.S. growth story. Earnings, employment, and production all reflect a strong underlying economy. While credit spreads have tightened considerably over the last six months, we feel all-in yields justify holding positions.

IG — Investment Grade

IG spreads tightened during the last quarter while treasury yields sold off, making curve location important. Looking at bond breakevens, the spread widening needed to wipe out total return, and one can now see compelling yield cushion at the short end of the curve compared with the long end.

EM — Emerging Markets

In local-currency markets, we see high nominal and real yields in Latin America where yields remain historically wide to the index. EM hard currency also offers attractive yields, particularly amongst high yield credit. We will continue to monitor the policy responses from developed market central banks and China policy.

SP — Securitized Products

Resiliency in home prices, household balance sheets, and the solid job market are supportive for securitized bonds. Agency mortgage-backed securities, seasoned credit-risk transfer notes and certain segments of structured credit offer attractive opportunities.

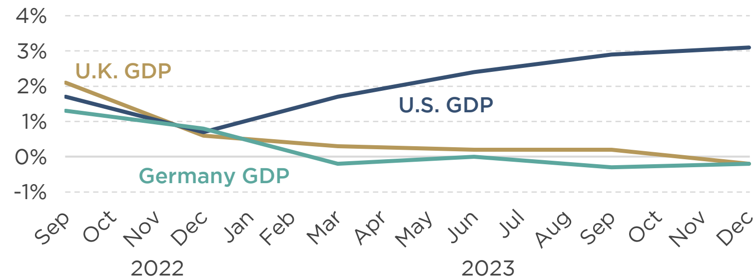
DM Developed Market Rates

- Since late 2022, the economic growth across Europe (Germany and United Kingdom) have underperformed that of the U.S. (see FIGURE 1)
- This growth differential has led to only moderate outperformance for bond returns over the prior year on a hedge-adjusted basis. (see FIGURE 2)
- Both central banks (Bank of China and European Central Bank) are beginning to capitulate on their hawkish stance as economic data continues to come in soft, posing a significant opportunity for U.S. investors to diversify their developed bond exposure beyond the U.S. Treasury market.
- Ultimately, bond yields should continue to be correlated across the markets, however outperformance can be achieved by selecting markets that may need to ease policy rates more aggressively.

HY High Yield

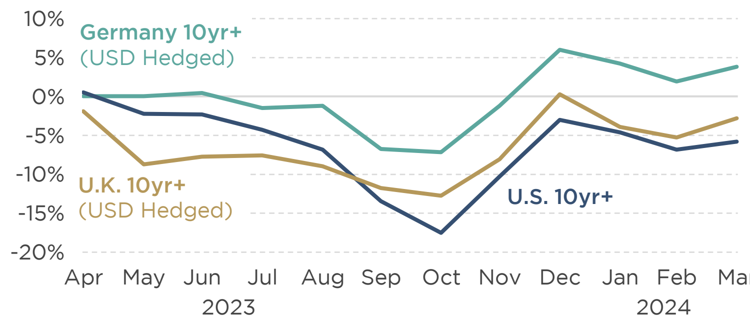
- High yield bond spreads have tightened almost 150 bps over the previous 12 months and now sit at just over 300 bps. Historically, this would flag as "rich" from a valuation perspective and may warrant caution from investors looking to allocate in this space. As shown in FIGURE 3, historically when spreads reach these types of levels, subsequent one-year returns seem relatively symmetric around the 0% axis.
- That said, we would note that today's market conditions haven't been seen for almost 20 years. The most notable difference is the underlying policy rate, boosting all-in yields across the entire fixed income investment universe. The last prolonged period of index spreads below 350, and yields above 7.5%, started in January 2006. While investors at that time may have thought spreads didn't offer enough compensation for risk, these conditions persisted for the next 18 months, and the index generated an 8.6% annualized return.
- FIGURE 4 considers a similar analysis but looks at yields rather than spreads. Here, historically the distribution of forward-looking returns is much more positively skewed given the starting point. Absent deterioration in macro economic data points, most notably in employment or growth, we think the yield proposition in high yield bonds compensates for the risk in the space.

1 GDP Growth Across Countries
12/31/2023, % Growth by Quarter



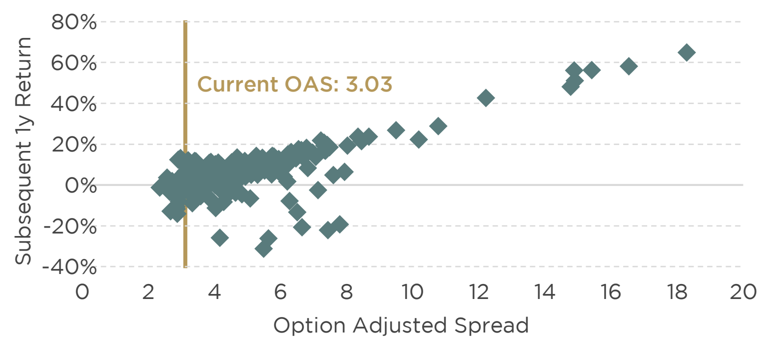
Source: Bloomberg (© 2024, Bloomberg Finance LP)

2 1-Year Bond Returns
As of 3/31/2024, %



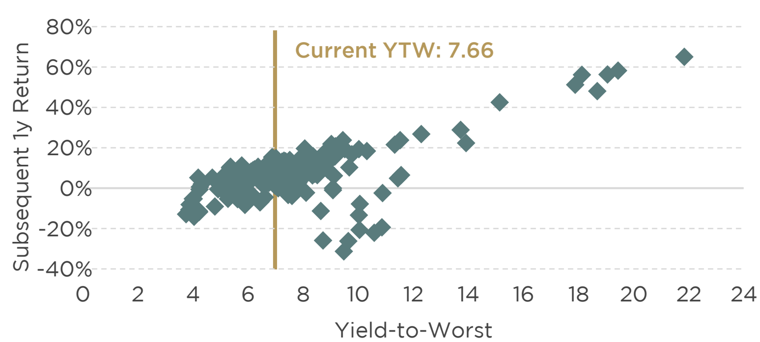
Source: Bloomberg (© 2024, Bloomberg Finance LP)

3 US HY – OAS vs. Subsequent 1-Year Return
As of 3/31/2024



Source: Bloomberg (© 2024, Bloomberg Finance LP)

4 US HY – YTW vs. Subsequent 1-Year Return
As of 3/31/2024



Source: Bloomberg (© 2024, Bloomberg Finance LP)

IG Investment Grade

- IG spreads tightened to 89 basis points (bps) at the end of the first quarter from around 100 bps at the start of the year. The U.S. 30-year Treasury long bond moved to over 4.4% yield from around 4% in the same time frame, given sticky inflation and still solid growth prospects.
- Where one is positioned on the curve has become increasingly important. FIGURE 5 shows different statistics for the IG index by maturity bucket, highlighting the difference in returns between the short and long end of the curve. We prefer opportunities in short-end credit, given total return and the potential for spread widening to be more pronounced further out.
- FIGURE 6 shows the breakeven spreads of the IG index broken down by maturity. Bond breakeven is defined as the basis point move in spread needed for the return of the index (or segment of the index) to result in a negative return; currently, the 1- to 3-year part of the curve would need 311 bps widening in spreads to cancel out the effect of the yield cushion and provide a negative return.
- The difference between the short end of the curve and the long end is striking and illustrates the compelling investment opportunity at the short end of the credit curve. Despite spreads being in the 92nd percentile (i.e., very tight with history going back to January 2000), yields are in the 30th percentile in relation to history (i.e., much wider).

5 U.S. IG Corporate Bond Index Statistics

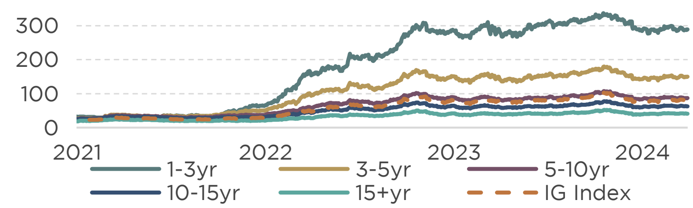
As of 3/31/2024

Maturity	YTW	OAD	OAS	Breakeven	YTD Returns
1-3 Year	5.36	1.85	57	289	0.85%
3-5 Year	5.16	3.45	78	150	0.49%
5-10 Year	5.28	6.10	101	87	0.05%
10-15 Year	5.44	8.66	110	63	-0.41%
15+ Year	5.50	13.46	106	41	-1.37%
Index	5.34	6.65	90	80	-0.08%

Source: ICE
Breakeven Spread Change (bps) needed to make returns 0 = (YTW * 100)/OAD

6 Breakeven by Maturity

As of 3/31/2024, BPS



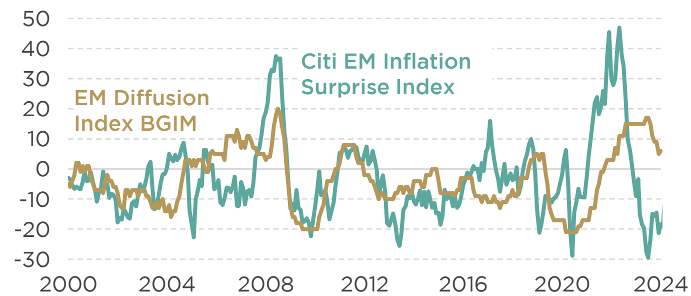
Source: ICE

EM Emerging Markets Debt

- In local markets, we continue to see attractive opportunities in Latin America where we find high nominal yields as well as high real yields with inflation continuing to decline (see FIGURE 7). Central banks in the region have begun their rate-cutting cycle. Ex-ante real policy rates remain quite elevated relative to history, and several banks are cutting at a cautious pace. Improving growth outlook in addition to rising commodity prices should be supportive to the markets we are invested. One thing we are following closely is the low levels of FX volatility across EM, a measure we use to think about complacency in local markets. FIGURE 8 shows the JP Morgan's EM Volatility Index is at extremely low levels today.
- In hard-currency markets, we have been finding a number of idiosyncratic opportunities in sovereigns and corporate issuers. Similar to developed market corporate credit, the hard-currency EM universe still offers attractive yields, particularly amongst high yield.
- We will continue to monitor the policy responses from developed market central banks. Despite inflation data in the U.S. coming in a bit more firm, we believe the Federal Reserve will begin cutting some time this year. The other area of focus will be China, stabilizing or improving Chinese growth would be constructive for EM.

7 Emerging Market Policy Diffusion vs. Inflation Surprise

As of March 2024



Source: Brandywine Global, Macrobond, Citi

8 JP Morgan Emerging Market Volatility Index

As of 4/7/2024

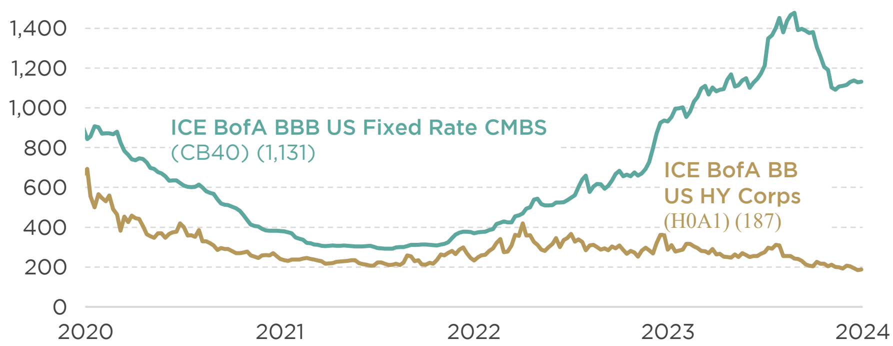
Source: Bloomberg (© 2024, Bloomberg Finance LP), Brandywine Global

SP Securitized Products

- Credit-risk transfer (CRT) securities continue to offer value over equivalent corporates. Solid collateral quality, reduced new issuance, and continued note tendering are supportive factors.
- Commercial mortgage-backed securities (CMBS) have priced in extremely negative outcomes for commercial real estate. We see mitigating factors in some non-office sectors as constructive for select AAA to A rated notes (see FIGURE 9).
- Agency mortgage-backed securities (MBS) remain cheap relative to corporates, and they still possess a favorable convexity profile. Higher-coupon bonds offer the best value in our view (see FIGURE 10).
- Asset-backed securities (ABS) are seeing increased delinquencies in both prime and subprime auto loans, but deal structures remain resilient for margin of safety. We favor seasoned top-tier subprime auto ABS rated AAA to BBB.

9 **BBB-Rated CMBS vs. BB-Rated Corporate Credit Spreads to U.S. Treasury Curve**

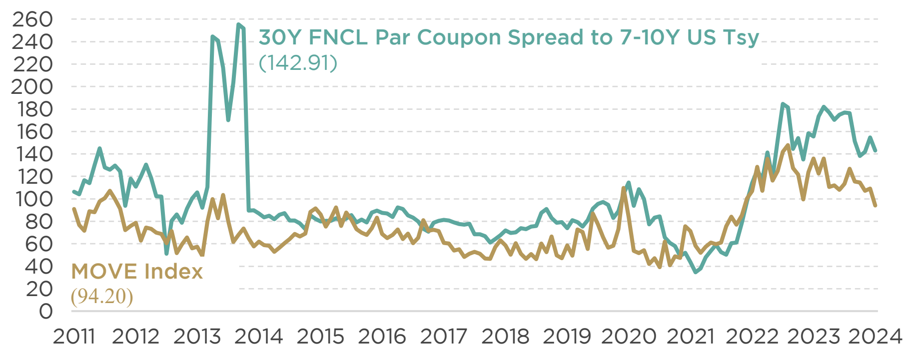
As of 3/29/2024, in Basis Points (bps)



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

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

As of 3/29/2024, in Basis Points (bps)



Source: Bloomberg (© 2024, Bloomberg Finance LP)

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Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, and a fixed coupon schedule. The ICE BAML AA Global Corporate Index is a subset of the ICE BAML Global Corporate Index, including all securities rated AA1 through AA3, inclusive. The ICE BAML Single-A Global Corporate Index is a subset of the ICE BAML Global Corporate Index, including all securities rated A1 through A3, inclusive. The ICE BAML BBB Global Corporate Index is a subset of The ICE BAML Global Corporate Index, including all securities rated BBB1 through BBB3, inclusive. The ICE BAML U.S. Corporate Index tracks the performance of U.S. dollar-denominated investment grade corporate debt publicly issued in the U.S. domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule, and a minimum amount outstanding of $250 million. The ICE BAML Global High Yield Index tracks the performance of USD-, CAD-, GBP-, and EUR-denominated below investment grade corporate debt publicly issued in the major domestic or eurobond markets. The ICE BAML BB Global High Yield Index is a subset of the ICE BAML Global High Yield Index, including all securities rated BB1 through BB3, inclusive. The ICE BAML Single-B Global High Yield Index is a subset of The ICE BAML Global High Yield Index, including all securities rated B1 through B3, inclusive. The ICE BAML CCC & Lower Global High Yield Index is a subset of The ICE BAML Global High Yield Index, including all securities rated CCC1 or lower. The ICE BAML U.S. High Yield Index tracks the performance of USD-denominated below investment grade corporate debt publicly issued in the major U.S. markets. The ICE BAML European High Yield index tracks the performance of below-investment grade corporate bonds publicly issued in Europe. The Credit Suisse Leveraged Loan Index tracks the investable market of the U.S. dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest-rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries. The ICE BAML U.S. Mortgage-Backed Securities Index tracks the performance of U.S. dollar-denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. domestic market. 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.

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