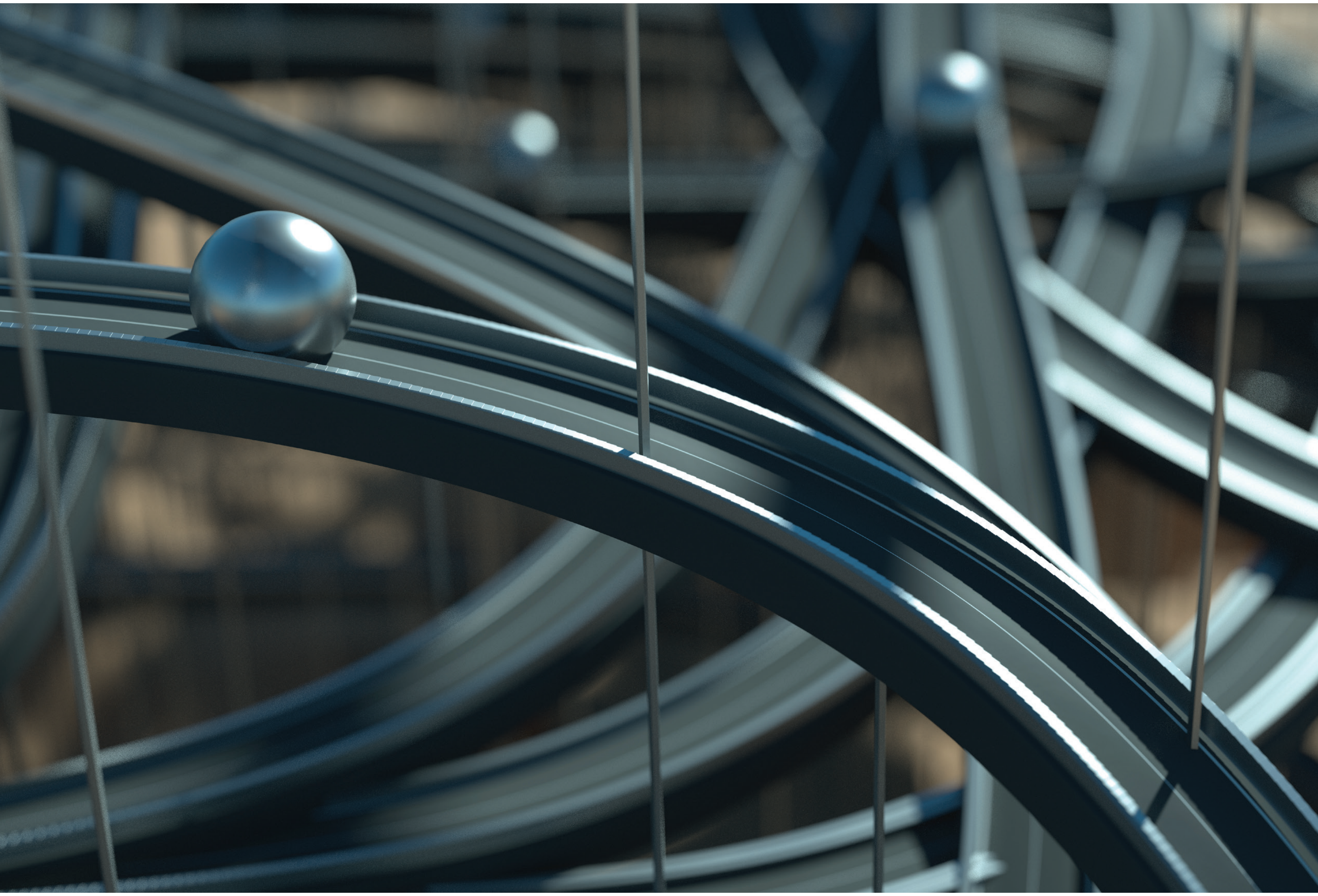


NEUBERGER BERMAN

# Fixed Income Investment Outlook 3Q 2024

**Widening Differences, New Opportunities**

After months of anticipation, a broader move to lower policy rates appears on its way. However, the varied pace of easing, along with dispersion in economic growth and strains on the credit front, may widen the gap between winners and losers across the fixed income spectrum. We believe this should enhance opportunities for active managers in navigating a new landscape.

Neuberger Berman is an employee-owned, private, independent investment manager founded in 1939 with over 2,800 employees in 26 countries. The firm manages $481 billion of equities, fixed income, private equity, real estate and hedge fund portfolios for global institutions, advisors and individuals. Neuberger Berman's investment philosophy is founded on active management, fundamental research and engaged ownership. The PRI identified the firm as part of the Leader's Group, a designation awarded to fewer than 1% of investment firms for excellence in environmental, social and governance practices. Neuberger Berman has been named by *Pensions & Investments* as the #1 or #2 Best Place to Work in Money Management for each of the last 10 years (firms with more than 1,000 employees). Visit www.nb.com for more information. Data as of June 30, 2024.

# Widening Differences, New Opportunities

*Monetary changes and economic stresses are starting to drive diverging fundamentals across fixed income markets, reinforcing the value of security selection.*

As the years of heavy monetary and fiscal intervention recede into the distance, economies and fixed income markets are increasingly reflecting individual fundamentals, with greater dispersion in interest rates and potential for increased (if still moderate) price volatility.

So far in 2024, the story has largely been one of changing expectations about inflation and interest rates—first bullish, then bearish, then more hopeful again. Developed economies are slowing—more rapidly in Europe than in the U.S.—and inflation has eased, but remains well above target levels. Most central banks remain cautious, seeking to avoid a bounce-back in inflation, but in our view risking downside policy mistakes. In general, we anticipate some further action on rate cuts this year, continuing into 2025 as pricing pressures come under greater control, justifying movement from cash positions into the short to intermediate "belly" of the yield curve.

In credit, we perceive a still-healthy environment, but with cracks around the edges, as lower-income consumers and many companies tighten their belts in the face of higher rates and prices. Although we believe tight spreads remain justified, they amplify the need to look carefully at risk-reward and capitalize on opportunities where they emerge, for example, in agency mortgage-backed securities (MBS), hybrids or local emerging markets, which are benefiting from moderating inflation, better relative growth and appealing real yields.

During an important and turbulent political year, we also maintain an eye toward election results and their policy implications for the future.

On the following pages, we present our key market and investment themes for the coming quarter.

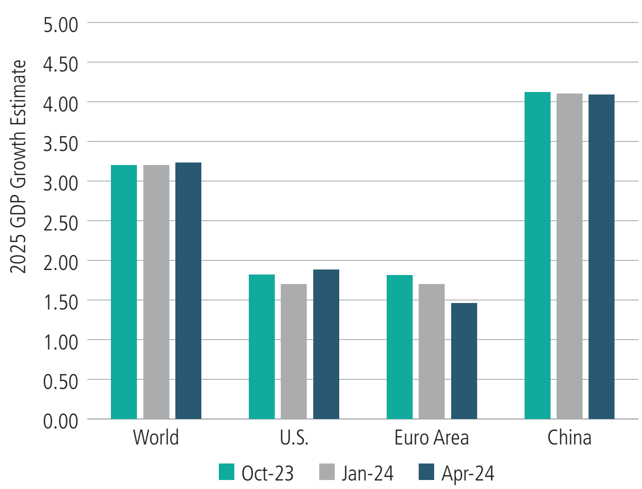
# 1. Global Growth: Moving On From Post-GFC and COVID Dynamics

We expect slowing growth and moderating inflation in the second half of 2024. With reduced central bank intervention, risks to growth should be more two-way, with macro forces largely driving outcomes. Longer term, we anticipate more frequent and shorter business cycles given the increased importance of fundamentals over stimulus to economic outcomes. In this environment, higher real rates should be the norm, while the term premium should experience a comeback given growing budget deficits and issues around debt sustainability.

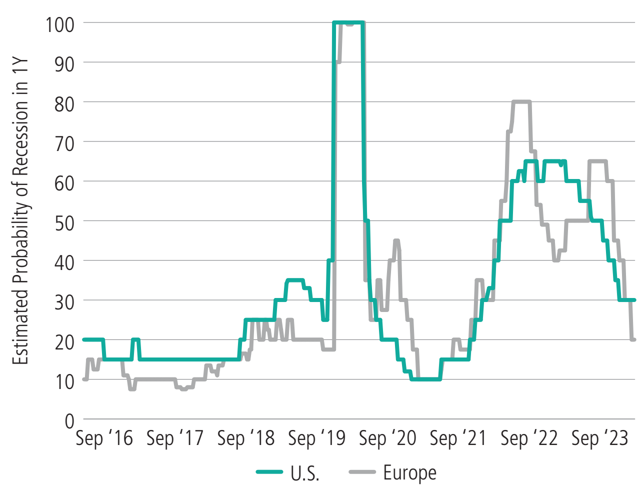
Following a period of surprising resilience, growth expectations remain generally stable, driven by U.S. strength and moderate outcomes in China. The U.S. consumer has been a source of strength, but with rising delinquency rates, lower-income cohorts are pulling back and more affluent consumers, while still healthy, are becoming more selective. While job creation remains strong, labor demand may be slowing. In Europe, affordability has become a key concern, particularly in Britain, while economic strength varies by region; governments may have limited fiscal room to support growth.

**GLOBAL GROWTH RISK IS SKEWED TO THE DOWNSIDE; FORECASTERS MAY BE TOO COMPLACENT**

IMF Forecasts Are Stable




Recession Expectations Are Near Pre-Pandemic Lows




Source: IMF and WEO, as of April 2024. Bloomberg. One-year recession forecasts as of July 5, 2024.

# 2. Monetary Policy: The Path May Be Clear, but the Timing Is Not

After an extended period waiting for definitive signs of normalized inflation, central banks remain cautious about cutting interest rates too quickly. Thus, although reductions have begun in Europe, the timing of a meaningful path downward, there and elsewhere, remains uncertain.

U.S. inflation numbers for June were slightly below expectations, appearing to give the Federal Reserve wiggle room to consider a rate cut as early as September. Although we have likely seen the end of improvement in goods inflation, shelter inflation appears to be easing off its peak; meanwhile, core services (ex-shelter) remain a wild card, but should fade next year. In the U.K. and eurozone, elevated wage costs and services inflation, respectively, remain stumbling blocks for monetary easing.

Overall, we currently anticipate two rate cuts this year from each of the Fed, European Central Bank and Bank of England, consistent with market expectations. However, given our awareness of downside economic risks, we anticipate more cuts than the consensus view in each of the following two years before terminal rates are achieved in 2026. Japan represents a significant outlier as authorities seek to transition out of the "lost years" of deflation, with limited rate increases anticipated over the next two years.

**CENTRAL BANK RATES OUTLOOK (DEVELOPED MARKETS)**

| Central Bank | Market Expectations | Neuberger Berman Expectations | Neuberger Berman Outlook |
|---|---|---|---|
| **FED** | • 2024: 2 Cuts<br>• 2025: 3 Cuts<br>• 2026: 1 Cut<br>• NR: 3.50% | • 2024: 2 Cuts<br>• 2025: 4 Cuts<br>• 2026: 2 Cuts<br>• NR: 3.50% | • Fed funds rate is at its peak with monetary policy easing firmly in focus. Though the Fed has adopted a data-dependent approach due to sticky inflation, resilient labor and elevated consumer spending, we expect the next policy action to be rate cut(s).<br>• We anticipate two rate cuts this year—in September and December—ushering in a gradual normalization of the policy rate, which should ultimately settle at around 3.50%. |
| **ECB** | • 2024: 2 Cuts<br>• 2025: 2 Cuts<br>• 2026: 1 Cut<br>• NR: 2.50% | • 2024: 2 Cuts<br>• 2025: 4 Cuts<br>• 2026: 1 Cut<br>• NR: 2.00% | • The ECB has started its well-telegraphed withdrawal of policy restriction, though with a cautious tone as updated economic projections saw upward revisions to the inflation forecast.<br>• We expect a quarterly pace of normalization leading to two more rate cuts for the year that ultimately settles policy rate at around 2.00% in 2026. |
| **BOE** | • 2024: 2 Cuts<br>• 2025: 2 Cuts<br>• 2026: 1 Cut<br>• NR: 3.75% | • 2024: 2 Cuts<br>• 2025: 4 Cuts<br>• 2026: 3 Cuts<br>• NR: 3.00% | • The BOE is increasingly confident in evidence "that risks of inflation persistence are abating" and signs of economy "tilted to the downside," driving our expectation that it will start policy rate adjustment this year, though the election has introduced some uncertainty around timing.<br>• We now expect two rate cuts for the year—starting post-election in August, after which we expect a quarterly pace of normalization that settles policy rate at around 3.00%. |
| **BOJ** | • 2024: 1 Hike<br>• 2025: 1 Hike<br>• 2026: 1 Hike<br>• NR: 1.00% | • 2024: 1 Hike<br>• 2025: 2 Hikes<br>• 2026: 2 Hikes<br>• NR: 1.25% | • With the BOJ's exit from negative interest rate policy, and the policy goal recently shifting to achieving the "price stability target" as well as acknowledgement that the policy rate is below the neutral level of rates, we now expect the BOJ to embark on a gradual rate-hiking cycle.<br>• We expect one rate hike starting in the second half of the year, after which BOJ adopts a biannual pace of adjustments that brings policy rate to a neutral rate of around 1.25%. |

**NR = Neutral Rate**

Source: Bloomberg, Neuberger Berman. As of June 30, 2024.

# 3. Interest Rates: Reduced Volatility, Increased Dispersion

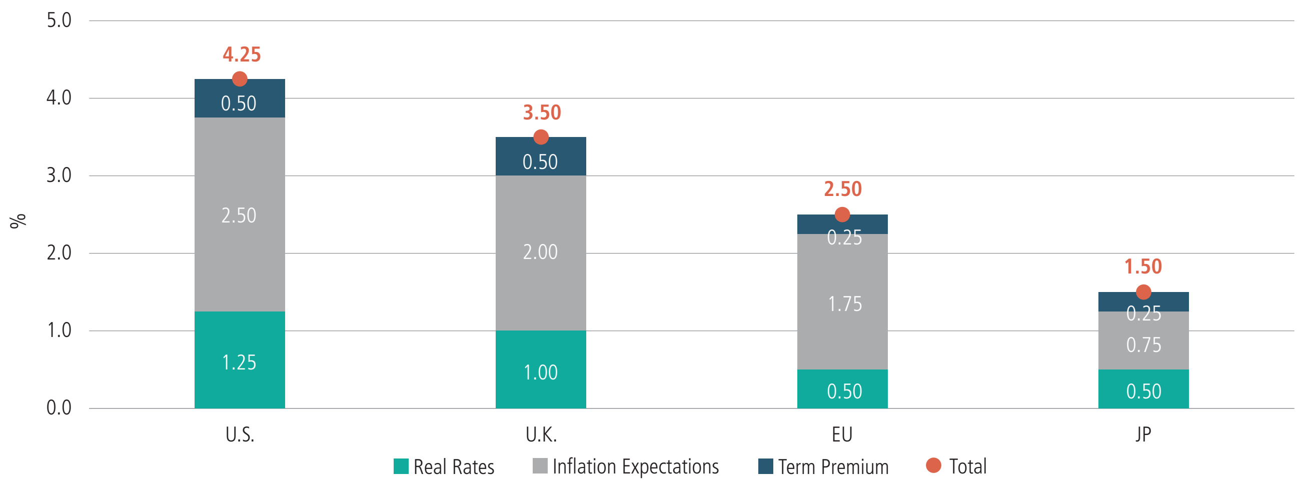
Assuming normalized inflation expectations and trend-like growth, we believe current rates are close to fair value. However, uncertainty around central bank policy and the pricing of the term premium could lead to continued (if diminished) volatility and rangebound action.

We also anticipate greater regional dispersion given divergence of economic performance. For example, we take a neutral view of U.S. government bonds in light of the market's relative economic strength and patience by the Fed, in contrast to the U.K. and Germany, where growth is weaker and (in the case of the U.K.) policy is somewhat more dovish. In contrast, France's political turbulence and deficit issues are reasons for caution.

Overall, we maintain a focus on short and intermediate maturities given the shape of the yield curve and debt sustainability risks.

**ALTHOUGH POLICY RATES ARE LIKELY HEADING OFF THE PEAK, LONGER-TERM FAIR VALUE IS IN FLUX**

DM 10-Year Rates Fair Value Composition




Source: Bloomberg, as of June 30, 2024.

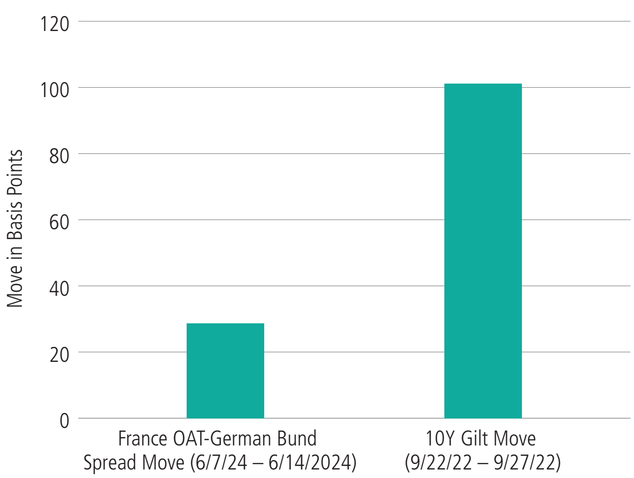
# 4. Politics Could Continue to Impact Markets

In a year when about half of the global population will have gone to the polls, election contests thus far have been a reminder of how results can affect markets based on their perceived implications for policy direction. In the U.K., the Labour Party's landslide victory was largely expected and the market reaction subdued given anticipation of moderate near-term fiscal changes even amid longer-term concerns. In contrast, the rightward tilt in the EU Parliament followed by a surprise leftist victory in French snap elections sharply widened French/German 10-year government spreads and dampened expectations for continued reforms. Similarly, the election of Claudia Sheinbaum in Mexico spooked investors worried about the continuation/expansion of populist policies. In the U.S., concerns over President Joe Biden's mental acuity triggered a temporary spike in bond yields in late September as markets anticipated a united government (and thus potentially greater budget deficits) under Donald Trump and the Republicans.

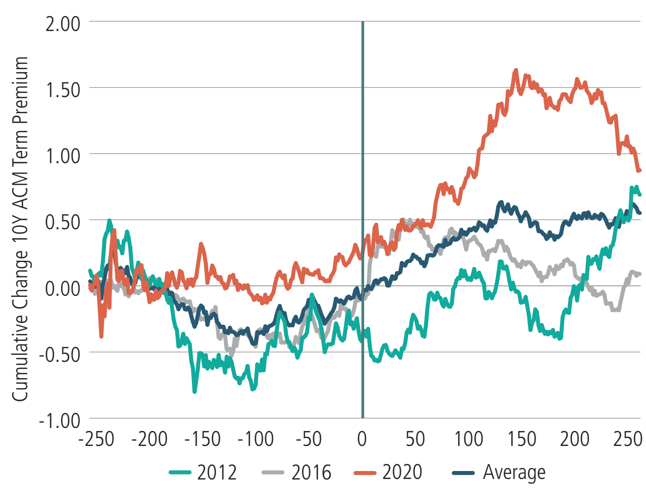
Still, immediate market reactions do not necessarily reflect the nuances. In India, although Prime Minister Narendra Modi's National Democratic Alliance lost Parliamentary seats, it should be able to execute on already approved reforms, even as further changes may face opposition in the legislature. Despite her progressive profile, Sheinbaum will likely need to work closely with businesses and the country's northern neighbor, perhaps softening the ultimate impact. In the U.S., neither candidate has appeared committed to reducing spending, making debt sustainability an issue regardless of who wins.

**ELECTIONS—AND THEIR POLICY IMPLICATIONS—CAN MATTER**

French Snap Elections Are Reminiscent of 2022's U.K. Fiscal Concerns




Historically, Term Premiums and Inflation Expectations Have Risen Prior to U.S. Elections




Source: Bloomberg.

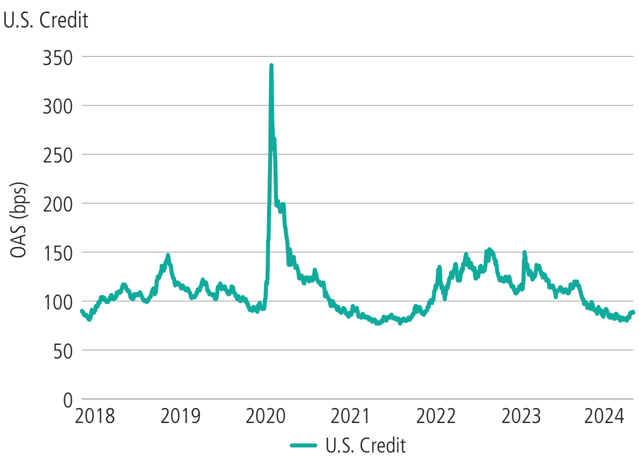
# 5. Credit: Emphasize Selectivity as Cycle Matures – Part 1

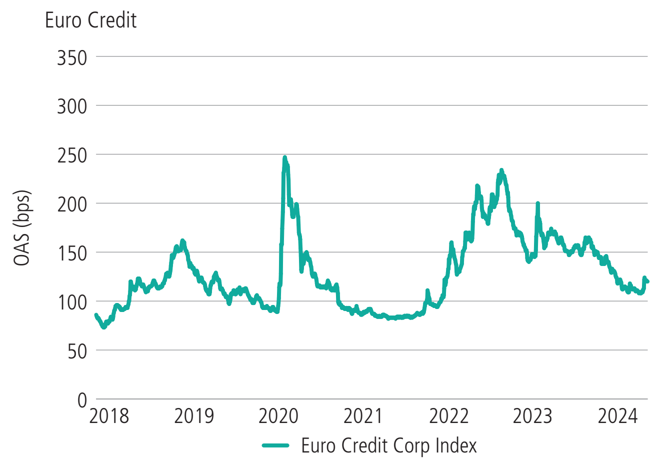
Although corporate spreads are tight relative to history, we believe all-in yields are attractive at these levels. However, given growing strains on the economy, "up-in-quality" credits with defendable balance sheets seem particularly appealing, in our view.

In the U.S., intermediate investment grade corporate credits look attractive to us relative to longer issues as the credit curve remains flat. And despite strong supply so far this year, demand for yield remains robust, creating a technical support for pricing. In looking at this market, we are taking a conservative but opportunistic approach as we consider individual corporate fundamentals with an eye toward idiosyncratic risks and financial policy. Although neutral relative to the overall market, we favor adding risk during bouts of volatility as opportunities arise.

In Europe, credit spreads have tightened this year, even as expectations for lower growth are driving softer near-term earnings estimates. Consumer demand, energy supply disruptions, margin headwinds and refinancing risks could be key drivers in corporate performance. At the same time, fundamentals generally remain solid, providing a buffer against credit deterioration.

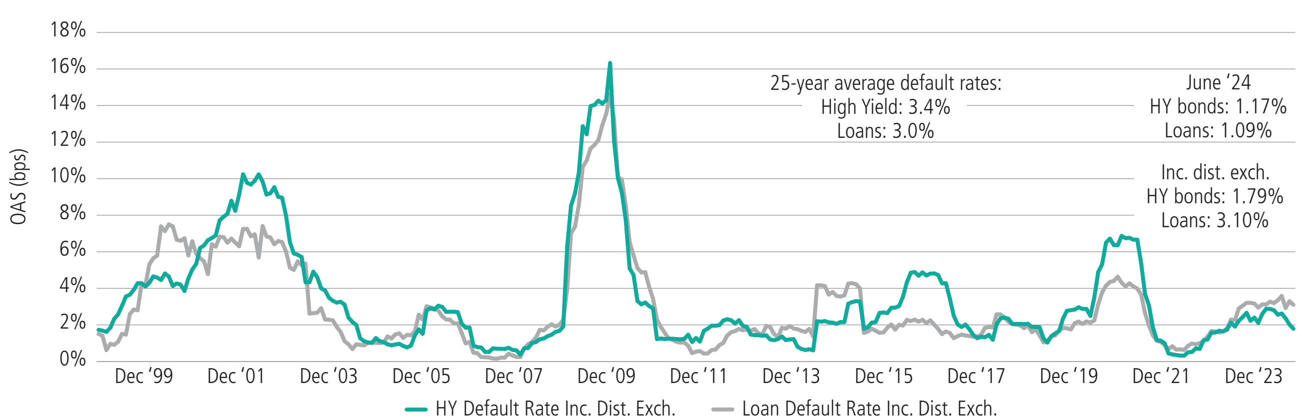
**INVESTMENT GRADE CREDIT SPREADS ARE TIGHT, BUT VOLATILITY COULD CREATE OPPORTUNITIES**




Source: Barclays LECPOAS and LUCROAS indices, as of June 30, 2024.

**NON-INVESTMENT GRADE DEFAULTS ARE UP FROM RECORD LOWS**




Source: J.P. Morgan; PitchBook Data, Inc, Bloomberg Finance L.P., S&P/IHSMarkit; as of June 30, 2024.

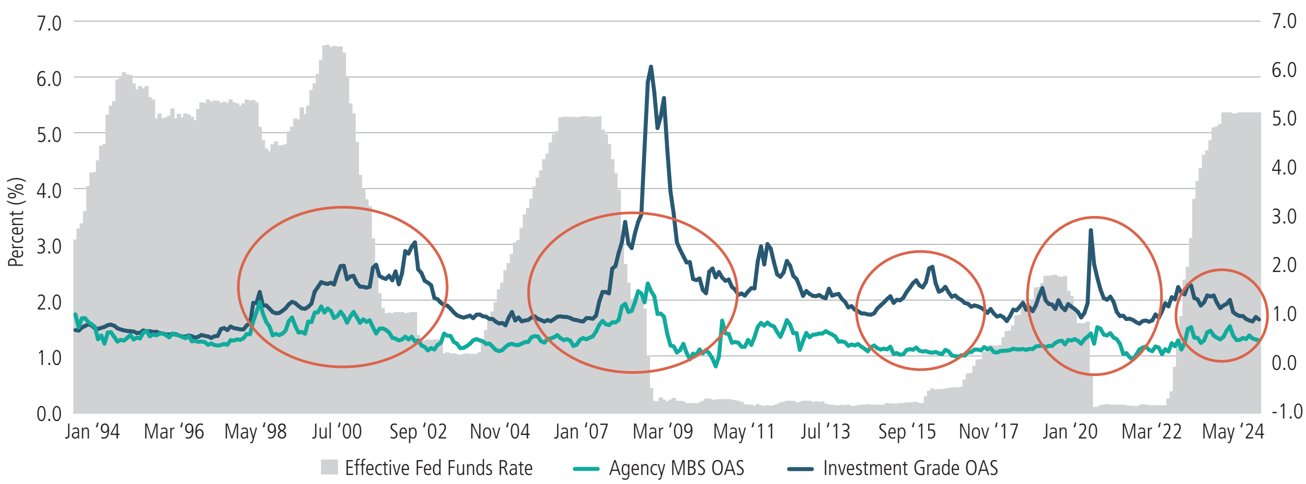
# 6. Credit: Emphasize Selectivity as Cycle Matures – Part 2

In an environment of generally narrow credit spreads, differentiation among segments and issuers has become especially important. We continue to find value within securitized products across various sectors, maturities and risk profiles, observing that spreads remain around long-term historical averages, in contrast to corporate credits.

Specifically focusing on mortgage-backed securities, many issues are trading at a discount, even as higher interest rates have caused prepayment activity to slow, with minimal expectation for a rebound. Positive fund flows combined with attractive valuations have been supportive for the asset class even with relatively modest demand from banks (typically the largest owners of MBS). Historically, U.S. agency MBS have outperformed after a peak in the fed funds rate.

**RATE CUTS HAVE BEEN A TAILWIND FOR AGENCY MBS**

Investment Grade Corporate OAS vs. Agency MBS OAS




Source: Bloomberg, as of July 5, 2024. OAS (option-adjusted spread) reflects the Bloomberg U.S. MBS Index and the Bloomberg U.S. Corporate Investment Grade Index.

# Market Views

Next 12 Months

| | UNDER −− | − | NEUTRAL ◇ | + | OVER ++ | CHANGE NOTES |
|---|---|---|---|---|---|---|
| **GOVERNMENT BOND MARKETS** | | | | | | |
| United States | ○ | ○ | ● | ← ○ | ○ | Increased Fed patience and limited market willingness to price a more aggressive cutting cycle should keep rates in tight range. |
| United Kingdom | ○ | ○ | ○ | ● | ○ | |
| Germany | ○ | ○ | ○ | ● | ○ | |
| France | ○ | ○ | ● | ← ○ | ○ | Risks remain from political uncertainty and sanctions tied to the EU's "excessive deficit procedure," but appear offset by wider spreads and front-loaded 2024 OAT issuance program. |
| Italy | ○ | ○ | ● | ○ | ○ | |
| Spain | ○ | ○ | ● | ○ | ○ | |
| Japan | ○ | ● | ○ | ○ | ○ | |
| Canada | ○ | ○ | ○ | ● | ○ | |
| 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 | ○ | ○ → | ● | ○ | ○ | The dollar may benefit temporarily from fiscal and political issues elsewhere, despite likely rate cuts and longer-term federal budget issues. |
| Euro | ○ | ○ | ● | ○ | ○ | |
| Pound | ○ | ● | ○ | ○ | ○ | |
| Yen | ○ | ○ | ○ | ● | ○ | |
| Swiss Franc | ○ | ○ → | ● | ○ | ○ | Political uncertainty in Europe, as well as French fiscal worries, offer near-term support for the Swiss franc as a safe-haven currency. |
| Australian Dollar | ○ | ○ | ○ | ● | ○ | |
| Swedish Krona | ○ | ○ | ● | ○ | ○ | |
| Norwegian Krone | ○ | ○ | ● | ○ | ○ | |
| Canadian Dollar | ○ | ○ | ● | ○ | ○ | |
| Mexican Peso | ○ | ○ | ○ | ● | ○ | |
| South African Rand | ○ | ○ | ○ | ● | ○ | |
| Brazilian Real | ○ | ○ | ● | ← ○ | ○ | Economic fundamentals are stable, but the market is waiting for evidence of the government's commitment to fiscal restraint in a difficult political environment. |
| Chinese Yuan | ○ | ● | ○ | ○ | ○ | |

Views expressed herein are generally those of the Neuberger Berman Fixed Income Investment Strategy Committee and do not reflect the views of the firm as a whole. Neuberger Berman advisors and portfolio managers may make recommendations or take positions contrary to the views expressed. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. See additional disclosures at the end of this material, which are an important part of this presentation.

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

# Talk to Neuberger Berman

For more information, please contact your Neuberger Berman representative or visit www.nb.com.

### FIRM HEADQUARTERS

New York
+1 800 223 6448

### REGIONAL HEADQUARTERS

Hong Kong
+852 3664 8800

London
+44 20 3214 9000

Shanghai
+86 21 5203 7700

Tokyo
+81 3 5218 1930

### PORTFOLIO MANAGEMENT CENTERS

Atlanta
Boston
Buenos Aires
Chicago
Dallas
Hamilton
Hong Kong
London
Los Angeles
Milan
New York
Paris
Philadelphia
Redwood City
Shanghai
Singapore
The Hague
Taipei
Tokyo
Toronto
West Palm Beach

### OFFICES

**AMERICAS**

Atlanta
Bogota
Boston
Buenos Aires
Chicago
Dallas
Hamilton
Los Angeles
Morristown
New York
Philadelphia
Redwood City
San Francisco
São Paulo
Tampa
Toronto
West Palm Beach
Wilmington

**EUROPE, MIDDLE EAST & AFRICA**

Dubai
Dublin
Frankfurt
London
Luxembourg
Madrid
Milan
Paris
Stockholm
Tel Aviv
The Hague
Zurich

**ASIA PACIFIC**

Hong Kong
Melbourne
Mumbai
Seoul
Shanghai
Singapore
Sydney
Taipei
Tokyo



NEUBERGER | BERMAN

**Neuberger Berman**
1290 Avenue of the Americas
New York, NY 10104-0001



**www.nb.com**