NEUBERGER BERMAN

Fixed Income Investment Outlook 4Q 2024

Treading Carefully Downhill

With the U.S. Federal Reserve's recent interest rate cut, we anticipate broad easing by central banks over the next year across the developed world. However, some caution may be warranted on duration, as markets may be overly optimistic about the initial pace of reductions. Meanwhile still sturdy, if softening, economic conditions along with strong investor demand have contributed to narrow corporate credit spreads, reinforcing the value of a quality emphasis and drawing on yield and price opportunities wherever they emerge.

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Treading Carefully Downhill

Fixed income investors are welcoming rate cuts, but caution on duration and selectivity on credit remain important.

The wait for monetary easing by the U.S. Federal Reserve is finally over, with the announcement of a 50-basis-point rate cut in September, starting what will likely be a series of reductions over the next year. Various other developed market central banks had already started to ease, but the move provided general comfort for these campaigns amid progress on inflation and fears of excessive economic weakness. Japan's move toward higher rates remains an outlier, although its increases from here should be moderate.

The world's economic trajectory appears mixed, with the U.S. likely to avoid recession and Europe more stressed by manufacturing and consumer weakness. China's structural issues remain a concern, even as monetary and fiscal authorities have moved to support domestic sentiment. Emerging market economies remain resilient overall. In our view, key issues include the current U.S. election cycle and geopolitical developments, as well as two-way risks associated with an inflation rebound or excessive weakness.

From an investment perspective, the force of rate reductions should support fixed income assets, particularly on the shorter segment of the yield curve, although we believe markets may be overly optimistic on the initial pace of the cuts, leading to caution on duration and potential opportunity in inflation-linked securities. In terms of credit, technical demand along with extended maturities and constructive fundamentals have kept spreads narrow, so we are looking for select opportunities leveraging credit research. We continue to favor structured credits both for yield and defensive characteristics, even as our exposures have eased somewhat due to pricing improvement. In our view, emerging markets debt is also appealing given constructive fundamentals and past strength in Fed rate-cutting cycles.

Our key investment themes and market views are provided on the pages that follow.

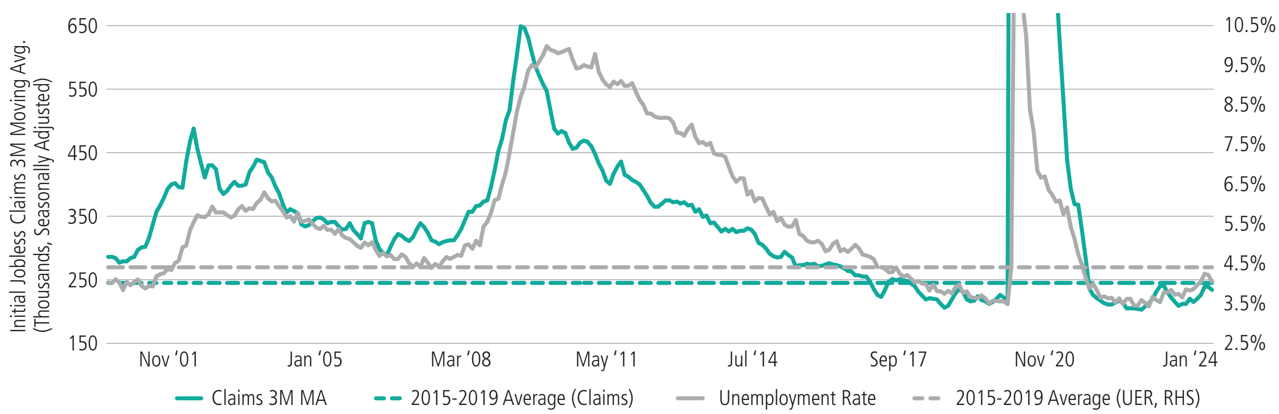
1. Soft Landing Appears Within Reach

The U.S. economy continues to slow, but appears likely to avoid recession. U.S. inflation has been declining steadily, and the Federal Reserve's focus has shifted toward maintaining employment as it begins its easing campaign. The country's job growth has become increasingly concentrated, with education and health accounting for nearly half of gains over the past year, even as they have yet to return to pre-pandemic levels. Initial jobless claims and the unemployment rate, although ticking up, remain muted in historical terms.

In Europe, conditions are weaker, with PMI reports in Germany and France showing continued stagnation, while fiscal measures have been less accommodating, creating a headwind to growth. Inflation readings have been coming in generally in line with market expectations, even as services prices remain a little sticky. Potentially bolstering the global economy are China's recent stimulative moves, including monetary easing, property sector supports and capital injections at banks. However, the scale and scope of these measures may be only enough to affect the global economic picture by creating something of a buffer against deflationary forces.

THE FED IS WATCHING JOBS NUMBERS

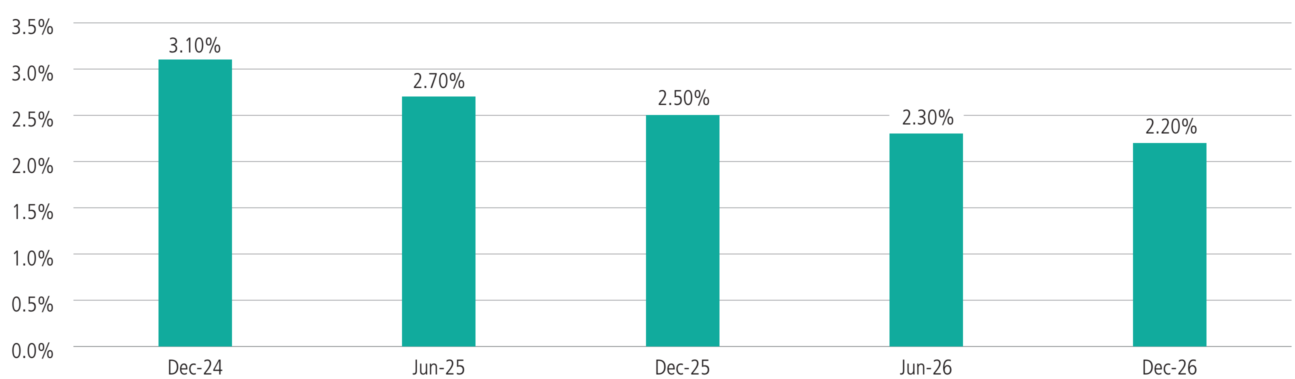
U.S. Unemployment Has Ticked Up, But Remains Muted



Source: Bloomberg. As of September 2024.

DEVELOPED MARKET INFLATION SHOULD CONTINUE TO COOL

Estimated U.S. Core Inflation (Year-Over-Year)



Source: Bloomberg, Neuberger Berman calculations and forecasts. As of September 2024.

2. The Fed Is Set to Ease, But Maybe Less Than Expected

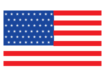
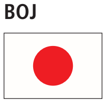
In our view, the Fed's large initial rate cut in September should be viewed as a catch-up measure, acknowledging that it might have cut rates in July with full information about pending U.S. payrolls. From here, we believe the Fed will likely move into a phase of data-dependent quarter-point moves, including two more cuts in 2024, and finish off with a neutral rate of around 3.25% toward the end of next year. The market, in contrast, anticipates a more front-loaded 75 basis points of cuts in 2024 and a terminal rate of 3.00%.

In Europe, ECB President Christine Lagarde has voiced increased confidence in the central bank's ability to cut rates after its initial reduction over the summer; in our view, two more cuts are likely this year from the ECB and from the Bank of England in light of sluggish growth and weak confidence levels. Lower-than-expected inflation readings in the euro area have reinforced that easing trajectory.

While the Bank of Japan remains in tightening mode, we anticipate just one further increase in 2024 and a cautious monetary stance overall. Depending on the impacts of its measures so far, China may seek to further loosen financial conditions. And although many emerging markets central banks acted earlier to tighten than developed market counterparts, the Fed's moves should provide space to loosen where that process has not started already.

MOVING INTO EASING MODE

Monetary Expectations

Central Bank	Market Expectations	Neuberger Berman Expectations	Neuberger Berman Outlook
FED 	• 2024: 3 Cuts • 2025: 5 Cuts • 2026: 0 Cuts • NR: 3.00%	• 2024: 2 Cuts • 2025: 5 Cuts • 2026: 0 Cuts • NR: 3.25%	• The Fed has started its easing cycle. Upside risks to inflation have diminished, but downside risks to labor remains elevated, keeping the pace/magnitude of rate cuts uncertain. • We anticipate two more 25bp rate cuts this year and cuts in subsequent meetings in 2025 until the neutral rate settles around 3.00 – 3.50%. We however acknowledge the increasing likelihood of a shorter path to neutral rate on a weaker labor trend.
ECB 	• 2024: 2 Cuts • 2025: 5 Cuts • 2026: 0 Cuts • NR: 2.00%	• 2024: 2 Cuts • 2025: 5 Cuts • 2026: 0 Cuts • NR: 2.00%	• With growth still sluggish yet ongoing inflation normalization and formal guidance by ECB to "reduce the level of monetary restriction," we expect continued cuts by the central bank. • We anticipate two more rate cuts for the rest of the year and a quarterly pace of policy normalization toward around 2.00% by the end of 2025.
BOE 	• 2024: 2 Cuts • 2025: 4 Cuts • 2026: 1 Cut • NR: 3.25%	• 2024: 2 Cuts • 2025: 4 Cuts • 2026: 2 Cuts • NR: 3.00%	• BoE focus on wage growth and services inflation points to gradual normalization in rates. Signs of intrinsic inflation persistence are fading, although confidence is weaker. • We now expect two additional rate cuts for the rest of the year and a quarterly pace into 2025 and 2026, with the policy rate settling at around 3.00%.
BOJ 	• 2024: 0 Hikes • 2025: 1 Hikes • NR: 0.75%	• 2024: 1 Hike • 2025: 2 Hikes • NR: 1.00%	• BOJ followed up on the exit from negative interest rate policy by raising rates again to 25bps in alignment with its stated policy goal of achieving "price stability" and moving policy toward a neutral level of rates. We expect the BOJ to continue on a gradual rate hiking cycle. • We expect a rate hike this year with the BOJ keeping a biannual pace of adjustments that brings the policy rate to a neutral rate of around 1.00%.

NR = Neutral Rate

Source: Bloomberg, Neuberger Berman. As of September 18, 2024.

3. A Key U.S. Election Could Drive Market Turbulence

With the closely contested U.S. election fast approaching, we see potential for increased market volatility and longer-term policy impacts across sectors.

The Republican candidate, former President Donald Trump, is seeking to further reduce corporate tax rates, particularly for companies producing goods domestically, and extend the lower individual tax rates established in 2017. His opponent, current Vice President Kamala Harris, would like to raise corporate taxes, and, while extending and expanding tax breaks for the middle class, increase levies on wealthy Americans. In the business sector, Trump has emphasized opening up traditional oil and gas exploration and production, while reducing regulation across the commercial landscape. Harris, in contrast, has advocated for clean energy and government intervention in the economy to help drive growth. Trump favors the use of broad tariffs on imports and has proposed more stringent levies on Chinese goods, while Harris would take a more limited approach.

The degree to which the candidates can implement their ideas depends on broader federal election outcomes. Assuming the currently expected split government, with a Republican Senate and Democratic House of Representatives, legislative action will likely require compromise. Neither side has talked meaningfully about how to reduce the growing U.S. fiscal deficit.

ELECTION UNCERTAINTY AND MARKET VOLATILITY

Historical Change in Term Premium Around U.S. Elections

Source: Bloomberg. 250 days before and 250 days after election. 2024 is as of September 23, 2024.

4. Caution on Duration Amid Rosy Expectations

Over the past year, the bond market has frequently been disappointed in the timing and pace of potential easing by the Fed. Although recent data has generally reinforced the downward trajectory of the fed funds over the next year, recently strong employment numbers provided a reminder of the central bank's data dependency, and the potential for a slower trajectory than expected should the economy and inflation maintain their resilience.

Of course, should economic and, in particular, employment statistics turn south from here, we could see an acceleration in accommodation. The Middle East conflict and China's recent stimulus have added new wrinkles, as further increases in oil prices could add to headline inflation, while China's measures have probably established a buffer against global deflation risk.

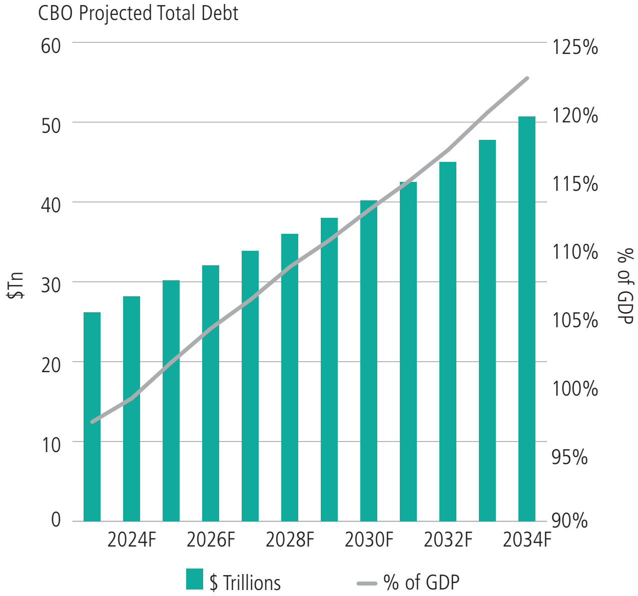
All this points to our relative caution on duration, even as the longer-term trend for rates is downward. For those who wish to gain some early exposure to duration, we favor investments in real rates via inflation-linked securities as any temporary upticks in yield will likely occur in nominal terms. Agency mortgage-backed securities may also be a part of duration positioning, offering higher yields than equivalent Treasuries and potentially generating more price return with the eventual reduction of interest rates.

Keep in mind that the picture for U.S. longer-maturity bonds is somewhat more convoluted than for shorter maturities, given concerns about fiscal policy and debt sustainability over time. Indeed, longer U.S. Treasuries may stagnate or face upward pressure as debt rises as a percentage of GDP and takes up an ever-greater portion of federal spending. European debt levels, while still elevated from pandemic-era spending, appear to be moderating as a percentage of GDP, though slowing spending may actually hinder recovery from here.

A CHALLENGING U.S. FISCAL PICTURE COULD WEIGH ON LONGER BONDS

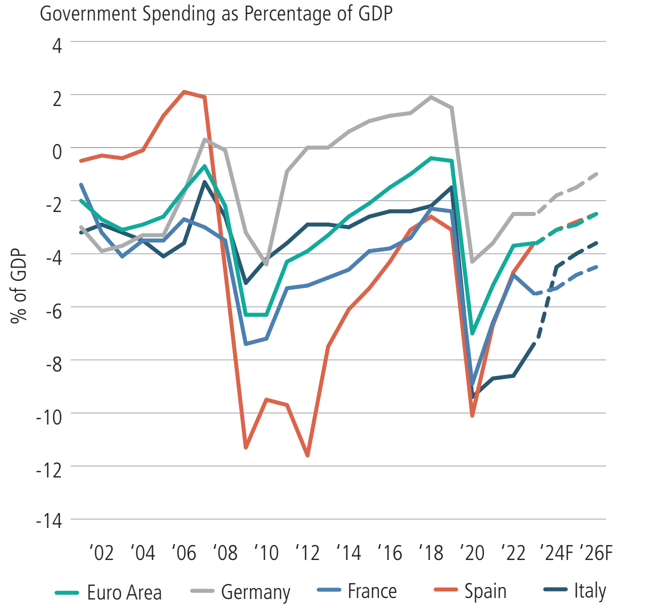
U.S. Debt Sustainability Concerns Are Not Going Away

CBO Projected Total Debt



Europe May See Fiscal Consolidation, With Implications For Growth

Government Spending as Percentage of GDP



Source: Congressional Budget Office. As of June 2024.

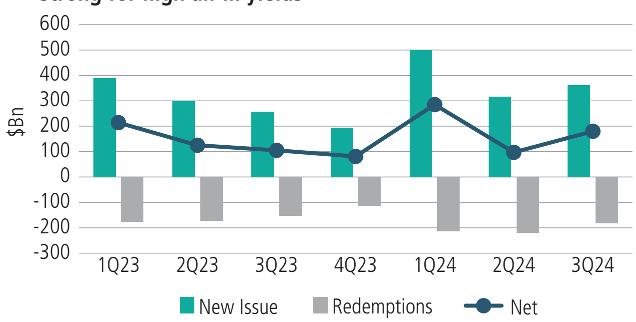
5. With Tight Corporate Credit Spreads, Focus on Quality and Broader Opportunity Sets

At the start of the year, we noted that supply-and-demand fundamentals could be a driving force of credit spreads this year, something that has emerged amid an ongoing bid for yield and appetite for risk. This has been coupled with continued solid corporate fundamentals, reflected in stable leverage and still ample cash positions. U.S. high yield spreads remain at roughly average historical levels, while capital markets remain open even to more stressed issuers. In general, spreads remain exceptionally tight, and could stay range-bound in the coming months due to technical forces.

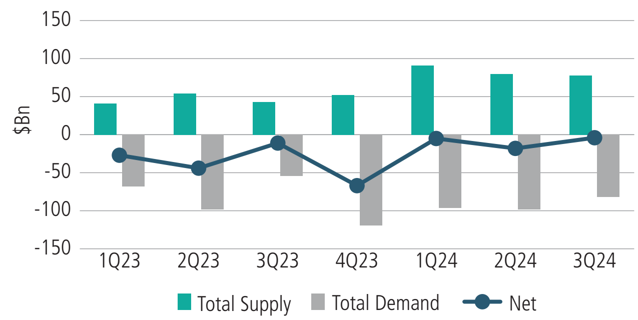
Overall, a focus on quality and exploiting dislocations makes sense to us, along with a broader view as to potential opportunities in order to capitalize on appealing all-in yield. Collateralized loan obligations, for example, are increasingly viewed as defensive against a slowing economy, given their often-senior position in the capital stack and expectations for a terminal rate above pre-pandemic norms. Although less than in recent quarters, agency mortgage-backed securities remain a key theme for us, offering appealing yields, but also likely to benefit particularly from easing short-term rates. Various other areas of structured credit, such as commercial mortgage-backed, asset-backed and residential mortgages could see fundamentals improve as lower rates reduce finance costs. Hybrid securities, meanwhile, are offering yields far wider than our estimate of fair value versus other opportunities.

SUPPORTIVE SUPPLY/DEMAND TECHNICALS SHOULD KEEP CORPORATE CREDIT SPREADS RANGE-BOUND

IG net supply to come in higher but demand remains strong for high all-in yields



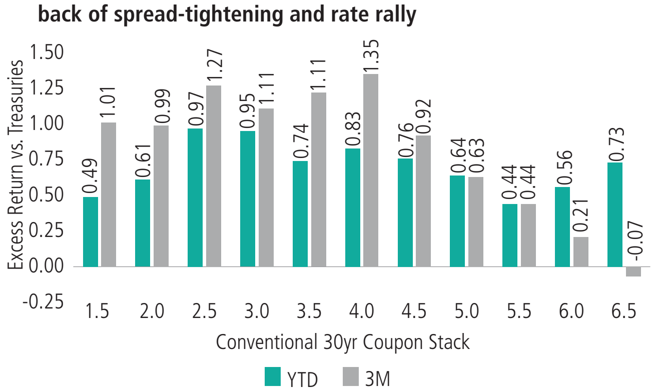
High Yield Supply and Demand



Source: Left: Barclays. Right: J.P. Morgan citing Bloomberg, S&P LCD and Lipper FMI. Total supply = gross new issuance + fallen angels. Total demand = calls, tenders, maturities, rising stars, coupon reinvestment at 75% and fund flows.

STILL CONSTRUCTIVE ON AGENCY MBS, BUT LESS SO

Both lower and higher coupons have performed well on the back of spread-tightening and rate rally



Par-to-premium prices on higher coupons, whereas lower coupons remain discounted

Source: Bloomberg, as of September 30, 2024. Indices shown: I35903US, I35762US, I28972US. I28849US, I24176US, I24177US, I24178US, I24179US, I24180US, I24181US, I24182US.

6. EMD Could Benefit From Rates, Fundamentals and Flows

Emerging market debt (EMD) stands to benefit from slower but not recessionary U.S. growth, lower global yields and a wider growth advantage for emerging versus developed countries. The asset class has tended to perform well after Fed hiking cycles. Should investor sentiment improve, an acceleration in flows could be a tailwind for EMD.

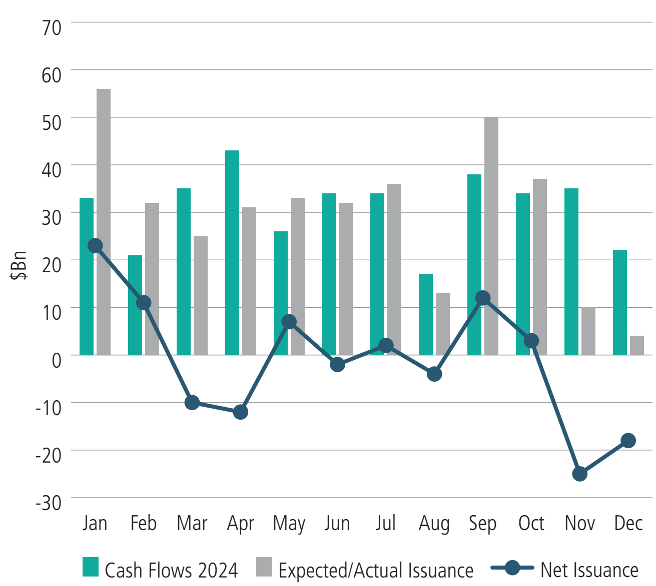
EM inflation rates have declined toward central bank comfort zones, suggesting that further disinflation could be more modest. Still, attractive real yields and monetary policy biased toward easing should support local bond performance. Forward interest rate differentials versus the U.S. due to Fed easing should provide support for EM currencies, which could also benefit from robust macro fundamentals and (outside Asia) high carry.

China continues to announce stimulus measures that may have a moderately positive impact on economic growth and limit downside risks, but will need to be more comprehensive in order to broadly affect bond market fundamentals. More broadly in the sovereign debt space, default risks appear limited in the coming months, as more vulnerable issuers have managed to secure new funding, while various countries' increased engagement with the International Monetary Fund should support funding needs and reform agendas.

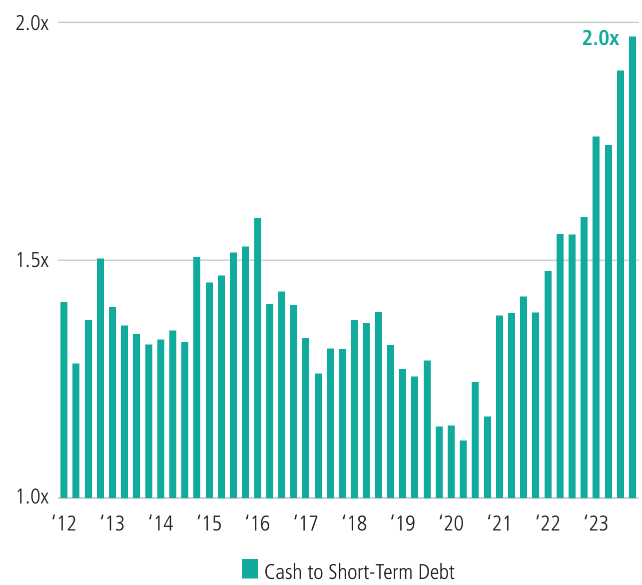
Among EM high yield corporates, default risk has also been declining, with our 2024 forecast now 3.2% compared to last year's 7.8%. Earnings growth is generally improving, while balance sheets are benefiting from elevated liquidity buffers. Deeply negative net issuance should also remain a positive technical for EM corporates. Lower-rated bonds appear to offer value, and we see opportunities for spread compression in specific issuers.

EM CORPORATES: SUPPORTIVE TECHNICAL AND FUNDAMENTAL BACKDROP

Net issuance of EM corporates expected to be negative in 4Q24



EM corporates retain strong liquidity buffers on average



Source: Left: JPMorgan and Neuberger Berman estimates. Right: BAML as of December 31, 2023.

Market Views
Next 12 Months

	UNDER − −	−	NEUTRAL ◇	+	OVER ++	CHANGE NOTES
GOVERNMENT BOND MARKETS						
United States	○	○	●	○	○	
United Kingdom	○	○	○	●	○	
Germany	○	●		○	○	ECB rate normalization path is in line with our expectations; German bonds experienced a strong rally in Q3.
France	○	○	●	○	○	
Italy	○	○	●	○	○	
Spain	○	○	○	●	○	Better growth/Inflation mix in southern EU than northern EU.
Japan	○	●	○	○	○	
Canada	○	○	●	○	○	Bank of Canada rate normalization path is in line with our expectations.
New Zealand	○	○	○	●	○	
Australia	○	●	○	○	○	
U.S. TIPS	○	○	○	●	○	
INVESTMENT GRADE SECTOR						
U.S. Agencies	○	○	●	○	○	
U.S. Agency MBS	○	○	○	●	○	
U.S. CMBS	○	○	○	●	○	
U.S. ABS	○	○	○	●	○	
U.S. Mortgage Credit	○	○	○	●	○	
U.S. Credit	○	○	○	●	○	
Europe Credit	○	○	○	●	○	
U.K. Credit	○	○	●	○	○	
Hybrid Financial Capital	○	○	○	●	○	
Municipals	○	○	●	○	○	

Market Views (continued)

Next 12 Months

	UNDER −−	−	NEUTRAL ◇	+	OVER ++	CHANGE NOTES
HIGH YIELD & EMERGING MARKETS						
U.S. Full-Market High Yield	○	○	●	○	○	
U.S. Short-Duration High Yield	○	○	○	●	○	
Pan-Euro High Yield	○	○	○	●	○	
Floating-Rate Loans	○	○	●	○	○	
U.S. CLO	○	○	○	●	○	
EM Hard-Currency Sovereigns	○	○	○	●	○	
EM Hard-Currency Corporates	○	○	●	○	○	
EM Hard-Currency Short Duration	○	○	○	●	○	
EM Local-Currency Sovereigns	○	○	○	●	○	
CURRENCY*						
U.S. Dollar	○	○	●	○	○	
Euro	○	○	●	○	○	
Pound	○	●	○	○	○	
Yen	○	○	●	○	○	We anticipate a period of consolidation following significant Q3 appreciation largely driven by a shift in expectations around U.S. monetary policy.
Swiss Franc	○	○	●	○	○	
Australian Dollar	○	○	○	●	○	
Swedish Krona	○	○	●	○	○	
Norwegian Krone	○	○	●	○	○	
Canadian Dollar	○	○	●	○	○	
Mexican Peso	○	○	●	○	○	U.S. election and policy uncertainty, poor growth and a dovish Banxico outweigh cheaper valuations and limited exposure by global investors.
South African Rand	○	○	○	●	○	
Brazilian Real	○	○	○	●	○	Local rate hikes cycle combined with decent growth, a manageable current account deficit, widening interest rate differentials and attractive valuations.
Chinese Yuan	○	●	○	○	○	

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*Currency views are based on spot rates, including carry.

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