Global Fixed Income Weekly

Executive Summary

- Central banks in the UK, Japan, and Norway kept policy unchanged this week. Sweden’s Riksbank raised its policy rate by 25bps to 0%; the central bank continues to characterize its policy stance as accommodative indicating potential for further rate hikes if macro data evolves in a positive direction. Heading into 2020, we believe we are entering a period of central bank inaction, in large part due to the degree of global monetary easing that has been delivered this year and limited room for central banks to maneuver in many advanced economies.

- We expect risk assets to be underpinned by improved sentiment into year-end given reduced geopolitical tail risks and global growth stabilization. Given this backdrop, we have added exposure to credit with a preference for high yield and we maintain a down-in-quality bias due to less extended valuations. Our exposures continue to be paired with duration as a hedge for risk-off episodes.

- Currency volatility has been low relative to interest rate volatility in 2019 (Chart of the Week). We believe this reflects pre-emptive central bank actions (due to a weak inflation environment) which in turn prevented currencies from strengthening. Both currency and rate volatility have trended lower into year-end.

Chart of the Week: Currency and Rate Volatility Decline into Year-End

Source: Currency volatility is the JP Morgan Currency Volatility Index, rate volatility is the ICE BAML MOVE Index. As of Dec. 20, 2019.

Macro Commentary and Strategy

Duration: We are modestly underweight global duration.

- In the US, we expect Federal Reserve (Fed) policy will be guided by incoming data and trade developments, with the two being linked. More broadly, we believe we are heading into a period of central bank inaction, in large part due to the degree of global monetary easing that has been delivered this year and limited room for central banks to maneuver in many advanced economies. That said, we continue to expect policy to be accommodative, with the bar for rate hikes being raised due to subdued inflation outcomes.

- The US core PCE index—the Fed’s preferred measure of inflation—rose 0.14% in November and the year-over-year rate declined by 0.05 percentage points to 1.51%. On the activity front, third quarter US real GDP growth was unrevised at 2.1% on an annualized quarter-over-quarter basis. That said, the composition was stronger with upward revisions to consumption growth and structures investment. This was offset by a downward revision in inventory investment.

- The Philadelphia Fed manufacturing index decreased by 10.1 points to 0.3 in December, a greater decline than expected. Its composition was mixed with gains in new orders and shipments and a decline in the employment category. Existing home sales fell 1.7% in November, a reversal from last month’s 1.9% increase.
Country: We are overweight rates in Canada, Europe and Japan and underweight rates in the US, Norway and Sweden.

- The Bank of England (BoE) held its policy rate steady at the December 19 central bank meeting. Today, the UK Parliament voted in favor of the EU Withdrawal Agreement Bill meaning the UK will leave the EU by January 31. The bill bans an extension of the transition period past 2020, which has reignited concerns around the potential for a 'no-deal' Brexit if future trade relations are not agreed upon with the EU by the end of the transition period. Gilt yields have fallen on the news. We continue to expect unchanged BoE policy next year.

- As expected, the Riksbank raised its policy rate by 25bps to 0% at this week’s meeting ending five years of negative rates. The central bank continues to characterize the policy stance as accommodative indicating potential for further rate hikes if macro data evolves in a positive direction. In turn, we maintain our underweight exposure to Swedish rates versus other G10 rates.

- We are also underweight rates in Norway. The Norges Bank kept policy unchanged at this week’s policy meeting as expected. We continue to think a healthy cyclical position given a closed output gap and healthy inflation creates a low bar for the Norges Bank to resume rate hikes in 2020.

Currency: We are overweight the Norwegian krone and select emerging market (EM) currencies.

- We remain overweight EM currencies which we fund through underweight exposure to developed market (DM) currencies from markets where we foresee monetary easing. We are also overweight the Norwegian krone and the Japanese yen, with the perceived safe-haven status of the latter currency providing a hedge for risk-off episodes. We are reducing risk going into year-end.

Cross Macro: We hold relative value positions across rates, currencies and credit.

- We are positioned for looser financial conditions in Australia versus Norway; this involves relative value exposures whereby we are overweight Australian rates and underweight the Australian dollar. With a combination of continued outperformance of Australian rates and strengthening of the Norwegian krone due to high oil prices and positive trade headlines; we have reduced exposure.

**Sovereign 10-Year Yield Levels**

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<th>Country</th>
<th>Range (Last 12 Months)</th>
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<td>US</td>
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<td>Switzerland</td>
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Source: MacroBond, GSAM. As of Friday, December 20, 2019.

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. Past performance does not guarantee future results, which may vary.
Sector Commentary and Strategy

Agency MBS: We are overweight.

- We remain overweight mortgages on account of attractive valuations. Given underperformance in higher coupon mortgages relative to lower coupon mortgages, we have increased our exposure to higher coupon mortgages at attractive levels. We expect higher coupon performance to improve due to lower new supply and slower prepayments. We are underweight belly coupons where prepayment risk is higher.

Non-Agency MBS/ABS: We are overweight.

- We remain overweight collateralized loan obligations (CLOs) where valuations appear attractive relative to history and other spread products. Slower new issuance will likely result in modest CLO spread tightening next year. Our exposures exhibit an up-in-quality bias centered on AAA- and AA-rated tranches.

Investment Grade Corporates: We are modestly overweight.

- Investment grade credit has performed well this year and spreads are at a 12-month tight. Sterling- and Euro-denominated issuance increased in 2019, while US dollar issuance moderated. We expect a similar trend in 2020.

High Yield & Bank Loans: We are overweight and have a preference for high yield bonds over loans.

- Sterling-denominated high yield underperformed Euro-denominated high yield in the first half of the year but this performance has since reversed. We added overweight exposure to Sterling-denominated high yield heading into last week’s early UK general election and have since reduced exposure on strong performance.

Emerging Markets: We are neutral to slightly overweight external emerging market debt (EMD) in multi-sector fixed income portfolios and see value in both external and corporate debt in dedicated EMD portfolios. Across local currency debt, we continue to identify idiosyncratic opportunities.

- The US and China reached a ‘Phase 1’ trade deal ahead of the planned tariff hike on December 15; the Trump Administration agreed to cancel the December tariffs and reduce the rate imposed on goods in September by half but kept the earlier $250bn of tariffs unchanged. This partial roll back of tariffs will be positive for onshore sentiment and will support the tentative signs of cyclical stabilization, providing a boost to Chinese GDP growth for 2020.

Sector Spreads

![Investment Grade Spreads](image1)

![High Yield and Emerging Market Spreads](image2)

Source: Macrobond, GSAM. As of Thursday, December 19, 2019.
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**Sector Spread Indexes:**
- **US Investment Grade Corporates**: Bloomberg Barclays US Corporate Index
- **US High Yield Corporates**: Bloomberg Barclays 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**: Bloomberg Barclays, U.S Aggregate, Asset-Backed Securities Index
- **MBS**: Bloomberg Barclays U.S Aggregate MBS: Agency Fixed Rate MBS Index
- **EM External Debt**: J.P. Morgan, EMBI Global Diversified Face Constrained Index

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