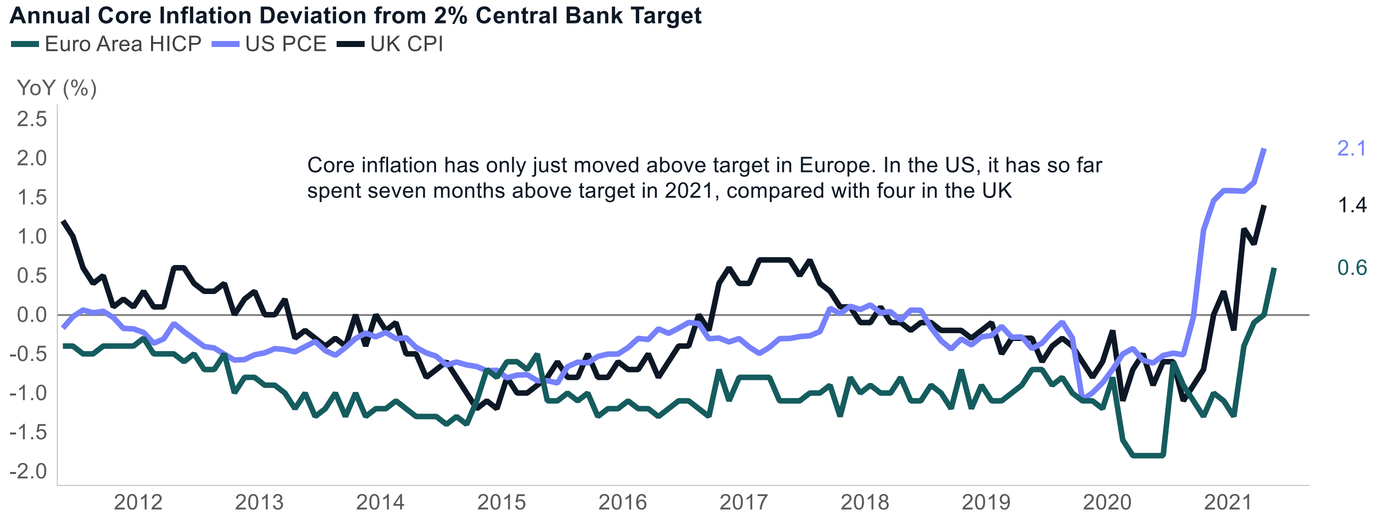
GLOBAL FIXED INCOME WEEKLY

EXECUTIVE SUMMARY

- Financial market focus will be on key central bank meetings next week. We expect the US Federal Reserve (Fed) to announce an acceleration in the pace of its asset purchase taper, however, we think the Bank of England (BoE) will delay a rate hike until its early February meeting. In addition, we think the European Central Bank (ECB) will announce a March-end to its pandemic emergency purchase program (PEPP).
- Big picture, there will be a sizeable reduction in central bank bond-buying in 2022, with the Fed set to conclude asset purchases, the ECB retiring the additional monetary support it launched at the start of the pandemic and the BoE ceasing reinvestments once its policy rate reaches 0.5%. In addition, we have pulled forward expectations for monetary tightening in advanced economies over the past quarter, particularly in the US, UK and Canada.
- We are overweight the US dollar and have reduced our exposure to emerging market (EM) currencies. We are also overweight corporate credit, securitized credit and emerging market debt (EMD), while underweight agency mortgage-backed securities (MBS). In addition, we maintain overweight exposure to Australian rates on a cross-market basis.

CHART OF THE WEEK

Core inflation is running above central bank targets in the US, Europe and in the UK



Source: Macrobond, Goldman Sachs Asset Management. As of October 2021.

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MARKET COMMENTARY AND GOLDMAN SACHS ASSET MANAGEMENT STRATEGY

Duration

- We expect the Fed to accelerate the pace of its taper from $15bn to $30bn per month from January given higher-than-expected inflation in recent months and healthy labor market data, though we will be closely monitoring developments in financial conditions ahead of next week's Federal Open Market Committee (FOMC) meeting.

- Looking ahead to 2022, we expect the Fed to begin to raise rates from mid-year, delivering three rate hikes in total. That said, we are mindful that a moderation in inflation and improvement in labor supply could lead to renewed focus on a still-large employment gap relative to the pre-pandemic level, and in turn a more gradual pace of rate rises.

Country

- We have pulled forward expectations for monetary tightening in advanced economies over the past quarter, particularly in the US, UK and Canada. That said, we continue to hold a more dovish view on monetary policy in Australia relative to market-implied pricing, and therefore remain overweight Australian rates on a cross-market basis.

- We expect the BoE to forego a rate hike next week given virus uncertainties. We also think the ECB will announce a March 2022 end to its PEPP bond-buying scheme, though we think the Council will likely keep some optionality to extend the program if economic conditions deteriorate. More broadly, although we expect the low yield environment to persist in Europe, we think a rate hike in 2024 is plausible given core inflation may settle close to 1.5% once pandemic and policy distortions subside, above the 1% average observed in the last cycle.

Currency

- We are overweight the US dollar given virus uncertainties and Fed policy normalization. Elsewhere, we are overweight Central Eastern European (CEE) currencies such as the Czech koruna and Polish zloty, while underweight EM currencies such as the Turkish lira and Mexican peso.

Cross Sector

- The US yield curve has flattened in recent weeks. This has previously been a forward metric for policy overtightening and recession risks. However, we think it is important to keep in mind that it can take more than a year following curve flattening before risk assets respond. In addition, prior flattening has coincided with Fed rate hikes, whereas the Fed is not expected to raise rates for at least six months.

- That said, we are mindful that recent flattening of the yield curve has been driven by higher front-end yields as well as lower longer-dated yields. In the past, long-end yields remained more stable. This dynamic presents a potential challenge for risk assets should the curve steepen on higher longer-dated yields.

Agency MBS

- We remain underweight given Fed tapering and due to high rate volatility. Spreads have been volatile over the past week, though much of the widening observed in November has retraced.

Investment Grade Corporate Credit

- Accommodative policy and improved risk sentiment amid vaccine rollout boosted investment grade corporate credit performance in 2021, with spreads hovering close to the tight end of their historical range. In 2022, we expect spreads to drift modestly wider, marking a new phase in this credit cycle.

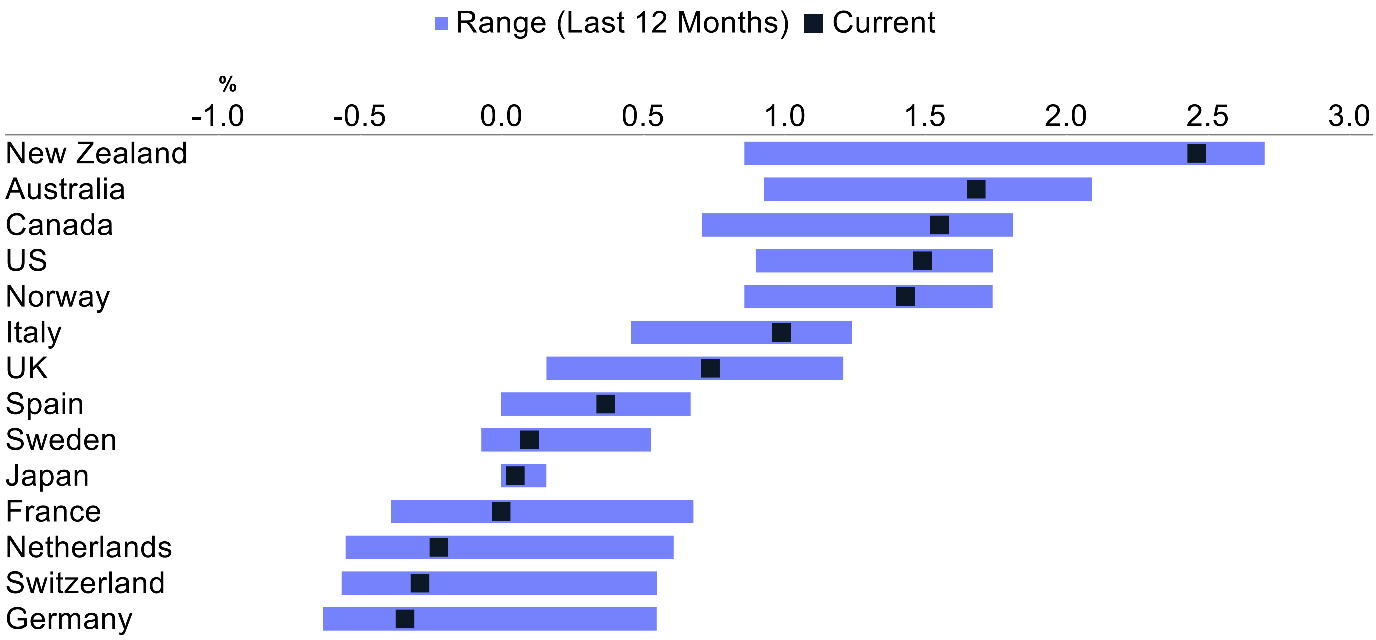
High Yield Corporate Credit and Bank Loans

- We believe the low levels of return dispersion experienced in 2021 will revert to normal levels in 2022 given the combined effects of a less supportive macro backdrop, elevated valuations and as corporate bond issuers continue to shift away from a stance of balance sheet repair to a capital management posture. From a quality standpoint, we believe that B-rated credits offer good opportunities going forward.

Emerging Market Debt

- In economies where rate hiking cycles are advanced, yield curves have flattened significantly, suggesting financial markets believe high inflation today will be brought under control and followed by weak growth. In some markets, particularly across Central Eastern Europe, we think the flattening is outsized.

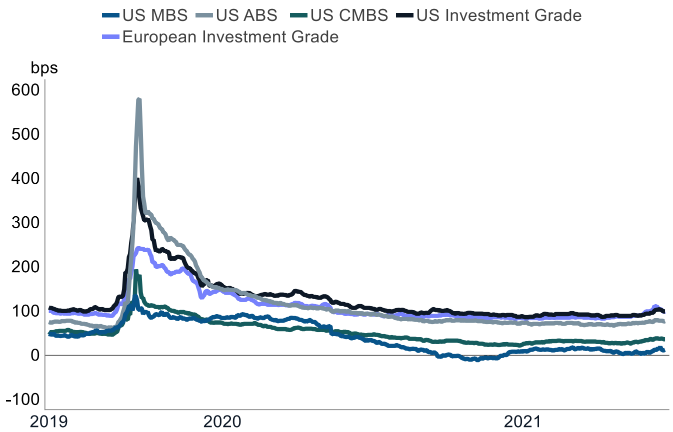
10-YEAR SOVEREIGN BOND YIELDS



Source: Macrobond, GSAM. As of 10 December 2021.

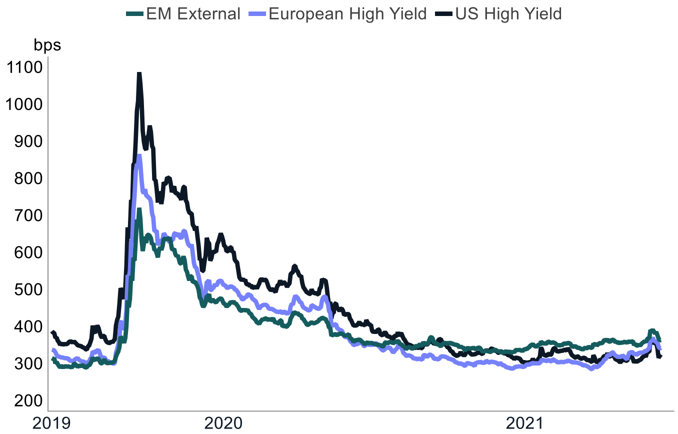
FIXED INCOME SECTOR SPREADS

Investment Grade and Securitized Spreads



Source: Macrobond. ICE BofAML indices.
As of 09 December 2021.

High Yield and Emerging Market Spreads



Source: Macrobond. ICE BofAML, J.P. Morgan indices.
As of 09 December 2021.

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Sector Spread Indexes

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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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