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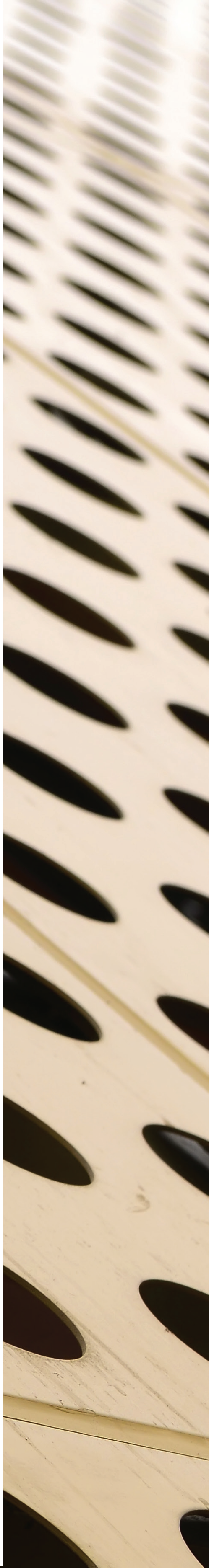


Global Fixed Income Bulletin

Alea iacta est*

FIXED INCOME | GLOBAL FIXED INCOME TEAM | MACRO INSIGHT | FEBRUARY 2021

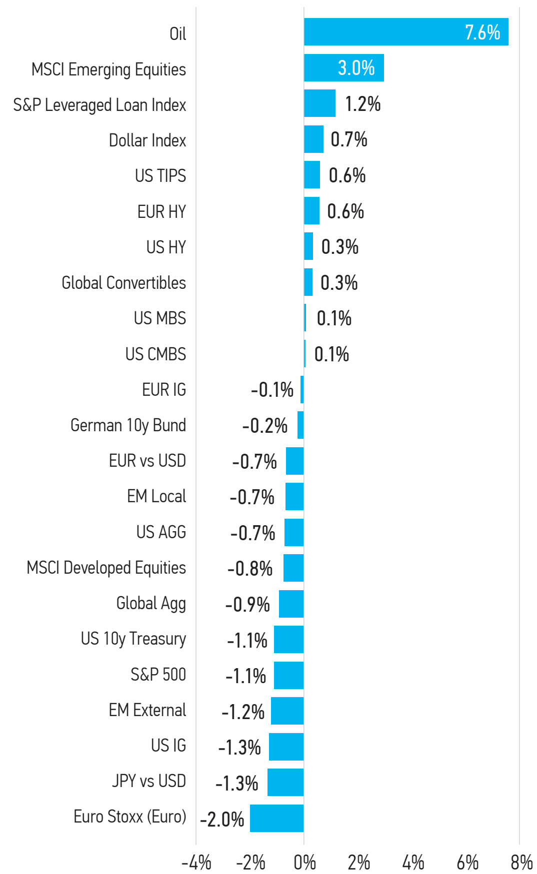
January ushered in a pause in the global melt-up in asset prices. Government bond yields rose in most countries with the sell-off in U.S. Treasuries amongst the worse. Only Australian and Canadian government yields rose more, while emerging market countries generally saw their yields rise even more. Returns were muted in credit markets as a deluge of supply in the high yield market counteracted good macro fundamentals. Securitized credit bucked the trend and delivered solid if not stellar returns (in some sectors).

The big policy news was of course the implications of the Democratic sweep of the Georgia U.S. Senate runoff elections. A Democratic majority in the Senate, combined with the inauguration of President Biden, offers a radical change in prognosis for fiscal policy. Instead of contentious negotiations with a Republican-controlled Senate, the new administration can use the Congressional budget reconciliation process (the one used by Republicans to get their tax cuts passed in 2017) to push through aggressive fiscal expansion. As of early February, it looks like the Democrats will aim to push through another fiscal support package north of $1 trillion. It also looks likely that this stimulus package will be followed by another in the fall of another $1 trillion or more, possibly with tax hikes included. These, of course, come on the heels of the $900 billion fiscal package passed just recently. If the Democrats succeed in legislating these two new fiscal deals, a truly extraordinary amount of support/stimulus will be injected into the economy. Forecasts of 6% plus 2021 U.S. GDP growth could be low. Indeed, the U.S. might grow faster than China!

What this means is that the hope/belief that yields on government and other high quality bonds would remain stable and low have been challenged. Expectations of low inflation, the pandemic, central bank quantitative easing (QE), and central bank

DISPLAY 1

Asset Performance Year-to-Date



Note: USD-based performance. Source: Bloomberg. Data as of January 31, 2021. The indexes are provided for illustrative purposes only and are not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.** See pages 6 and 7 for index definitions.

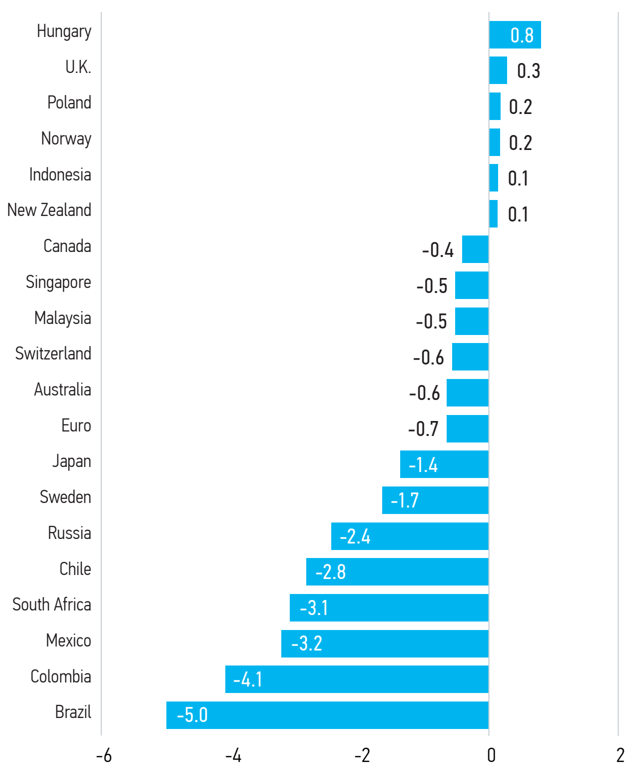
* "The die is cast"

forward guidance are slowing the rate rise, but rising they are. The Fed and other central banks are unlikely to enter the fray (meaning commenting or doing something policywise) until the consequences are known. Financial conditions remain very easy in the U.S.; not as easy in the eurozone but with euro credit spreads low, most government bond yields negative and, maybe most importantly, with 10-year Italian/German bond yield spreads sub 100 basis points (bps), there is little evidence that financial conditions are not propitious for economic recovery.

On the other hand, the global economy looks to have decelerated in Q1 due to rising COVID-19 infection rates/hospitalizations, renewed/enhanced targeted social distancing and a slow rollout of vaccinations. The emergence of new COVID-19 strains also gives rise to new risks concerning the efficacy of vaccines and the potential continuation of social distancing restrictions further into the future or continued conservatism of households and companies with regard to normalization of behavior. The good news is that social distancing restrictions seem to be working in bringing down infection rates, vaccination rates are improving and the Johnson & Johnson vaccine looks likely to be approved for emergency use in the U.S. soon.

As previously discussed, interest rate/duration risk has not been friendly to bond market returns in 2021; this is likely to continue.

DISPLAY 2
Currency Monthly Changes Versus U.S. Dollar
(+ = appreciation)



Note: Positive change means appreciation of the currency against the USD.
Source: Bloomberg. Data as of January 31, 2021.

Massive (proposed) U.S. fiscal spending is expected to propel the U.S. economy stronger, with some of the spending spilling over to the rest of the world. Increased spending in conjunction with greater normalization of behavior should be good for corporate cash flow (earnings will depend on costs), which should be supportive of credit markets. We remain positioned to benefit from riskier fixed income assets outperforming and government bonds underperforming, with duration likely to be a headwind to returns rather than a tailwind, like in 2020.

DISPLAY 3
Major Monthly Changes in 10-Year Yields and Spreads

COUNTRY	10-YR YIELD LEVEL (%)	MONTH CHANGE (BPS)	10-YR SPREAD (BPS)	MONTH CHANGE (BPS)
			(Spread over USTs)	
United States	1.07	+15		
United Kingdom	0.33	+13	-74	-2
Germany	-0.52	+5	-158	-10
Japan	0.05	+3	-101	-12
Australia	1.13	+16	7	+1
Canada	0.89	+21	-18	+6
New Zealand	1.12	+13	5	-2
EUROPE			(Spread over Bunds)	
France	-0.28	+6	24	+1
Greece	0.68	+6	120	0
Italy	0.64	+10	116	+5
Portugal	0.04	+1	56	-4
Spain	0.10	+5	62	0
EM	**INDEX LOCAL YIELD (%)**	**MTD CHANGE (BPS)**	**USD SPREAD (BPS)**	**MTD CHANGE (BPS)**
EM External Spreads			383	-17
EM Local Yields	4.76	+15		
EM Corporate Spreads			351	-27
Brazil	6.28	+70	288	+28
Colombia	5.11	+4	223	+14
Hungary	1.61	+8	99	-12
Indonesia	6.24	+17	151	-14
Mexico	5.62	+3	212	+13
Peru	3.75	+15	105	-4
Philippines	3.61	-4	98	-10
Poland	0.59	-4	20	+1
Russia	5.97	+26	157	-2
South Africa	9.65	0	380	+14
Turkey	13.31	+20	444	+1
Venezuela	–	–	20519	+1154
CREDIT			**SPREAD (BPS)**	**MTD CHANGE (BPS)**
U.S. IG			97	+1
EUR IG			93	+1
U.S. HY			362	+2
EUR HY			343	-4
SECURITIZED				
Agency MBS			69	-2
U.S. BBB CMBS			407	-66

Positive Neutral Negative

Source: Bloomberg, JPMorgan. Data as of January 31, 2021.

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Fixed Income Outlook

Policy news continues to be good for the global economy. Despite wobbles in Europe and deceleration in the U.S., the economic outlook remains positive, leading to a rebound in growth over the course of the first quarter into the second. The benefits of vaccinations should become more and more apparent as vaccination rates rise; targeted restrictions on social mobility should be relaxed; and fiscal policy is running at its most procyclical in generations. The Biden administration appears determined to add another huge dollop of spending to the U.S. economy as it accelerates later in Q1. Moreover, the likely surge in the U.S. economy will occur when other countries are also expanding again, resulting in a synchronized global expansion. Financial conditions are easy: policy rates are zero (in most of the world outside of emerging markets (EM); short and long-term real yields are negative; corporate yields are low (if not negative in real terms for higher quality companies); companies continue to report better-than-expected earnings; commodity prices are rising; inflation is rising but off very low levels; and, big-time fiscal easing is coming in the U.S., more modestly in Europe, and importantly, no tightening anywhere else. These conditions are an excellent backdrop for risk taking; not so good for government bonds.

With policymakers fixated on expansionary policies, obsessed with not making the same mistakes post-global financial crisis, we may end up with procyclical monetary and fiscal policies for the first time in a generation. There is a commitment to get unemployment down in the U.S. almost at any cost, it seems. The logic is that any delays (not related to COVID-imposed restrictions) will lead to hysteresis in unemployment, the tendency of high unemployment to persist such that we end up in an equilibrium with too high an unemployment rate and a very unequal distribution of that resultant unemployment. Thus, expect monetary and fiscal policy to focus on creating boom-like conditions, risking of course, that inflation rises sooner than later, an outcome welcomed if contained; problematic if it rises too quickly.

Thus, outside of ongoing pandemic risks (vaccination rates, vaccine-resistant new strains), policies are looking very, very easy, risking going too far, resulting in inflation rising faster and more than expected, putting pressure on central banks to dial back monetary policy, before employment/growth targets are achieved. We think central banks will resist any calls to reign in policy measures and will allow inflation and nominal yields to rise. Indeed, with short rates anchored, this is a recipe for steeper yield curves globally. Of course, the more vaccines work, the more powerful effect easy policies will likely have, creating a powerful virtuous circle in terms of stronger and stronger growth and lower and lower unemployment and higher yields. And, as long as rises in yields do not tighten financial conditions, central banks are likely to stand aside and let them rise (a big change from market views at the beginning of the year). This reflation process is unlikely to be smooth, and asset prices and interest rates will likely fluctuate along the way. In this environment, we believe active management, security selection and valuation will be critical to generate a robust fixed income strategy.

This suggests that one of the impediments to investment returns in 2021 might be duration, the reverse of 2020 when falling government bond yields significantly boosted the returns of other assets. The duration of the bond universe has lengthened significantly in recent years, helping boost returns as yields fell. Now markets are at risk of the reverse: longer-duration bonds with higher yields lead to even lower returns. While we are not looking for large upward movement in yields, they are likely to trend higher. Indeed, markets may decide, as they want to, to test the Fed's mettle when it comes to levels which might be construed as uncomfortable for the Fed. This is a recipe for overshooting to the upside. All this suggests the optimal investment strategy is to reduce interest rate sensitivity where one can.

Given the procyclical policies expected in 2021 and beyond; the synchronized nature of the global business cycle and the relatively low level of nominal and real yields, we believe fixed income asset allocation should be oriented towards cyclical assets and away from high quality/high interest rate-sensitive ones. However, discrimination remains key given valuation levels. The search for yield in a yield-starved world has eliminated undervaluation in most sectors. But, we believe to generate reasonable income, more risk needs to be taken. Given the very strong macro outlook, a movement to generally reduce credit quality; reduce interest rate sensitivity; overweight emerging markets and look for reasonable risk premium seems appropriate. This includes moving down the credit spectrum in high yield from BB to B; from A to BBB in investment grade: more default risk, less interest risk. Of course, the major risk to this outlook is a resurgence of the pandemic, or more likely, the inability of the world to rid itself of COVID-19 to the degree it does not keep households socially distant.

Therefore, discrimination remains key in our choice of assets, and we continue to try to avoid the two tails of the risk spectrum: very high-quality/low yielders and very low-quality/high yielders in credit, securitized and sovereign markets. We want to own exposure in those areas that can withstand some further volatility in macro/virus backdrop and higher yields but have enough yield/spread to offer reasonable 2021 return potential.

	MONTHLY REVIEW	OUTLOOK
Developed Market (DM) Rate/Foreign Currency (FX)	In anticipation of a strong rebound in growth by the end of 2021, government bond yields across the developed markets moved higher in January, despite the emergence of new, more contagious COVID-19 strains. The “reflation trade” continued to pick-up momentum in the markets, as inflation breakevens hit multiyear highs.	We expect a global economic recovery, especially in procyclical sectors. Central banks will likely remain accommodative and keep yields low almost regardless of how robust the recovery turns out to be due to a desire to close output gaps and return inflation to target levels, or possibly higher. Having arguably tightened too quickly in the previous economic cycle, having inflation stay below target is more of a credibility threat to most central banks than having it above. In addition, higher inflation is likely to help the post-COVID deleveraging process. Nonetheless, this still means the risks are skewed to government bond yields rising. In terms of currencies, we expect the U.S. dollar to weaken due to continued easy monetary policy and fiscal policy, risk-positive sentiment and a relative decline in U.S. real yields versus other currencies.
Emerging Market (EM) Rate/FX	EM debt posted negative returns in January across the board, i.e., in both local and hard currency bonds. From a sector perspective, companies in the Financial, Diversified and Infrastructure segments led the market, while those in the Oil & Gas, Telecom (TMT), and Transport sectors underperformed.	Despite the performance setback in January, we still hold a positive outlook on EM debt for the rest of 2021. Our constructive view on risk assets, and expectations of a weaker U.S. dollar, should be supportive for the emerging market asset class. Excessive optimism about reduced trade frictions under the Biden administration (particularly, in U.S.-China relations) could challenge our positive scenarios for global trade and growth, and thus negatively impact the performance of growth-sensitive EM assets.

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	MONTHLY REVIEW	OUTLOOK
Credit	Spreads were unchanged over the month in spite of an increase in equity market volatility and increased political risk in Italy. On the technical front, January supply was heavy, as expected, and credit funds and ETFs experienced net outflows.	We see credit being supported by expectations of an economic rebound in 2021. Our base case reflects the consensus view that COVID-19 is transitory and continued positive support from monetary and fiscal policy will likely drive spreads tighter in the medium term. We expect an overshoot in valuations in H1 2021, especially given central banks continue to support credit markets directly and indirectly, but with a likely correction in H2 as M&A activity increases and corporates shift some of the cash they have hoarded to business expansion activities. We think issuance could be lighter, given many companies prefunded in 2020.
Securitized Products	Agency MBS and securitized credit continued to perform very well. Mortgage prepayment speeds showed no signs of slowing as mortgage rates again hit new historic lows in January. U.S. asset-backed securities (ABS) were generally tighter, while European RMBS spreads were largely unchanged in January. U.S. non-agency residential mortgage-backed securities (RMBS) and U.S. commercial mortgage-backed securities (CMBS) spreads tightened in January, with AAA CMBS spreads now trading 75-90 bps above comparable duration swaps.	We expect continued strong performance in the coming months. Agency MBS looks moderately expensive, but benefits from continued Fed buying. U.S. non-agency RMBS have largely recovered to pre-pandemic levels, but still offer reasonably attractive relative value. U.S. ABS has a mixed outlook for 2021, with traditional consumer ABS (credit cards and auto loans) looking relatively expensive while the most COVID-challenged ABS sectors offer much greater recovery potential. CMBS valuations have also richened over the past few months, but the sector remains very idiosyncratic, with some attractive value opportunities and some potential credit problems as well. Multifamily housing (apartments) and office buildings have performed better and have lower risks of near-term default, but could still face challenges if there are fundamental shifts in how people want to live and work in the post-pandemic world. European markets are experiencing similar sector-specific performance dynamics, and overall European credit performance has been comparable to U.S. markets.

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Risk Considerations

Diversification neither assures a profit nor guarantees against loss in a declining market.

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to **market risk**, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in a portfolio. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. Certain **U.S. government securities** purchased by the strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **Public bank loans** are subject to liquidity risk and the credit risks of lower-rated securities. **High-yield securities (junk bonds)** are lower-rated securities that may have a higher degree of credit and liquidity risk. **Sovereign debt securities** are subject to default risk. **Mortgage- and asset-backed securities** are sensitive to early prepayment risk and a higher risk of default, and may be hard to value and difficult to sell (**liquidity risk**). They are also subject to credit, market and interest rate risks. The **currency market** is highly volatile. Prices in these markets are influenced by, among other things, changing supply and demand for a particular currency; trade; fiscal, money and domestic or foreign exchange control programs and policies; and changes in domestic and foreign interest rates. Investments in **foreign markets** entail special risks such as currency, political, economic and market risks. The risks of investing in **emerging market** countries are greater than the risks generally associated with foreign investments. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). Due to the possibility that prepayments will alter the cash flows on **collateralized mortgage obligations (CMOs)**, it is not possible to determine in advance their final maturity date or average life. In addition, if the collateral securing the CMOs or any third-party guarantees are insufficient to make payments, the portfolio could sustain a loss.

DEFINITIONS

R* is the real short term interest rate that would occur when the economy is at equilibrium, meaning that unemployment is at the neutral rate and inflation is at the target rate. **Basis point:** One basis point = 0.01%.

INDEX DEFINITIONS

The indexes shown in this report are not meant to depict the performance of any specific investment, and the indexes shown do not include any expenses, fees or sales charges, which would lower performance. The indexes shown are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

The **Bloomberg Barclays Euro Aggregate Corporate Index (Bloomberg Barclays Euro IG Corporate)** is an index designed to reflect the performance of the euro-denominated investment-grade corporate bond market.

The **Bloomberg Barclays Global Aggregate Corporate Index** is the corporate component of the Barclays Global Aggregate index, which provides a broad-based measure of the global investment-grade fixed income markets.

The **Bloomberg Barclays U.S. Corporate Index (Bloomberg Barclays U.S. IG Corp)** is a broad-based benchmark that measures the investment-grade, fixed-rate, taxable corporate bond market.

The **Bloomberg Barclays U.S. Corporate High Yield Index** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging market debt.

The **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable, corporate bond market.

The **Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index** tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage. Introduced in 1985, the GNMA, FHLMC and FNMA fixed-rate indexes for 30- and 15-year securities were backdated to January 1976, May 1977 and November 1982, respectively. In April 2007, agency hybrid adjustable-rate mortgage (ARM) pass-through securities were added to the index.

Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care.

Euro vs. USD – Euro total return versus U.S. dollar.

German 10YR bonds – Germany Benchmark 10-Year Datastream Government Index; **Japan 10YR government bonds** – Japan Benchmark 10-Year Datastream Government Index; and **10YR U.S. Treasury** – U.S. Benchmark 10-Year Datastream Government Index.

The **ICE BofAML European Currency High-Yield Constrained Index (ICE BofAML Euro HY constrained)** is designed to track the performance of euro- and British pound sterling-denominated below investment-grade corporate debt publicly issued in the eurobond, sterling

The **ICE BofAML U.S. Mortgage-Backed Securities (ICE BofAML U.S. Mortgage Master) Index** tracks the performance of U.S. dollar-denominated, fixed-rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. domestic market.

The **ICE BofAML U.S. High Yield Master II Constrained Index (ICE BofAML U.S. High Yield)** is a market value-weighted index of all domestic and Yankee high-yield bonds, including deferred-interest bonds and payment-in-kind

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securities. Its securities have maturities of one year or more and a credit rating lower than BBB-/Baa3, but are not in default.

The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Italy 10-Year Government Bonds – Italy Benchmark 10-Year Datastream Government Index.

The **JP Morgan CEMBI Broad Diversified Index** is a global, liquid corporate emerging markets benchmark that tracks U.S.-denominated corporate bonds issued by emerging markets entities.

The **JPMorgan Government Bond Index** – Emerging markets (**JPM local EM debt**) tracks local currency bonds issued by emerging market governments. The index is positioned as the investable benchmark that includes only those countries that are accessible by most of the international investor base (excludes China and India as of September 2013).

The **JPMorgan Government Bond Index Emerging Markets (JPM External EM Debt)** tracks local currency bonds issued by emerging market governments. The index is positioned as the investable benchmark that includes only those countries that are accessible by most of the international investor base (excludes China and India as of September 2013).

The **JP Morgan Emerging Markets Bond Index Global (EMBI Global)** tracks total returns for traded external debt instruments in the emerging markets and is an expanded version of the EMBI+. As with the EMBI+, the EMBI Global includes U.S. dollar-denominated Brady bonds, loans and eurobonds with an outstanding face value of at least $500 million.

The **JP Morgan GBI-EM Global Diversified Index** is a market-capitalization weighted, liquid global benchmark for U.S.-dollar corporate emerging market bonds representing Asia, Latin America, Europe and the Middle East/Africa.

JPY vs. USD – Japanese yen total return versus U.S. dollar.

The **National Association of Realtors Home Affordability Index** compares the median income to the cost of the median home.

The **Nikkei 225 Index (Japan Nikkei 225)** is a price-weighted index of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

The **MSCI AC Asia ex-Japan Index (MSCI Asia ex-Japan)** captures large- and mid-cap representation across two of three developed markets countries (excluding Japan) and eight emerging markets countries in Asia.

The **MSCI All Country World Index (ACWI, MSCI global equities)** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

MSCI Emerging Markets Index (MSCI emerging equities) captures large- and mid-cap representation across 23 emerging markets (EM) countries.

The **MSCI World Index (MSCI developed equities)** captures large and mid-cap representation across 23 developed market (DM) countries.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector.

The **Russell 2000® Index** is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The **S&P 500® Index (U.S. S&P 500)** measures the performance of the large-cap segment of the U.S. equities market, covering approximately 75 percent of the U.S. equities market. The index includes 500 leading companies in leading industries of the U.S. economy.

The **S&P/LSTA U.S. Leveraged Loan 100 Index (S&P/LSTA Leveraged Loan Index)** is designed to reflect the performance of the largest facilities in the leveraged loan market.

The **S&P GSCI Copper Index (Copper)**, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark for investment performance in the copper commodity market.

The **S&P GSCI Softs (GSCI soft commodities) Index** is a sub-index of the S&P GSCI that measures the performance of only the soft commodities, weighted on a world production basis. In 2012, the S&P GSCI Softs Index included the following commodities: coffee, sugar, cocoa and cotton.

Spain 10-Year Government Bonds – Spain Benchmark 10-Year Datastream Government Index.

The **Thomson Reuters Convertible Global Focus USD Hedged Index** is a market weighted index with a minimum size for inclusion of $500 million (U.S.), 200 million euro (Europe), 22 billion yen, and $275 million (Other) of convertible bonds with an equity link.

U.K. 10YR government bonds – U.K. Benchmark 10-Year Datastream Government Index. For the following Datastream government bond indexes, benchmark indexes are based on single bonds. The bond chosen for each series is the most representative bond available for the given maturity band at each point in time. Benchmarks are selected according to the accepted conventions within each market. Generally, the benchmark bond is the latest issue within the given maturity band; consideration is also given to yield, liquidity, issue size and coupon.

The **U.S. Dollar Index (DXY)** is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies.

The **Chicago Board Options Exchange (CBOE) Market Volatility (VIX) Index** shows the market's expectation of 30-day volatility.

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