Global Fixed Income Perspectives

Brandywine GLOBAL
A Franklin Templeton Company

Global Market Outlook

- The quarter ended on a low note for developed market government bonds; never have U.S. Treasury bonds had three consecutive years of negative returns. Much ink has been spilled defining these markets—inflation versus disinflation, strength of labor markets, term premia, r*, excess savings depletion, U.S. economy strength, and the forthcoming supply of government bonds to fund deficits.
- Labor markets continue stronger than anticipated albeit with discrepancies between the payroll data and the household survey.
- China's reopening remains subdued, potentially setting up 2024 to be promising from a "base effect" perspective. We still anticipate that the policy response will be very targeted to achieve certain goals.
- Corporate earnings appear to have been guided lower, but we focus on forward guidance and anticipate continued volatility.

About this Publication

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

DM **Developed Market Rates**

When do real yields start to matter? That's the question many bond investors are asking themselves recently. As inflation had broadly decreased, nominal yields continued their march higher, leaving attractive real yields when measured versus historical levels. The economic ramifications are just beginning to be felt.

HY **High Yield**

With longer-dated Treasuries now reflecting the "higher for longer" narrative, we continue to remain cautious in the high yield space. Subdued high yield issuance over the previous two years has brought the time to maturity for the overall index to all-time lows. We continue to favor up in quality and shorter duration high yield credits.

IG **Investment Grade**

Spreads have traded sideways while long-end rates have sold off. While spreads are tight, the all-in yield and low dollar price are still attractive to investors. Corporates, especially those that secured long-term, low-rate financing, have fixed balance sheets, and are in good industries, should do well in the current macro environment.

SP **Securitized Products**

As markets adjust to a higher for longer interest rate regime, we reiterate our preference to position up in credit and short in duration. We remain constructive on selective credits, particularly floating rate credit risk transfer (CRT) securities.

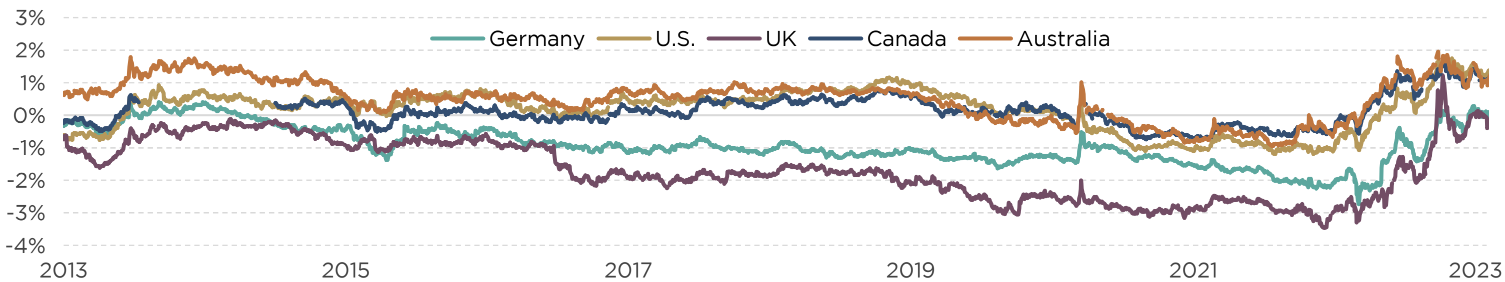
EM **Emerging Markets**

Higher U.S. real rates have been putting downward pressure on local EM markets following strong returns since October 2022. We continue to see select opportunities in high yielding Latam markets and in U.S. dollar EM, especially corporates generating hard currency revenues.

DM Developed Market Rates

- Across the multiple developed markets, 10-year real yields are reaching decade highs (FIGURE 1). Many central banks felt this condition was necessary to achieve their goal of cooling off their economies.
- Higher real yields are a boon for savers after enduring years of low and, at times, negative levels. However, after two years of negative returns stemming from rising rates, bonds investors remain hesitant to extend their duration profile.
- At the same time, high real yields typically create a significant impairment to economic growth and credit expansion. Thus far, global economies have largely withstood higher rates without incurring much damage.
- While timing remains the most difficult aspect, signs indicate that the lag from monetary policy is taking effect, supportive of a continued slowdown. Hence, buying in at current rates offer a very compelling value despite the volatility that currently exists.

1 Developed Market Real Yields
As of 9/29/2023, %

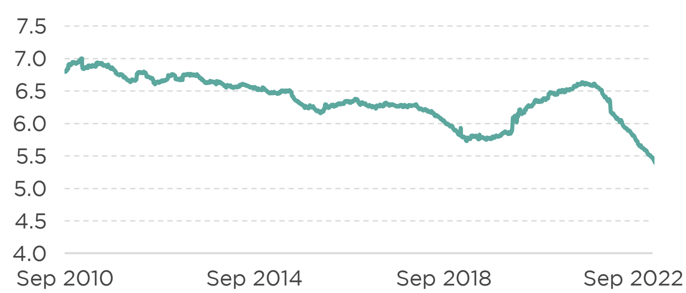


Source: Bloomberg (© 2023, Bloomberg Finance LP)

HY High Yield

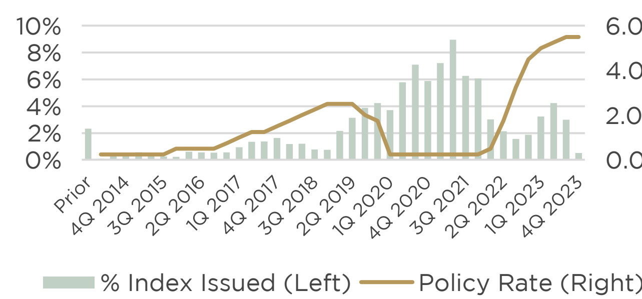
- Year-to-date issuance in the HY credit space remains subdued for the second straight calendar year. Most corporate issuers rushed to lock in the lower rates offered in '20/'21, issuing almost $900 billion of new high yield paper over that period. In the two years since, less than $250 billion of new high yield has been issued. The understandable reluctance to issue new debt with policy rates at 20-year highs has caused the average time to maturity for the high yield corporate bond index to fall below five years, the lowest ever recorded (FIGURE 2).
- The majority of outstanding debt within the index was issued while policy rates were zero (FIGURE 3). When corporates start coming back to market to roll into new maturities, the coupons will be significantly higher than previous issues. This will flow through to corporate balance sheets and start to reduce profitability and free cash flow generation. This supports our preference to remain in "front pay" paper, or the first maturities due within capital stacks. We feel these shorter maturity bonds offer an attractive total return profile.

2 U.S. Corporate HY - Weighted Average Years to Maturity As of 9/30/2023



Source: Bloomberg (© 2023, Bloomberg Finance LP)

3 U.S. Corporate High Yield Index - % of Outstanding Debt Issued by Quarter
As of 9/30/2023



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IG Investment Grade

- Significant rate volatility has occurred over the last quarter with long-end rates selling off on "higher for longer" and concerns about increased fiscal spending. U.S. IG spreads have traded sideways, however, as the all-in yield and low dollar price is still attractive to investors seeking a cushion over Treasuries with carry near 50 bps per month (FIGURE 4).
- Year to date, IG credit has returned 235 bps of excess return, with the communications and energy sectors driving the outperformance.
- FIGURE 5 shows the spread of the index. Autos and financials have seen some spread widening, but this is still relatively contained. Autos have widened due to the UAW union strikes at the major manufacturers (OEMs) while financials are in the potential "higher for longer" scenario, which hurts their profitability.
- Corporates, especially those that secured long-term, low-rate financing, have fixed balance sheets, and are in good industries, should do well in the current macro environment even as spreads widen but rates rally.

4 U.S. IG Option Adjusted Spreads

As of 9/30/2023, Bps

Source: Bloomberg (© 2023, Bloomberg Finance LP)

5 Select IG Sector Spread Monitor

As of 10/4/2023

Sector	Most Recent	Low (1yr)	High (1yr)	Percent Rank (1yr) 0% 50% 100%	Chg Mnth	Z-Score
IG Index	128	119	171		6	0.2
Autos	113	82	150		12	0.2
Cap Goods	103	95	146		5	0.3
Energy	135	129	182		0	0.0
Financials	142	127	216		10	0.3
Leisure	151	128	311		5	0.1
Real Estate	161	147	208		4	0.1
Transport	118	111	169		2	0.1
Utilities	132	127	178		-1	-0.1

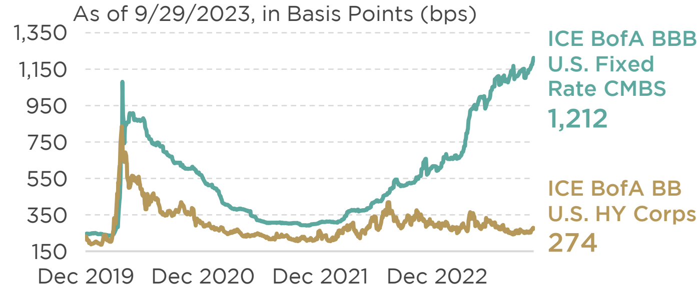
Source: ICE BAML

SP Securitized Products

- Credit-risk transfer (CRT) securities remain the most attractive segment with their floating rate coupons as interest rates continue to rise. Collateral performance has remained benign and current technicals are a helpful tailwind.
- Commercial mortgage-backed securities (CMBS) offer attractive spreads, but they reflect considerable risks in the office sector. We remain up in credit and seek opportunities selectively. (FIGURE 6)
- Agency mortgage-backed securities (MBS), with historically high spreads and low negative convexity, offer outstanding value with no credit risk. However, rising long-term rates and fragile supply-demand technicals may delay realization.
- Collateral loan obligations (CLOs) have performed well amid resilient consumer spending and strong corporate profits. They continue to offer good carry, but signs of economic weakness keep us cautious. (FIGURE 7)

6 BBB- CMBS vs BB HY Corporate Credit Spreads to U.S. Treasury Curve

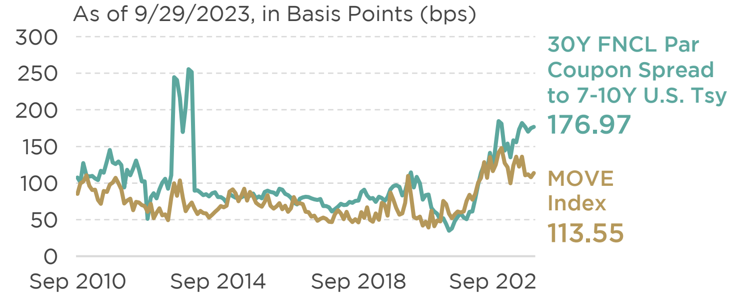
As of 9/29/2023, in Basis Points (bps)



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

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

As of 9/29/2023, in Basis Points (bps)

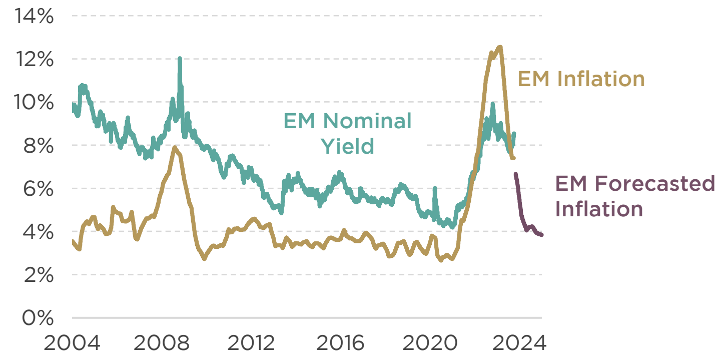


Source: Bloomberg (© 2023, Bloomberg Finance LP)

EM Emerging Markets Debt

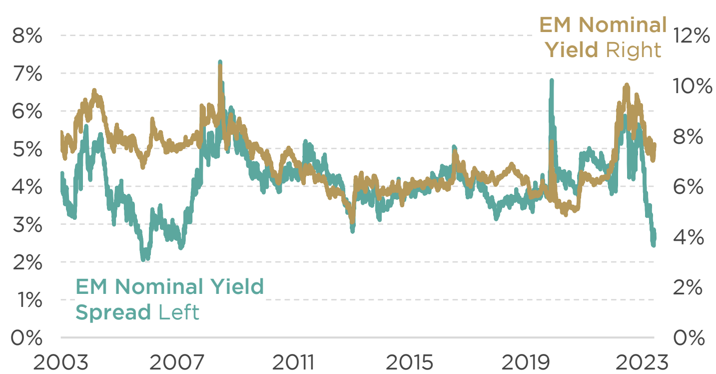
- After a strong rally, EM partially retraced. JP Morgan GBI-EM Diversified Index rose almost 20% from mid-October 2022 to mid-July 2023, but then lost over 6% through the end of September. This coincided with a 95 bps rise in 10-year U.S. Treasury yield and, even more critically, an 85 bps increase in 10-year TIPS. Rising real rates stems from many factors, including U.S. exceptionalism, higher Treasury issuance, central banks selling reserves, and normalization of rates back to pre-global financial crisis levels. The disinflation process continues, and we believe it will continue to do so in the U.S. and in EMs. Historically, falling inflation in EMs is supportive of local rates (FIGURE 8); however, the rise in U.S. real rates is a risk worth watching.
- While nominal and real yields in select local emerging markets remain attractive relative to history, the spread over Treasury yields has fallen (FIGURE 9) and a further rise could put downward pressure on the asset class. Latam bond yields are still quite attractive, particularly as inflation falls. Chile and Brazil's central banks have started rate cutting cycles with others expected to follow in the coming months.
- We believe certain EM currencies offer a mix of attractive valuations, positive balance of payments dynamics, and historically high real short rates. We also find attractive opportunities in the U.S. dollar EM corporates, especially those companies that generate dollar revenues.

8 EM Disinflation to Continue
As of 10/04/2023, %



Source: Bloomberg (© 2023, Bloomberg Finance LP)

9 EM Nominal Yield vs. Spread to U.S. Treasuries As of 10/04/2023, %



Source: Bloomberg (© 2023, Bloomberg Finance LP)

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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. 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