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Macro Talking Points

Fixed Income Insights

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Author

Benoit Anne
Managing Director
Investment Solutions Group

In brief

- **The Goldilocks macro regime seems entrenched and supportive of both fixed income and equities**
- **The case for long duration is getting stronger**
- **Key client questions from our recent visit to Paris**
- **The soft and hard data are sending conflicting signals in the US**

Goldilocks on steroids. The Goldilocks macro scenario got a major boost last week from the market-friendly US CPI print. Disinflation is now back on track, while the growth trajectory seems to be consistent with a soft landing. These factors precisely underpin that Goldilocks regime, one that is supportive of both fixed income and risky assets and an ideal scenario for the 60/40 portfolio, with the two sides pushing in the right direction. What the Goldilocks regime does not do, however, is to restore the role of fixed income as a portfolio diversifier. Indeed, the bond-stock correlation is set to stay elevated in the period ahead, but this time for all the good reasons. Overall, the macro backdrop is supportive, but it is also true it has already been reflected in market prices. For instance, our fixed income portfolio managers navigate an environment where generally spreads are generally on the tight side, which means that manager skills and reliance on a thorough research process need to be utilized to generate alpha.

The stronger case for long duration. The case for being long duration seems to have strengthened on the back of the most recent macro data. That is what we hear from our fixed income risk-takers with a global multi-sector focus or a global government mandate. From a strategic perspective, it is also worth noting that the US Treasury curve is back into steepening mode, which ultimately is going to make the 10-year segment more attractive on a relative basis as an entry point. With the case for rate cuts being solidified, fixed income is well positioned in the period ahead. Within fixed income, the longer-duration indices, those that felt the pain of rising rates in the first half of the year, now have an opportunity to bounce back. For instance, the taxable muni index has produced a positive return of 2.77% since its recent low on 1 July.[1] Looking ahead, carry and cuts are going to be the key drivers of fixed income returns as opposed to spread compression, which is a much tougher proposition to entertain in many markets.

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The French connection. We spent a couple of days last week talking to clients in Paris. Here are the key topics on their minds. First and foremost, French politics, which, pardon my French, was the topic du jour. Clients wanted to know our view on French sovereign risk and spreads. "Ooh la la!" is a good summary of where we stand as a firm about French risk. Away from France, clients asked about the global monetary policy outlooks, including for the Fed, the ECB and the BoE. On the macro side, recession risks came up as a major topic, along with inflation, especially in the US in the context of a hypothetical Trump win, which may mean inflationary policies. The US election and its global impact was pretty much on everybody's radar, and so were public debt dynamics and fiscal risks. Geopolitics was also a hot item, along with the commodity price outlook. Moving on to markets, the top questions revolved around spread valuation, optimal curve positioning, the role of fixed income in a multi-asset portfolio and finally, the role of private credit in asset allocation.

Soft vs hard. In keeping with the French theme, you might think that I am now discussing French cheese. But in fact we are on to the equally exciting topic of soft vs. hard data. The soft data are defined as opinion- or survey-based indicators, such as the ISM, the PMI, consumer confidence or business sentiment surveys, among others. Overall, this group paints a pretty bleak picture for the US economy. In contrast, the hard data — *i.e.*, the actual output or activity numbers — continue to be quite robust. So how can we explain this major disconnect? One very relevant point made by our chief economist, Erik Weisman, is that consumers continue to feel the impact of past inflation even if current inflation dynamics are a lot more favorable. With that in mind, it should be no surprise that consumer confidence numbers have yet to fully recover. This suggests that the soft data is erring on the side of being overly pessimistic. It is important to keep monitoring the macro backdrop, however. The main risk ahead, according to Erik, is that the unemployment picture deteriorates a lot more, which would bring back recession fears. That would be when the soft landing data would look too runny, like an old French cheese.

Endnotes

[1] Source: Bloomberg. Bloomberg Taxable Muni US Agg eligible. Data as of 12 July 2024. Returns are gross and in USD.

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