GLOBAL FIXED INCOME WEEKLY

EXECUTIVE SUMMARY

- Momentum in global activity continues to show a bifurcation between demand and supply, a dynamic driving upward pressure on prices. While our proprietary current activity indicators paint a picture of stabilizing US growth, increasing for the first time since the first quarter of 2021, they also point towards intensifying supply-chain bottlenecks. We believe that as supply expands and demand rotates from goods to services, supply and cost-push price pressures will ease.

- UK core inflation rose sharply from an annual rate of 2.9% in September to 3.4% in October. While used car and furniture prices—where price increases are typically considered to be temporary—contributed significantly to the upshoot, the composition of price rises was broad-based. We think UK inflation will continue to rise in the near-term followed by a moderation in the second half of 2022.

- Our key currency positions entail underweight exposure to the euro and overweight exposure to the US dollar. We remain overweight fixed income spread sectors including corporate credit, while underweight agency mortgage-backed securities (MBS). In addition, we continue to balance these exposures with interest rates.

CHART OF THE WEEK

US activity indicators rose in October

US Industrial Production and Retail Sales

- Core Retail Sales
- Industrial Production

MARKET COMMENTARY AND GOLDMAN SACHS ASSET MANAGEMENT STRATEGY

Duration

- Recent US activity data have exceeded expectations. US industrial production rebounded from a month-on-month (MoM) rate of -1.3% in September to 1.6% in October (see Chart of the Week), while retail sales reflected broad-based growth. Given the good growth backdrop, at target inflation and upside risks to inflation in the near-term, we think there is potential for the US Federal Reserve (Fed) to hasten the pace of its monetary policy normalization. This may entail a swifter conclusion of its asset purchase taper and an earlier timeline for rate liftoff.

- Tepid Australian wage growth data supported our overweight exposure to Australian rates, while weakness in US rates amid upside data surprises supported our underweight exposure at the 7-year node of the curve. Elsewhere, we have reduced exposure to steepening of the UK curve and removed our overweight position in front-end Canadian rates.

Country

- The UK labor market showed signs of continued improvement ahead of the end of the UK’s job retention (or ‘furlough’) scheme. The three-month average unemployment rate fell from 4.5% in August to 4.3% in September. Following a dovish surprise at the BoE’s November meeting, we think this data may support a rate hike at the central bank’s December meeting. That said, we think an upcoming BoE rate hiking cycle will be short-lived, concluding in mid-2022 and followed by a prolonged period of unchanged rates. On a cross-market basis, we are underweight UK rates and overweight Australian rates.

Currency

- Our view of a robust but delayed US recovery with high near-term inflation has corroborated with recent US economic data. The resultant rise in US yields has supported the US dollar, benefiting our overweight exposure to the US dollar versus other G10 currencies (including the euro, Japanese yen and British pound) and Asian currencies (such as the Taiwanese dollar and South Korean won). Looking ahead, we are closely monitoring US inflation and labor market signals ahead of the Fed’s December meeting.

Cross Sector

- We remain overweight fixed income spread sectors including corporate credit, while underweight agency mortgage-backed securities (MBS). In addition, we continue to balance these exposures with interest rates.

Securitized credit

- Within agency MBS, we favor Ginnie Mae versus Fannie Mae MBS due to attractive valuations and supportive seasonal factors such as an anticipated reduction in prepayment rates.

Investment Grade Corporate Credit

- We derive three key takeaways from third quarter corporate earnings releases. First, demand remains solid. Second, companies are benefiting from pricing power which is lending to revenue growth. Finally, corporates are finding short-term solutions to address high inflation and supply-chain disruptions. Against this backdrop, we are closely monitoring which companies are experiencing profit margin pressures.

High Yield Corporate Credit and Bank Loans

- The volume of new supply year-to-date has already surpassed the annual record set in 2020. In the first half of the year, new issuance was motivated by refinancing given the low rate environment. More recently, new supply has been driven by merger and acquisition (M&A) and leverage buyout (LBO) activity, a trend we expect to continue into 2022.

Emerging Market Debt

- The central bank in Turkey cut its policy rate by 100bps, a further marker of unorthodox policy-setting, with annual inflation running at 20%. We are overweight external Turkish rates due to modest debt levels, reduced leverage in the banking system relative to prior periods of currency weakness and expectations for additional monetary easing before year-end.
10-YEAR SOVEREIGN BOND YIELDS

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Source: Macrobond, GSAM. As of 19 November 2021.

FIXED INCOME SECTOR SPREADS

Investment Grade and Securitized Spreads

High Yield and Emerging Market Spreads

Source: Macrobond, ICE BofAML indices. As of 18 November 2021.
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- **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

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