Goldman Sachs | Asset Management

November 18, 2022

MUSINGS

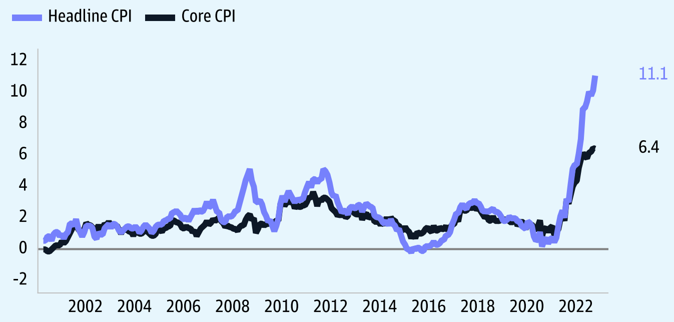
MACRO AT A GLANCE

The inflation picture in the US and UK appear to be trending in opposite directions. Recent US CPI and PPI data suggests inflation may have passed its peak, supporting a slower pace in Fed tightening. In contrast, strong inflation continues to fuel stagflation risks in the UK as annual headline inflation increased from 10.1% in September to 11.1% in October (see Chart). The sharp increase was primarily driven by food and energy prices, despite the implementation of the Energy Price Guarantee (EPG) which seeks to limit household energy price rises.

Apart from inflation, signals from a tight UK labour market also suggests the BoE will continue to tighten policy at an elevated pace. The three-month moving average unemployment rate increased by 0.1% to 3.6% in September but remains historically low and wage growth continues to surprise to the upside.

UK headline inflation reaches highest level since 1981

Annual UK inflation (%)



Source: Goldman Sachs Asset Management, Macrobond. As of October 2022.

POLICY PICTURE

UK Chancellor, Jeremy Hunt, unveiled the Autumn Statement which amounted to £55 billion of tax rises and spending cuts. Some of the measures include a reduced threshold for the 45% rate of income tax, an increase in the energy windfall tax and a slowdown in public spending.

The austere budget comes against a backdrop of a cost-of-living crisis and a deteriorating growth picture. Projections from the Office for Budget Responsibility (OBR) indicate the economy is set to contract by 1.4% in 2023 and is not expected to reach pre-pandemic levels until the end of 2024. To address the challenges faced by households, the budget also includes an increase in the national living wage and the Energy Price Guarantee (EPG) will remain in place until 2024.

UK Autumn Statement in numbers

1% The growth of public spending in real terms beginning in 2024 for three years.

9.7% The increase in the national living wage beginning in April 2023.

£3000 The new EPG level, an increase from the current £2500.

Source: Goldman Sachs Global Investment Research - UK—Chancellor Hunt Announces £55 Billion Fiscal Consolidation (November 17, 2022).

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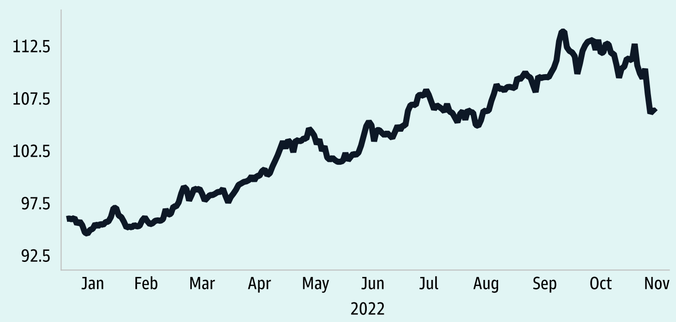
NAVIGATING FIXED INCOME

A sustained weakness in the US dollar requires clear evidence of a peak or pivot in Fed policy tightening and an improvement in the global growth picture. The recent dollar slide (see Chart) has been a result of progress on both fronts. The lower-than-expected US inflation data supports the case for a slower pace of Fed tightening while prospects of China reopening in 2023 bolsters the global growth outlook. In response to the risk-on environment, we have shifted from an overweight to an underweight stance on the dollar for the first time this year.

The improvement in risk sentiment has also tightened spreads in fixed income sectors, including investment grade credit and emerging market debt. Elsewhere, European credit has seen a recent outperformance given warmer-than-average temperatures and a build-up of gas supplies, both of which suggests an extreme tail scenario of the energy shock is unlikely to materialize.

US dollar slides further as risk-sentiment improves

DXY Index



Source: Goldman Sachs Asset Management, Macrobond. As of November 18, 2022. The DXY Index is a benchmark for the international value of the US dollar, tracking moves in the value of the US dollar relative to a basket of other currencies.

RISK MONITOR

Could expeditious monetary tightening raise risks elsewhere? This question is top of mind for investors and policymakers. Most observers believe targeted tools should be used temporarily to address financial instability risks, like the BoE's interventions in long-end UK gilts to stem stress in the pension industry. Our strategists believe the following five factors make a similar episode less likely in the US:

1. US pension plans are on average only about half as leveraged as UK ones.

2. Leveraged liability-driven investment (LDI) funds are less common in the US compared to the UK.

3. The size of the US Treasury market relative to amount of leveraged Treasury exposure in US funds is much larger than UK equivalent.

4. The depth and liquidity of US Treasury market makes dislocations less likely.

5. A fiscal 'mini-budget' shock like we saw in the UK is unlikely under a divided US government.

> We don't expect the UK crisis to repeat in Europe given the pension system is a smaller share of the economy and pension fund holdings are more diversified, implying lower sensitivity to sharply rising rates, though liquidity and leverage risks are worth monitoring."
>
> **Matthew Maciaszek, Goldman Sachs Fixed Income Pensions PM**

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CHINA CHECK-IN

Bottom line: China released a 20-measures document to improve its Covid control measures and announced 16 measures to support the property market recovery. The market has reacted positively, yet there are still uncertainties around growth. We continue to expect the economy to grow just 3% this year.

Reopening prospects emerge as restrictions ease

A change in Covid control guidelines (see Table) will likely have limited near term economic impact, not least given rising cases in major cities and the risk of a further rise over winter and Lunar New Year. Nonetheless, the measures raise hopes of an exit from three years of zero-Covid policy next year. The positive implications for the global growth outlook added to the risk-on market sentiment catalysed by weaker-than-expected October US inflation data.

Property sector support to stabilize the market

Supportive measures include commercial banks extending maturing loans to developers and policy banks providing lending to ensure completion of pre-sold homes. Regulator for China's domestic corporate bond market also expanded financing support for private enterprises including real estate. The announcements were likely prompted by weak property sector activity data for October.

Economic Implications

We expect China's reopening to be gradual once all the medical and communication preparations are done, likely after the March "Two Sessions" next year. Further, we think the reopening rebound may be more muted than in other major economies owing to higher consumer caution and the absence of large-scale fiscal support. Nonetheless, reopening-oriented growth will be a helpful contrast to decelerating growth in the global economy in 2023.

Investment Implications

Although we expect further defaults in the China Property sector, we are reassured by the commitment of policymakers to limit contagion risk. Importantly, we continue to believe a 19.9% effective yield reflects attractive compensation for credit risks in the Asia High Yield market, which benefits from strong fundamentals and relatively benign near-term maturity profile.

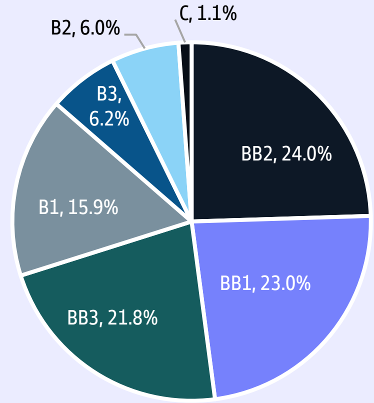
Covid restrictions ease as China looks to reopen

Covid control guidelines

June 2022	November 2022 ("20 measures")
Centralized quarantine for 7 days + home health-monitoring for 3 days	Centralized quarantine for 5 days + home quarantine for 3 days
Applying the high/mid/low-risk district classification nationwide	Applying the high/low-risk district classification nationwide
No local case over 7 consecutive days for downgrading from high- to mid-risk districts, and no local cases over consecutive 3 days for downgrading from mid- to low-risk districts	No local case over consecutive 5 days for downgrading from high- to low-risk districts
International flight "circuit breaker" remains in place	Removing "circuit breaker" for international flights
Home quarantine for 7 days	Close contacts of close contacts will no longer be identified and traced

Source: Goldman Sachs Investment Research - China: A strong signal on 2023 reopening (November 11, 2022).

Credit rating breakdown of the Asia HY market



Source: Goldman Sachs Asset Management, ICE-BAML.

Asia HY ex. China property sector benchmark statistics

2.7 Average duration*

13.8% Weighted effective yield*

5.1x Yield/duration ratio

Source: Goldman Sachs Asset Management, ICE-BAML. *Based on calculations after the Asia high-yield ex. China property segment is reweighted to 100%.

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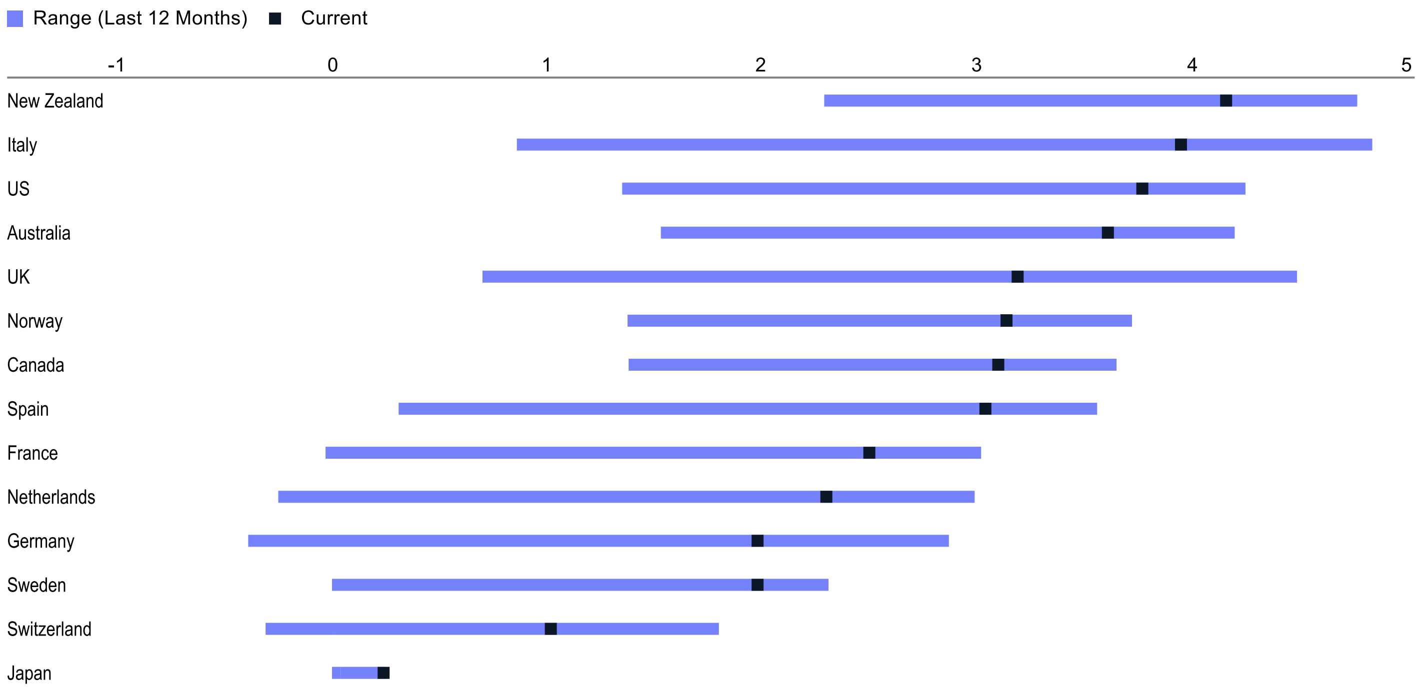
CENTRAL BANK SNAPSHOT

	Interest Rate Policy	Balance Sheet Policy	Outlook	Our outlook relative to market-implied pricing
Fed	Federal funds rate: 3.75-4.0% Prior changes: November 2022 (+75bps) September 2022 (+75bps) July 2022 (+75bps) June 2022 (+75bps) May 2022 (+50bps) March 2022 (+25bps)	Started reducing the monthly pace of its net asset purchases in November 2021 and ended net additional purchases of Treasuries and agency MBS in early March. Balance sheet runoff begins in June; an eventual monthly cap will be set at $95bn—split $60bn-$35bn between US Treasury and mortgage-backed securities (MBS)—and the caps will initially be set at half of those levels for the first three months of runoff ($30bn UST-$17.5bn MBS). Balance sheet size: 37% of GDP	We expect a 50bps rate hike in December and early 2023 then another 25bps after. However, we flag substantial upside risks to the December hike. Expected terminal rate: 5.0%-5.25%	Neutral
ECB	Deposit facility rate: 1.5% Prior changes: Oct 2022 (+75bps) Sept 2022 (+75bps) July 2022 (+50bps), the first hike since 2011	The ECB will end net APP purchases from July 1, 2022. Reinvestments under the PEPP will continue until at least the end of 2024. On July 21, the ECB announced a new anti-fragmentation tool, the Transmission Protection Instrument (TPI), used to ensure monetary policy is transmitted smoothly across all euro area countries. Balance sheet size: 65% of GDP	We expect a 50bps hikes at the December and February meetings. Expected terminal rate: 2.5%.	Slightly dovish
BoE	Bank Rate: 3.0% Prior changes: November 2022 (+75bps) September 2022 (+50bps) August 2022 (+50bps) June 2022 (+25bps) Prior changes: May 2022 (+25bps) March 2022 (+25bps) February 2022 (+25bps) December 2021 (+15bps)	BoE members voted in February 2022 to begin reducing the stock of UK government bond purchases by ceasing to reinvest maturing assets, as well as to begin to reduce the stock of sterling non-financial investment grade corporate bond purchases by ceasing to reinvest maturing assets and by a program of corporate bond sales. The BoE announced it will temporarily purchase long-dated UK gilts until October 14 and postpone gilt sales until November 1. Balance sheet size: 30% of GDP	We expect a 75bps hike at the December meeting and a 50bps hike at both the February and March meeting. Finally we expect a 25bps hike in May. Expected terminal rate: 5.0%.	Slightly hawkish
BoJ	Policy deposit rate: -0.10% Prior changes: January 2016, when the Bank introduced its negative interest rate policy (NIRP) 10-year JGB yield target: ~0%, with tolerance band of -/+25bp (yield curve control policy)	Higher global rates have challenged the BoJ's YCC policy. Recently, the annualized weekly pace of JGB buying (to defend the +/- 10bps band on the 10-year JGB yield) has increased close to ¥30tn. Targets for ETF, corporate bond and other risk asset purchases remain in place but in practice there has been limited recent buying. Balance sheet size: 135% of GDP	We expect yield curve control (YCC) in 2022-23 with significant risk of a rate hike.	Hawkish

Source: Goldman Sachs Asset Management. As of November 3, 2022. The economic and market forecasts presented herein are for informational purposes as of the date of this presentation. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation.

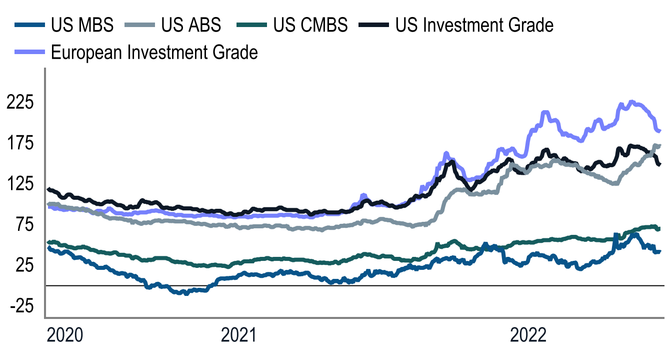
10-YEAR SOVEREIGN BOND YIELDS (%)



Source: Goldman Sachs Asset Management, Macrobond. As of November 18, 2022.

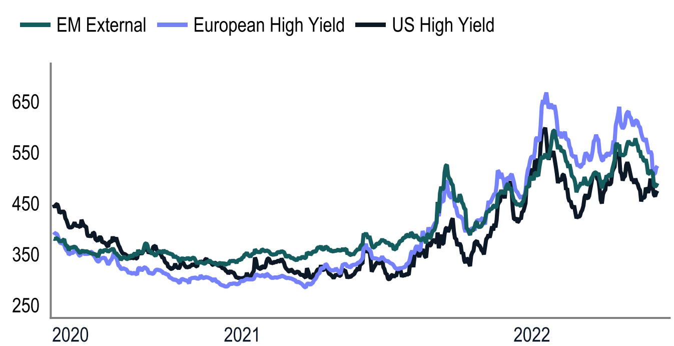
FIXED INCOME SECTOR SPREADS

Investment Grade and Securitized Spreads (bps)



Source:: Macrobond. ICE BoAML indices. As of November 17, 2022.

High Yield and Emerging Market Spreads (bps)



Source: Macrobond. ICE BoAML indices. As of As of November 17, 2022.

PAST MUSINGS

[MUSINGS — November 11, 2022](#)

[MUSINGS — November 4, 2022](#)

[MUSINGS — October 28, 2022](#)

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Indices are unmanaged. The figures for the index reflect the reinvestment of all income or dividends, as applicable, but do not reflect the deduction of any fees or expenses which would reduce returns. Investors cannot invest directly in indices.

The indices referenced herein have been selected because they are well known, easily recognized by investors, and reflect those indices that the Investment Manager believes, in part based on industry practice, provide a suitable benchmark against which to evaluate the investment or broader market described herein. The exclusion of "failed" or closed hedge funds may mean that each index overstates the performance of hedge funds generally.

Sector Spread Indexes

US Investment Grade Corporates: ICE BofAML US Corporate Index
US High Yield Corporates: ICE BofAML US Corporate High Yield Index
European Investment Grade Corporates: ICE BofAML Euro Corporate Index
European High Yield Corporates: ICE BofAML Euro High Yield Index
ABS: ICE BofAML US Fixed Rate Asset-Backed Securities Index
MBS: ICE BofAML US Agency Mortgage-Backed Securities Index
CMBS: ICE BofAML US Fixed Rate Commercial Mortgage-Backed Securities Index
EM External Debt: J.P. Morgan, EMBI Global Diversified Face Constrained Index

Past performance does not guarantee future results, which may vary. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur.

Abbreviations: US Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ), Swiss National Bank (SNB), Central Bank of Sweden (Riksbank), Reserve Bank of New Zealand (RBNZ), Central Bank of Norway (Norges Bank) Bank of Canada (BoC), Reserve Bank of Australia (RBA), Quantitative Easing (QE), Quantitative Tightening (QT), Pandemic Emergency Purchase Program (PEPP), Consumer price index (CPI), producer price index (PPI), developed markets (DM), emerging markets (EM), Japanese Government Bond (JGB).