MacroResearchBoard
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Independent Investment Strategy

GLOBAL
FIXED INCOME

November 22, 2023

2024 Fixed Income Outlook: Diverging Trends

- The U.S. economy will prove resilient over the next year, while the euro area has scope to firm somewhat and surprise to the upside. Conversely, recessionary forces will develop in the other weak link developed economies with housing excesses.

- Consumer price inflation will continue to be heavily influenced by aggregate global forces. DM core inflation will ease further in early-2024, but should bottom well above central bank targets due to the resilience of the U.S. and euro area household sectors (the two dominant global price setters).

- Central banks are finished hiking rates. The Fed is intent on cutting, but Fed and ECB policy rates will remain higher than market expectations for significant rate cuts next year. Conversely, central banks in weak-link economies will eventually be forced to cut rates (and allow currencies to depreciate) to offset housing fallouts.

- We have shifted closer to benchmark duration, but remain underweight government bonds (especially the U.S. and euro area), while staying overweight those in weak link economies, as well as corporate bonds and EM local-currency debt within a global (currency hedged) fixed-income portfolio.

This has been a challenging but somewhat better year for global fixed-income markets than the disastrous 2022 (**chart 1**). The total return of G7 10-year government bonds is down almost 1% year-to-date (after plunging 16% in 2022), but U.S. corporate bonds have performed well, with the high-yield aggregate up nearly 8%. Emerging market local currency debt has also generated a healthy total return of about 4% so far this year (and 7% when excluding Turkey) when translated into U.S. dollars. Looking ahead to 2024, we expect global bond markets to generate modest positive nominal returns, albeit it will likely continue to be a volatile ride.

MRB has been considerably more upbeat on the global economy and much more negative on the outlook for G7 government bonds in recent years than the consensus. Like most others, we agree that the likely catalyst for the next global recession will be restrictive monetary conditions. However, where we have repeatedly disagreed is in the level of interest rates and bond yields that is

MRB Global Fixed Income Recommendations*

	-	N	+
Duration	■		
Government Bonds	■		
Yield Curve**			■
Inflation Protection		■	
Corporates: Investment-Grade			■
High-Yield		■	
EM: USD-Denominated Debt		■	
Local Currency Debt			■
DM Government Bonds (Currency Hedged)* **			
Australia			■
Canada			■
Euro Area	■		
Euro Area Ex-Germany	■		
Germany	■		
Japan		■	
New Zealand			■
Norway			■
Sweden			■
Switzerland		■	
U.K.		→	■
U.S.	■		

* 6-12 month horizon
** + = steepener and – = flattener
*** Relative to hedged global fixed income benchmark
Note: + = overweight, N = neutral, – = underweight

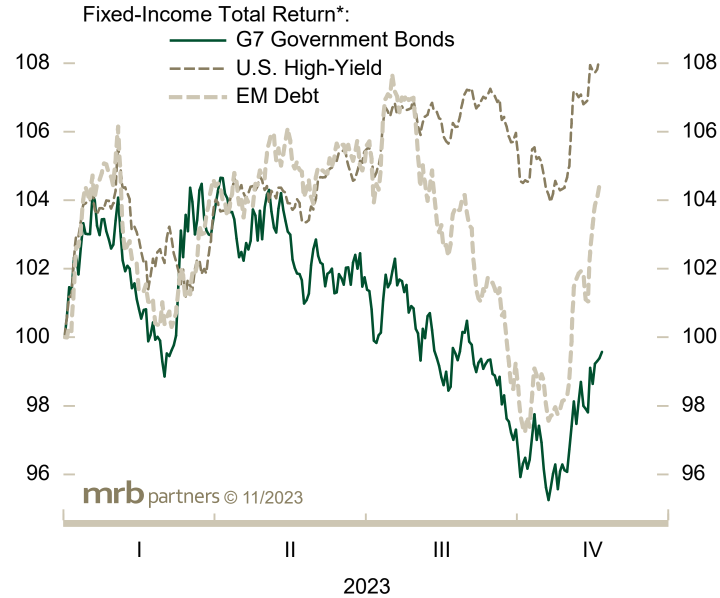
sufficiently restrictive to set in motion a recession, and thus the timing of the inevitable endpoint of the cycle.

Central banks and most investors have struggled to realize that the 2010s was a unique environment rather than the baseline for what to expect once pandemic-related distortions were unwound. They have been hung up on the wrong macro framework, rooted in the misplaced secular stagnation narrative, which has caused bond bulls to be repeatedly wrongfooted[1] (**chart 2**).

Our frameworks recognized that the U.S. and euro area household sectors (two major sources of global final demand) had become much less vulnerable to higher interest rates this decade after spending the prior 10+ years deleveraging. While much of the policy accommodation has now been removed, our research indicates that monetary conditions remain mildly supportive for the U.S. and euro area economies; certainly not restrictive as the Fed and others assert. Rate cuts are not warranted in either economy, although the Fed appears determined to do so anyway. That said, we expect any decline in Fed or ECB policy rates to be modest, rather than the deep cuts bond investors are again expecting.

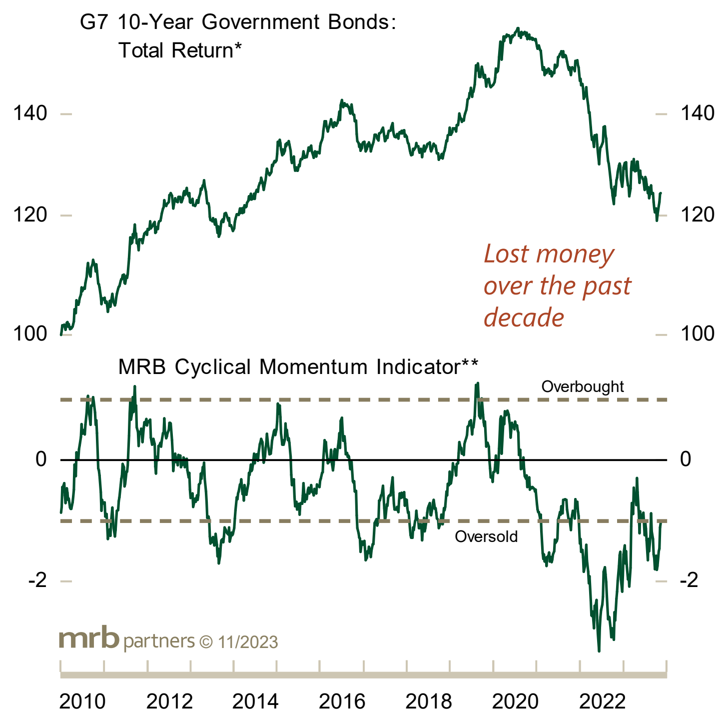
In contrast, imbalances have built in other (smaller) segments of the global economy (our list of so-called "weak links") which have become increasingly vulnerable as the cost of capital rose[2]. Recessionary forces will likely develop in these economies in 2024 (if mortgage rates do not fall significantly) and force their central banks to cut rates. This could be the precursor to the next global recession, but the fallout in

Chart 1 A Volatile Year For Fixed Income Markets



* Rebased; source: Bloomberg

Chart 2 A Very Difficult 3-Years For G7 Bonds



* Rebased
** Standardized
Note: Panel 1 shown in log scale

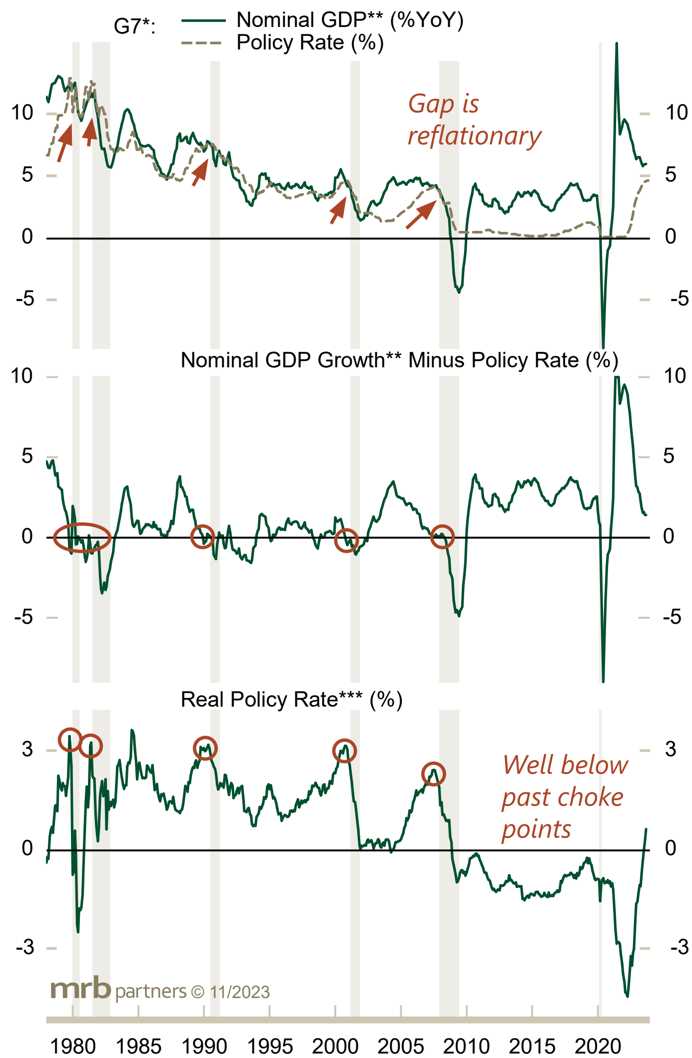
[1] MRB *Theme Reports:* "*Path To Recession: Timing Is Everything*", July 21, 2022 and "*Investors Misinterpret The Cycle Yet Again*", February 10, 2023

[2] MRB *Charts:* "*Are The Global Weak Links About To Snap?*", October 4, 2023

the global weak links would first need to cause significant spillover contagion to the overall global economy, which will take time. Nonetheless, the next global recession will likely originate in this segment of the globe, rather than a retrenchment in the relatively healthy U.S. and euro area consumer sectors.

Diverging economic and policy trends will be the theme for 2024. However, the G7 bond market will still be driven by the dominant U.S. and euro area economies for now. This should soon put a floor under bond yields, albeit to the detriment of the weak-link economies. The risk/reward profile for fixed income is not yet overly appealing but has significantly improved over the past two years. In turn, we have recently shifted towards benchmark duration and a neutral allocation to bonds within a global multi-asset portfolio[3]. A further shift towards lengthening duration and overweighting bonds is possible in 2024, but not assured.

Chart 3 **Policy Has Become Less Supportive, But Not Yet Restrictive**



* GDP-weighted aggregate
** Source: OECD
*** Policy rate deflated by core CPI inflation; source: OECD
Note: Shaded for NBER-designated U.S. recessions; panel 2 truncated at 10%

2023 Outlook Review

This time ***a year ago*** our research highlighted that the global cost of capital (interest rates and bond yields) was still accommodative and not yet threatening, even for most global weak links (**charts 3** and **4**). This was in stark contrast with the prevailing narrative at the time. Consequently, we leaned aggressively against the entrenched consensus, calling for no U.S. (or global) recession, still higher developed market policy rates and an eventual breakout in bond yields, before yet another extended consolidation phase. Specifically, the **MRB *2023 Fixed Income Outlook*** in ***December 2022*** suggested[4]:

Our 2023 outlook panned out exceptionally well

"G7 government bonds remain oversold following the surge in yields through to October 2022. The recent digestion phase is likely to persist over the next several months, and with

[3] **MRB *Asset Allocation Strategy:*** "***A Reprieve Before The Endgame***", November 3, 2023

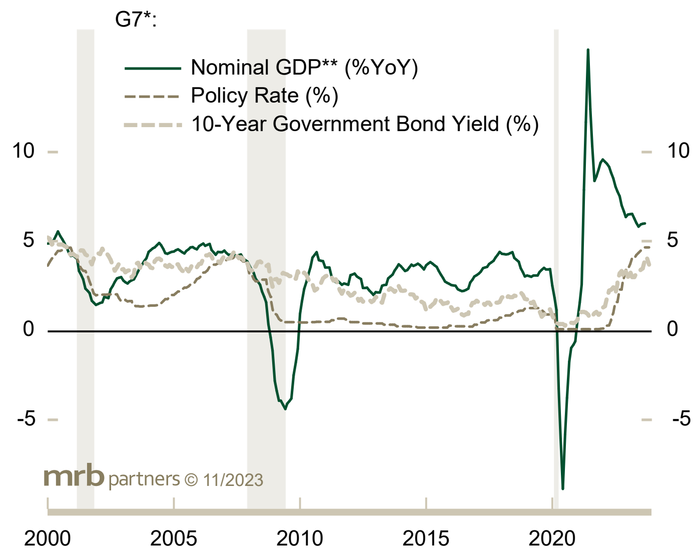
[4] **MRB *2023 Fixed Income Outlook:*** "***Some Calm Before The Next Storm***", December 6, 2022

a bias to lower yields while inflation eases and until cyclical bond momentum measures return closer to neutral readings.

However, another bond market riot is coming down the road since the global economy is not as weak or fragile as widely perceived."

By ***May 2023*** we took another hard shot at the recession view[5], as well as bond bulls, and their reading of the inverted yield curve[6]. We recommended betting on an unwinding of expectations for deep Fed rate cuts[7] and ultimately called for the benchmark 10-year Treasury yield (and other developed market bond yields) to break to decisive new highs[8].

Chart 4 The Gap Between GDP Growth And Cost Of Capital Is Still Mildly Positive



* GDP-weighted aggregate
** Source: OECD
Note: Shaded for NBER-designated U.S. recessions

That said, we have never been dogmatic in our bond market outlook. In ***October 2023*** once the 10-year U.S. Treasury yield had surged to 5%, we warned of another extended consolidation phase[9]. We covered our short bond recommendations in the **MRB *Absolute Return Strategy***, and upgraded bonds from underweight to neutral within a global multi-asset portfolio[3].

2024 Outlook

The outlook for 2024 is more nuanced now that the global cost of capital has risen materially

Looking ahead to 2024, the picture has become more nuanced given that the global cost of capital has risen decisively over the past year, notably in real terms (**charts 3** and **4**). Our research suggests that monetary conditions are still supportive for the U.S. and euro area economies but have become restrictive for many of the weak links, particularly those with major household sector imbalances[10] (**chart 5**). High-yield credit spreads and equity prices are also consistent with our conclusion

[5] **MRB *Research Highlight:*** "*Challenging The U.S. Recession View (Part I)*", May 9, 2023 and "*(Part II)*", May 11, 2023

[6] **MRB *Fixed Income:*** "*The Irony Of The Inverted Yield Curve*", May 26, 2023

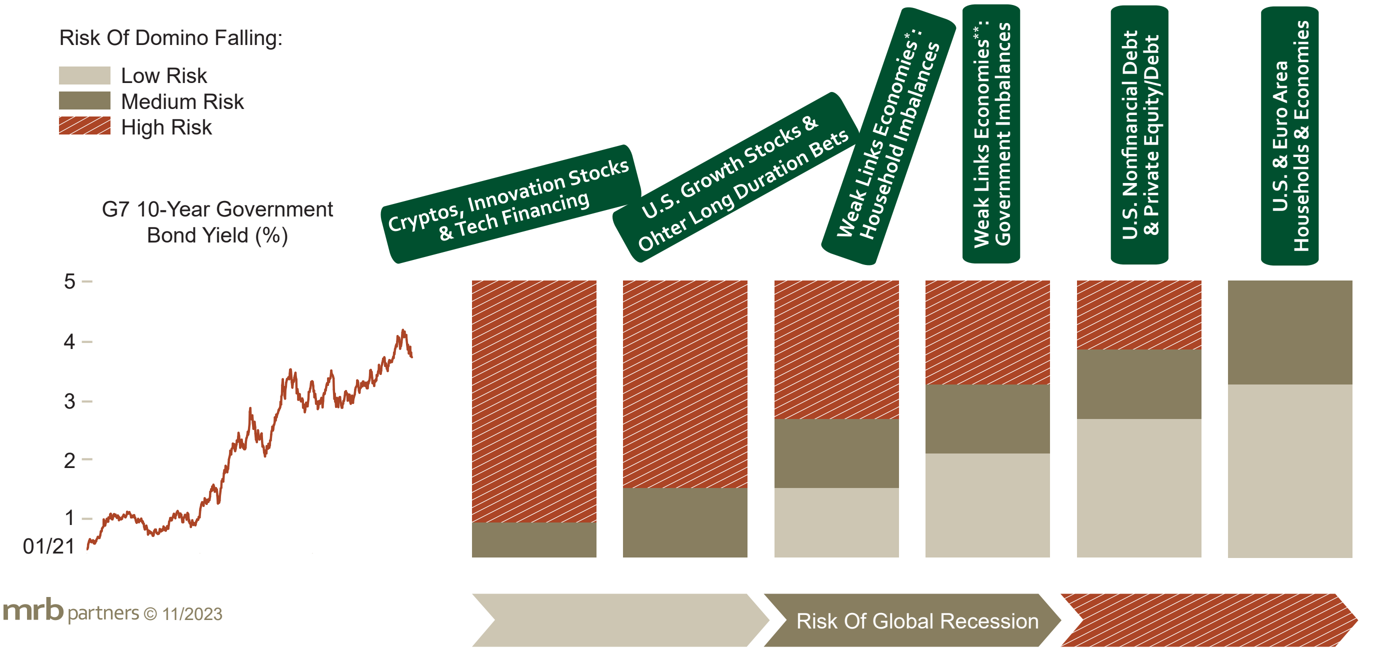
[7] **MRB *Absolute Return Strategy:*** "*Playing The Late Cycle: Leaning Against The Consensus Yet Again*", May 18, 2023

[8] **MRB *Global Fixed Income:*** "*Another Upwave In Bond Yields Is Inevitable*", August 9, 2023

[9] **MRB *Absolute Return Strategy:*** "*Will Higher Bond Yields Break The Global Economy?*", October 20, 2023

[10] Includes Australia, Canada, New Zealand, Norway, Sweden, and the U.K.

Chart 5 Mapping The Fallout From A Higher Cost Of Capital: Monitor The "Weak Links"



* Includes: Australia, Canada, Denmark, Hong Kong, Netherlands, New Zealand, Norway, Sweden, Switzerland and U.K.
** Includes: France, Greece, Italy, Japan, Portugal and Spain

that monetary conditions are not yet restrictive in the U.S. and euro area. In turn, the theme for the year ahead will be diverging trends across the developed world in terms of economic growth, monetary policy, and bond market performance.

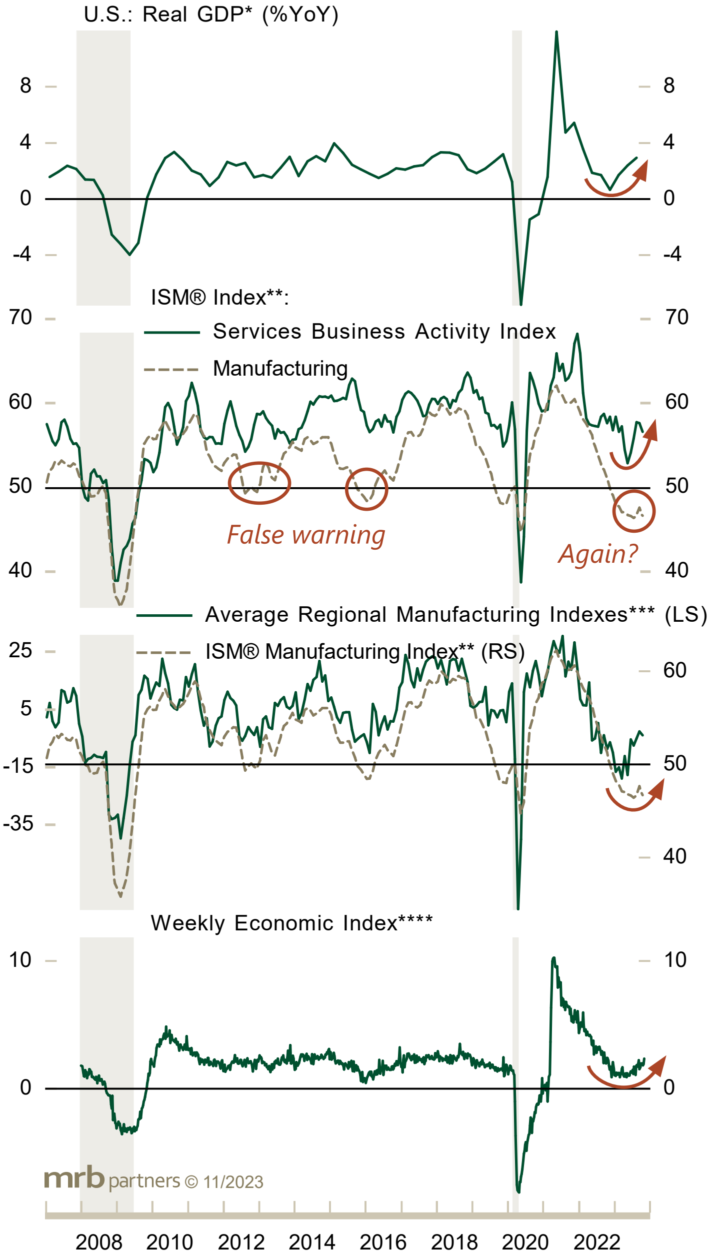
U.S.: Resilient Economy & Higher-For-Longer Rates

The U.S. economy is durable and does not require Fed cut rates, even though the Fed appears determined to do so anyway (policy misstep)

Bond bulls have repeatedly and prematurely called for a U.S. recession and deep Fed rate cuts during the past two years and are calling for the same in 2024, despite being wrongfooted on this view in 2023. Stopped clocks are right twice a day and a recession will eventually arrive, but timing is everything for investment strategy. MRB's view is that the economic cycle has matured, but a sufficient recessionary catalyst is still missing within the U.S. economy.

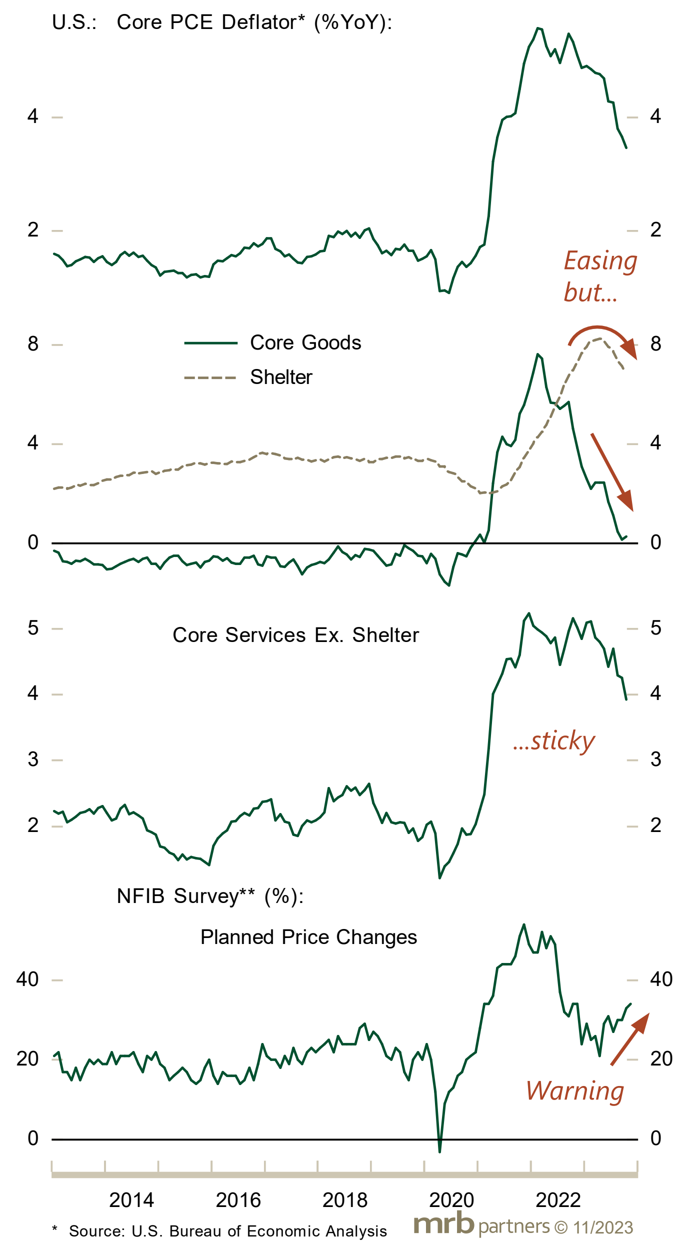
U.S. real GDP growth will cool from a blistering 4.9% in 2023 Q3 but will settle into a still healthy above-potential run-rate (**chart 6**). Indeed, consumer spending remains resilient, with consumer services activity showing no signs of flagging. The Fed's *Weekly Economic Index* is firming (despite this year's rise in interest rates and bond yields), and regional manufacturing surveys warn of a rebound in the widely followed ISM manufacturing index above its boom/bust line. Core consumer price inflation will continue to ease through early-2024 (providing some comfort for the Fed and bond investors), but it will bottom out before mid-year, well above expectations and likely above 3% (**chart 7**).

Chart 6 **The U.S. Economy Is Resilient**



* Source: U.S. Bureau of Economic Analysis
** Smoothed; source: Institute for Supply Management®
*** Source: Federal Reserve Banks of New York, Philadelphia & Richmond
**** Source: Federal Reserve Bank of New York
Note: Shaded for NBER-designated U.S. recessions

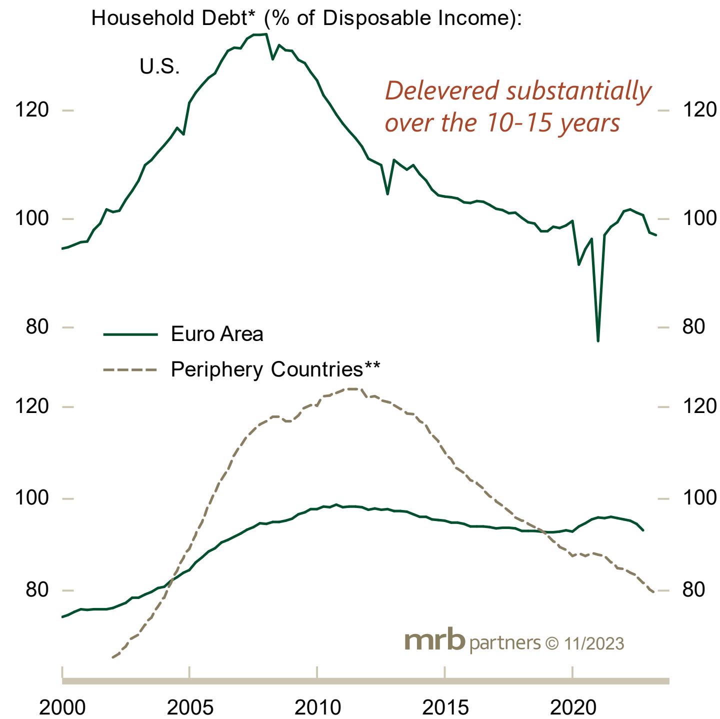
Chart 7 **U.S. Core Inflation Will Be Stickier Than Expected**



* Source: U.S. Bureau of Economic Analysis
** Source: National Federation of Independent Business

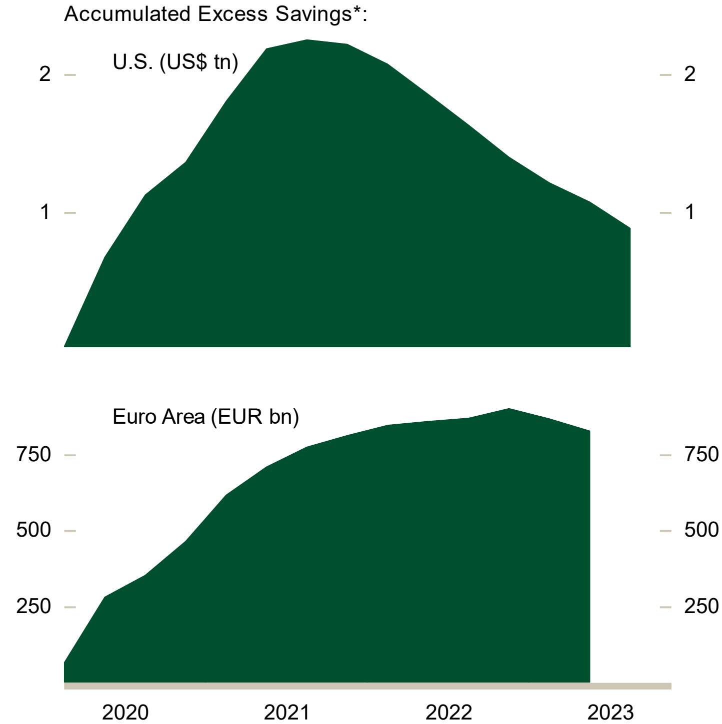
The durability of the U.S. economy, despite significant rate hikes, is the result of the starting point of absurdly low policy rates and bond yields, along with substantial household sector deleveraging over the past 15 years (**chart 8**) and a significant stockpile of excess savings that has not yet been fully spent (**chart 9**). Households are also experiencing solid wage gains (**chart 10**), a testament to a tight labor market

Chart 8 U.S. And Euro Area Households Have Healthy Balance Sheets



* Source: Federal Reserve & ECB
** Equally-weighted aggregate of Greece, Ireland, Italy, Portugal, and Spain

Chart 9 U.S. And Euro Area: Lots Of Excess Savings

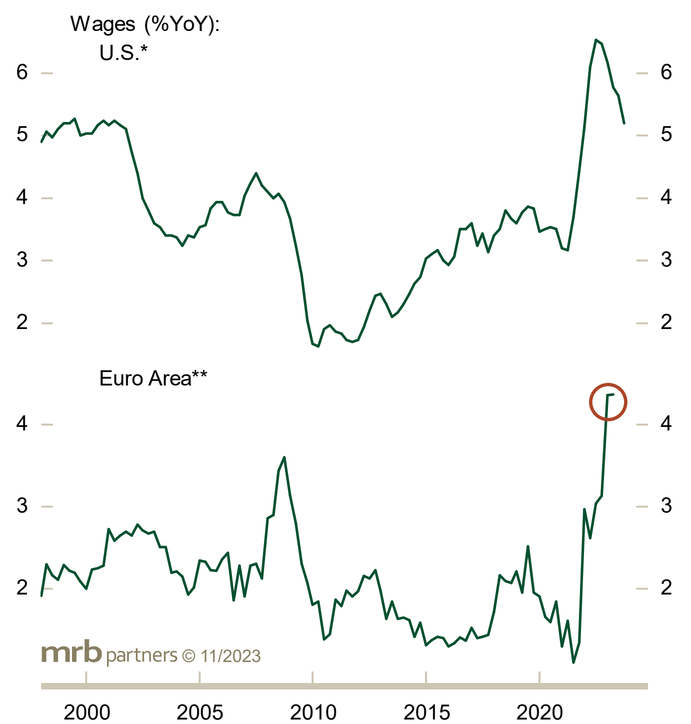


* MRB calculation

and buoyant corporate profits. Together this makes consumer spending much less vulnerable to a higher cost of capital than the consensus has perceived, especially since most home mortgages are at pre-2022 fixed rates.

The U.S. economy will become more sensitive to interest rates over time, albeit only gradually and after household excess savings are fully spent (later in 2024) and the nonfinancial corporate sector faces need to refinance its outstanding debt obligations (which is more of a 2025 issue, see below). For now, the increase in the cost of capital has helped dampen demand for housing and durable goods, but any decline in interest rates and/or bond yields at this point would likely stoke activity, since aggregate monetary conditions remain mildly accommodative for the U.S. economy.

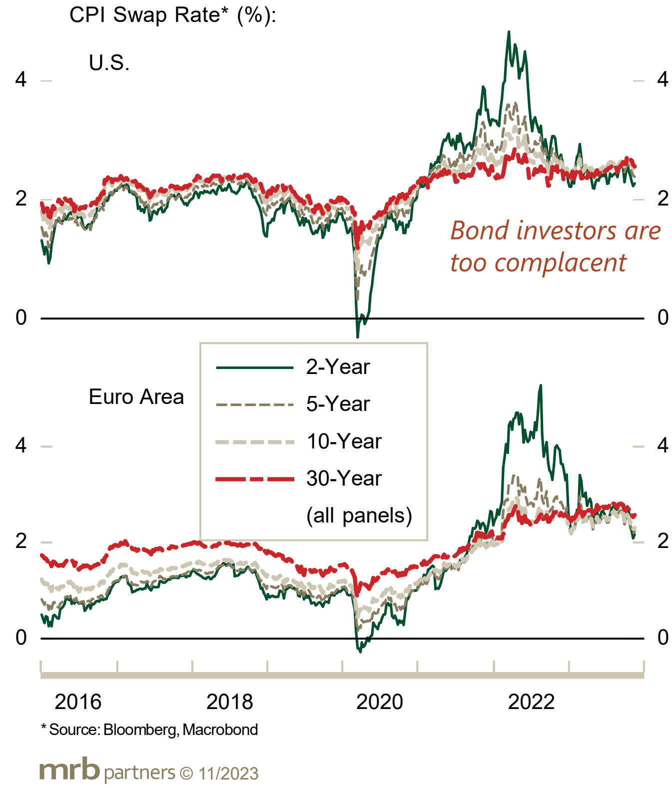
Chart 10 U.S. And Euro Area: Solid Wage Gains



* Smoothed; source: Federal Reserve Bank of Atlanta
** Source: ECB

Regardless, the Fed appears determined to take advantage of easing inflation and cut rates in 2024. However, providing the deep rate cuts that bond investors are currently expecting will be hard to justify when the economy is shrugging off previous tightening (signaling conditions are not yet restrictive), employment conditions are solid (even if moderating), and core PCE inflation is likely to bottom well above the central bank's target. We also suspect that the Fed would prefer to keep its head low and remain out of the political crossfire in what will be a contentious election year.

Chart 11 Inflation Expectations: All Roads Lead Back Near 2%



As for U.S. Treasurys, our view is that another extended digestion phase is currently underway after bonds become oversold. However, in contrast to the consensus view, the risks are again becoming skewed in favor of another upwave for bond yields. Earlier this year, the Fed and investors were forced to rethink their overly depressed perception of the equilibrium policy rates and the so-called R-Star when the economy reaccelerated despite significant rate hikes[11]. Next year when inflation bottoms, the consensus will have to reconsider its entrenched belief that all roads lead near 2% inflation, which could put further upward pressure on Treasury yields (**chart 11**).

Euro Area: Firmer Economy & Higher-For-Longer Rates

The euro area economy will be surprisingly firm in 2024 and the ECB will keep rates relatively elevated

The euro area economy perhaps has the most potential to beat expectations, since it has suffered two years of chronic disappointment, and the bar for regional growth to outperform is now extremely low[12]. The euro area economy reopened from the pandemic later than the U.S. and then suffered from an energy crisis. In turn, the economy is lagging the U.S. by many months and is currently experiencing a material slowdown, much like the U.S. experienced until early-2023. However, we expect the economy to firm as it heads into 2024, albeit to a much lesser degree than the sharp bounce back in U.S. real GDP this year.

Much like the U.S., the foundations under the regional economy are stronger than are widely perceived. Households deleveraged last decade, leaving the euro area

[11] MRB ***Research Highlight:*** "R-Starring The U.S. Economy", September 6, 2023

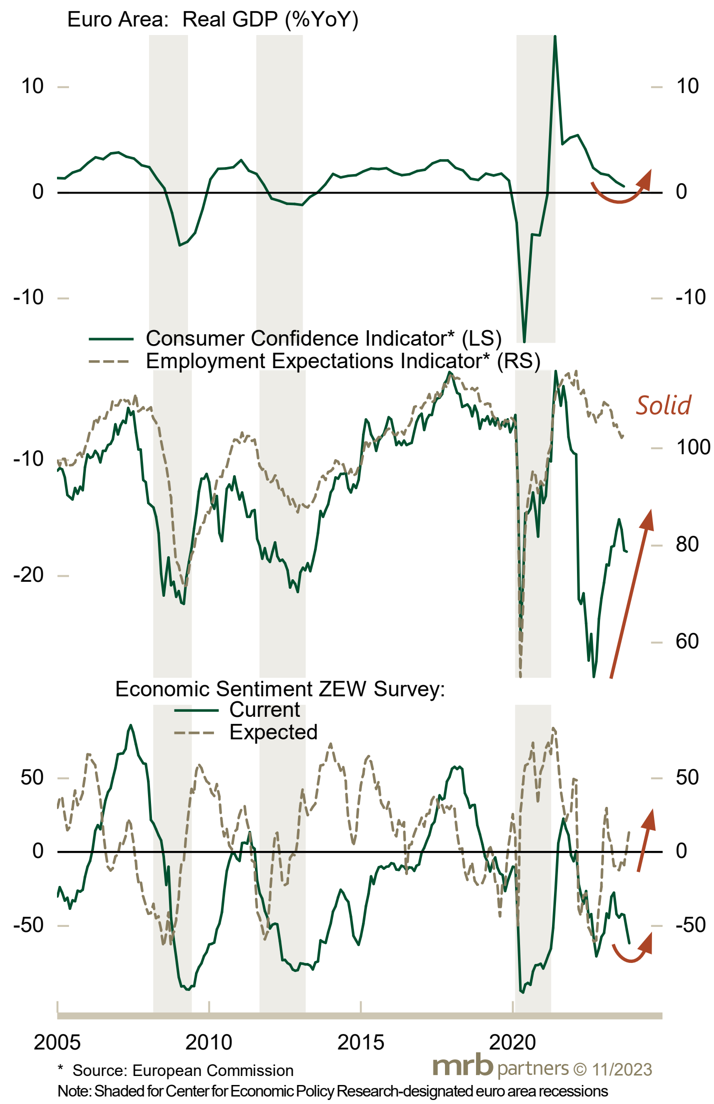
[12] MRB ***Weekly Macro Strategy:*** "More Of The Same", November 17, 2023

less interest rate sensitive than anytime since before the GFC[13] (**chart 8**). Households also have record levels of excess household savings (due to under-spending this decade, **chart 9**), and solid labor demand and wages to support spending (**chart 10**).

Chart 12 shows that consumer confidence has recovered following the energy crisis but remains historically subdued. That said, the outlook for employment remains positive and should bolster sentiment and spending in the months ahead. Notably, the ZEW economic expectations index has hooked up this autumn, which heralds better current conditions ahead, absent some new headwind. For the most part, service sector confidence has held up throughout the region, but industrial confidence is weak (**chart 13**). However, the latter could improve markedly next year as the global trade cycle firms (see below).

Euro area core consumer price inflation is decelerating and should continue to do so well into next year. However, underlying price pressures are also likely to remain sticky, supported by elevated service sector inflation, a lack of spare capacity, and historically strong wage gains (**chart 14**). Ultimately, we do not expect core inflation to fall as much as the ECB or bond investors currently believe (**chart 11**).

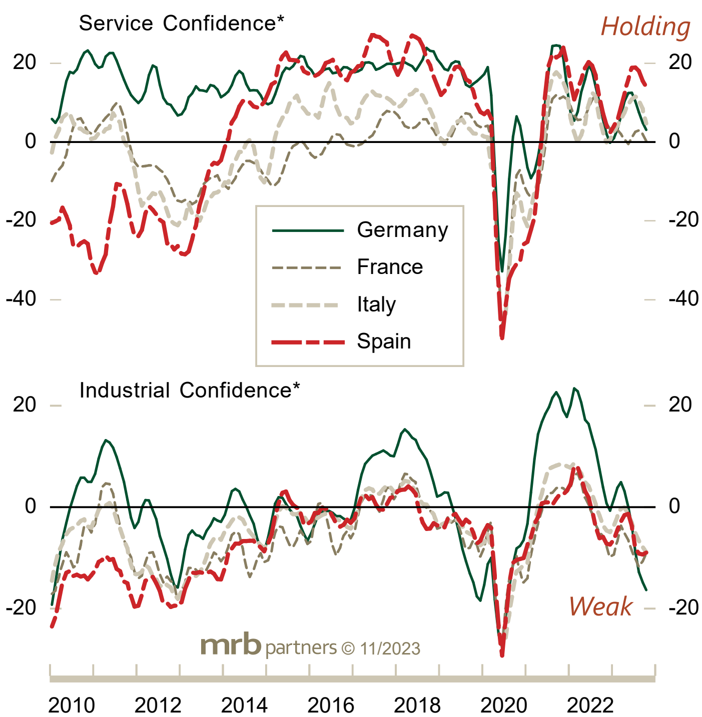
Chart 12 **Euro Area Economy Should Firm**



The combination of a firming regional economy and stickier-than-expected inflation in 2024 should encourage the ECB to keep policy rates higher-for-longer. The major caveat and tail risk that investors need to monitor is Italy. The Italian government has excessive debt burdens which leave it exposed to higher bond yields. The key will be for the ECB and regional authorities to remain determined to offset any stresses that develop, which seems likely after experiencing multiple waves of the sovereign debt crisis last decade. The 10-year Italian versus German bond spread signals no signs of stress (**chart 15**, page 11). Last week's upgrade by Moody's of the outlook for Italy's debt to stable from negative should bolster investor sentiment.

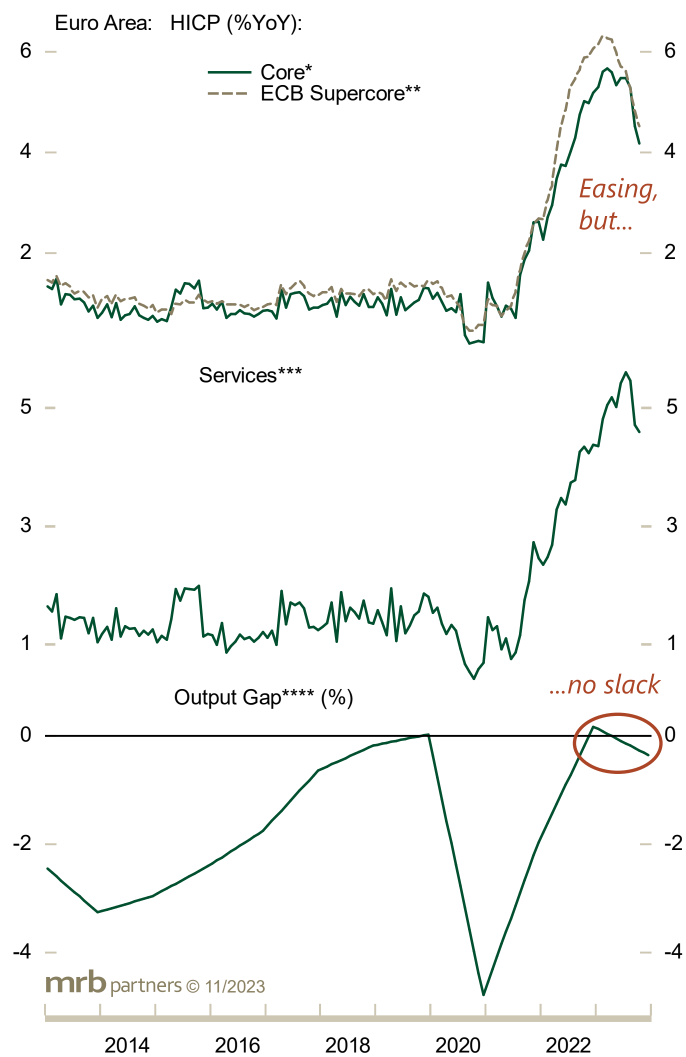
[13] **MRB *Research Highlight:*** "*Euro Area: Down But Not Out*", August 16, 2023

Chart 13 **Euro Area Economy: A Mixed Picture**



* Smoothed; source: Eurostat

Chart 14 **Euro Area Inflation Will Also Be Sticky**



* Excludes food, energy, alcohol, and tobacco; source: Eurostat
** Includes core HICP items that are sensitive to changes in the output gap; source: ECB
*** Source: Eurostat
**** Source: IMF

Weak Link Economies: Recessionary Forces & Lower Rates

Much of the developed world outside of the U.S. and euro area now have housing bubbles that were inflated throughout the 2010s as their central banks focused on competitive currency devaluation and inappropriately adopted ultra-easy Fed and ECB policies (**chart 16**). The COVID-19 pandemic further turbo-charged home prices due to substantial monetary, fiscal stimulus and an increase in demand. These weak links now face a housing affordability crisis, due to both sky-high home prices and the surge in mortgage rates.

Recessionary forces will build in the weak link economies

An even larger concern is the household debt bubbles underpinning home prices (**chart 16**). Household debt-to-disposable income ratios in these economies are dramatically higher than in the U.S. prior to the Great Financial Crisis, and mortgage resets are causing rapidly problematic debt servicing burdens. A major problem for these economies is that homeowners do not have the benefit of 30-year fixed rate mortgages (as is common in the U.S.) and are progressively being reset to much higher borrowing rates. This amplifies the risks of eventual forced selling, defaults, and much increased financial system strains.

Chart 15 **Italian Bonds Are Not Showing Signs Of Stress**

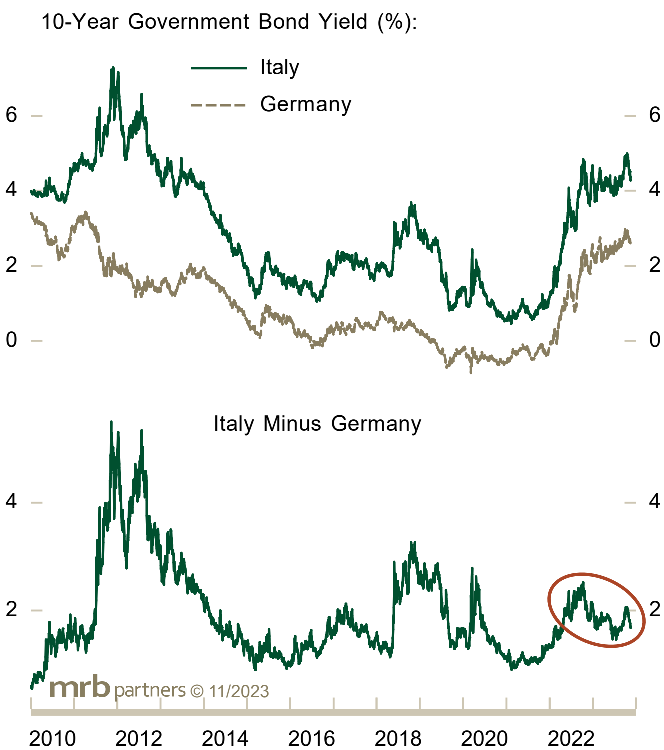
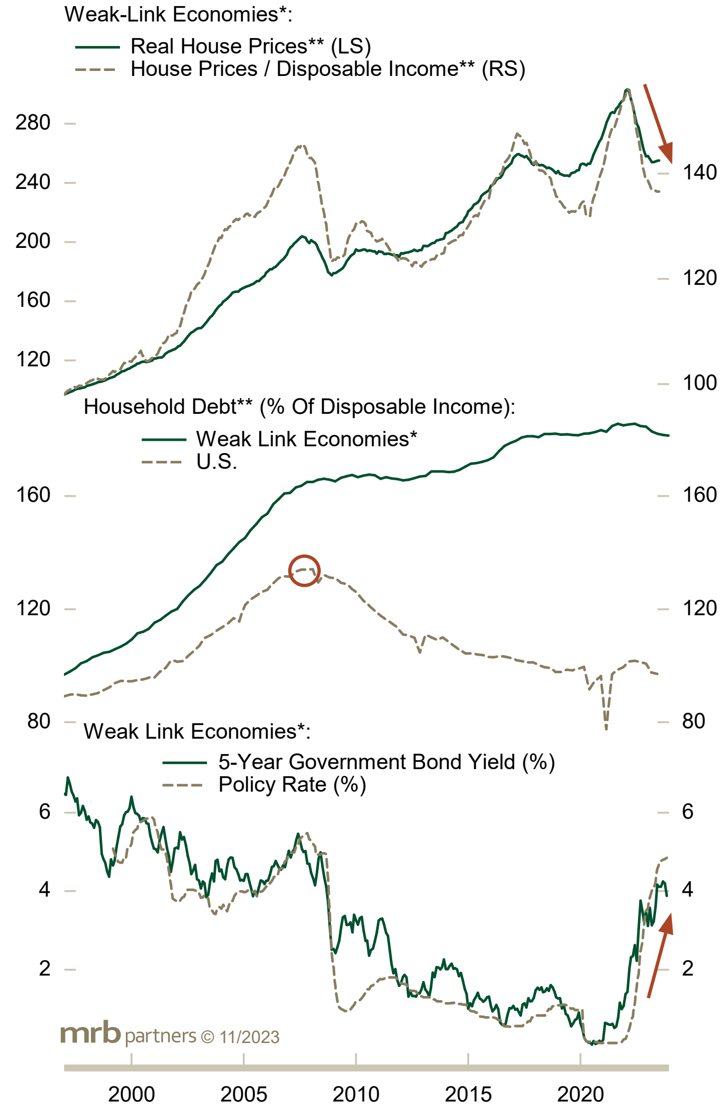


Chart 16 **Weak Links: Housing Bubbles Are Vulnerable**



* Equally-weighted; includes Australia, Canada, New Zealand, Norway, Sweden, and the U.K.
** Rebased; source: national sources

Canada provides a clear example of this risk, given that homeowners can only fix their rate for a maximum of 5-years[14]. According to the *Bank Of Canada Financial System Review*, about 45% of outstanding mortgages have now been reset to higher borrowing rates and the rest will be reset over the next couple of years (**chart 17**). Alarmingly, Canadian banks have reported a dramatic increase in the number of Canadian homeowners unable to fulfill their mortgage obligations once their interest rates were reset higher. Three of the five major banks - Bank of Montreal (BMO), Canadian Imperial Bank of Commerce (CIBC) and Toronto-Dominion Bank (TD) - are reporting that roughly 20% of all outstanding mortgages now have negative amortization (**table 1**). In other words, payments by borrowers are insufficient to meet interest obligations, forcing banks to add the residual to the principle and extend the duration of these mortgages to avoid defaults.

Current interest rates already threatens to burst these housing bubbles

[14] **MRB *Research Highlight:*** "*Canadian Housing: Sliding Down The Slippery Slope Of Hope*", September 8, 2023

Chart 17 Canada: The Wave Of Mortgages Resets Will Continue

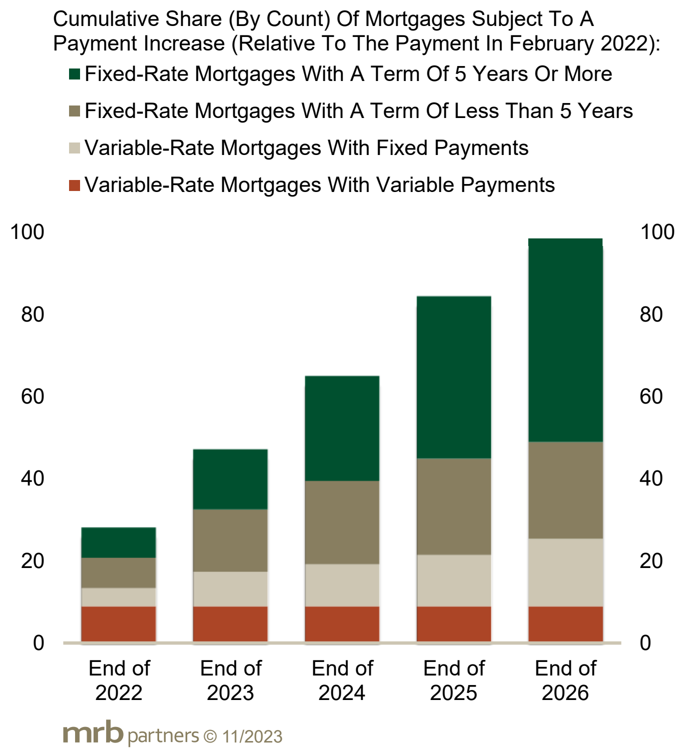


Table 1 Canadians Struggle To Pay Mortgages After Rate Resets

Amortizations For Canadian Residential Mortgages		
BMO	Q3 2023	Q1 2022
Up to 25 years	60%	77%
25-30 years	15%	23%
>30 years	25%	0%
% of Negative Amortization	22%	NA
CIBC	Q3 2023	Q1 2022
Up to 25 years	53%	73%
25-30 years	20%	27%
>30 years	27%	0%
% of Negative Amortization	19%	NA
TD	Q3 2023	Q1 2022
Up to 25 years	52%	70%
25-30 years	22%	30%
>30 years	26%	0%
% of Negative Amortization	18%	NA

Source: Corporate Earnings Releases mrb partners © 11/2023

In short, a slow-moving but steady crisis is already beginning in many of the weak-link economies, as increased debt servicing costs have weakened housing demand and consumption by soaking up discretionary incomes. The catalyst for a housing bust, financial system strains, and recession is already in place. Employment conditions have remained firm so far (**chart 18**), but economic conditions will deteriorate for these economies unless borrowing costs fall substantially[15]. Note that interest rates do not need to rise further to become threatening: time is currently working against their housing markets if mortgage rates remain near current levels.

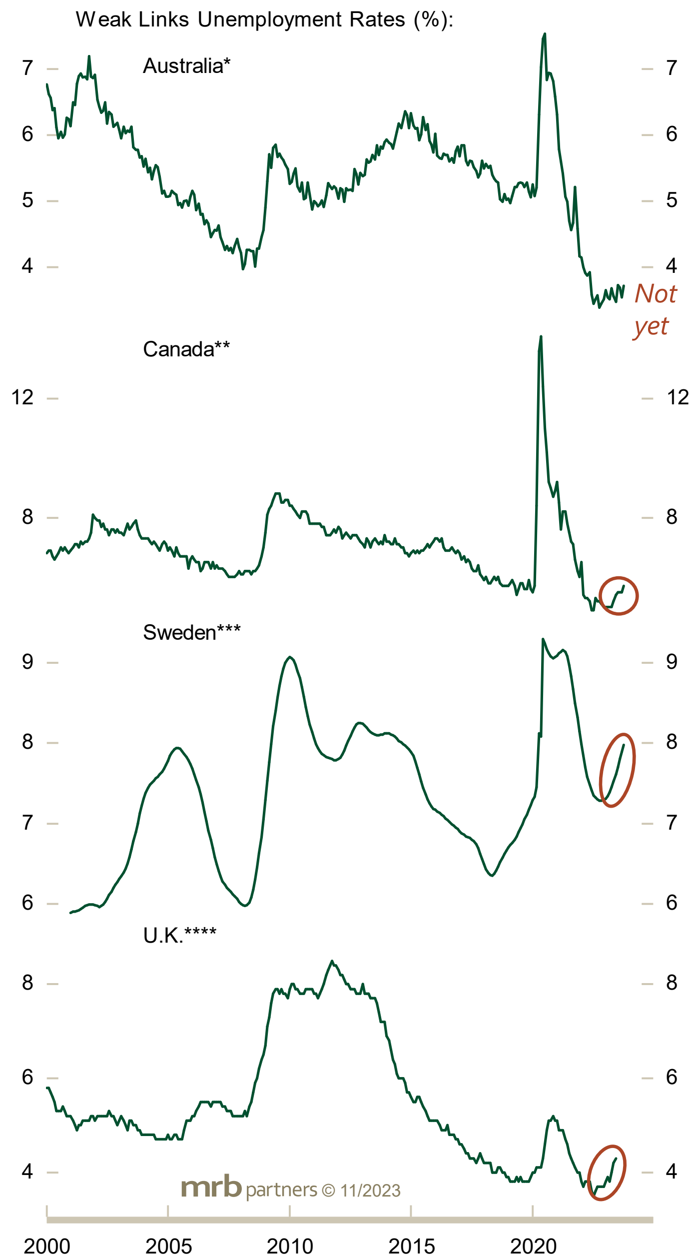
Central banks in weak link economies will be forced to cut rates

With global forces holding up longer-dated bond yields, these central banks will be forced to provide an offset and cut policy rates in 2024. These economies are price-takers since they import much of what they consume, and rate cuts would lead to currency depreciation and potentially firmer price pressures. The danger is that these central banks may have to abandon their inflation targets for the sake of financial system stability.

[15] **MRB *Weekly Macro Strategy:*** "***The Wolf Always Eventually Arrives, But Not Yet***", November 10, 2023

In terms of the global economy, the weak-link economies with imbalanced household sectors only account for 10-12% of global GDP, unlike last decade when the U.S. and euro area were included. That said, even small economies can cause disproportionate global financial strains as seen over the past few decades, albeit usually after the housing bust is well advanced and the domestic banking system is hemorrhaging, which takes time.

Chart 18 Monitoring The Weak Links For Cracks In Employment



* Source: Australian Bureau of Statistics
** Source: Statistics Canada
*** Source: Statistics Sweden
**** Source: U.K. Office for National Statistics

Final Word: *Interest rates and bond yields have risen significantly over the past two years, soaking up much of the policy accommodation in the global economy. That said, monetary conditions are net yet restrictive for the U.S. or euro area economies, as generally believed by these central banks and bond investors. The U.S. economy will remain more resilient than expected in 2024, while the euro area should firm and surprise to the upside. Core inflation in both economies will ease further but remain sticker than expected. The Fed has signaled a desire to cut but will not be able to validate the deep rate cuts currently priced by the bond market. Indeed, the Fed and ECB are liekly to keep policy rates much higher in 2024 than the concensus perceives.*

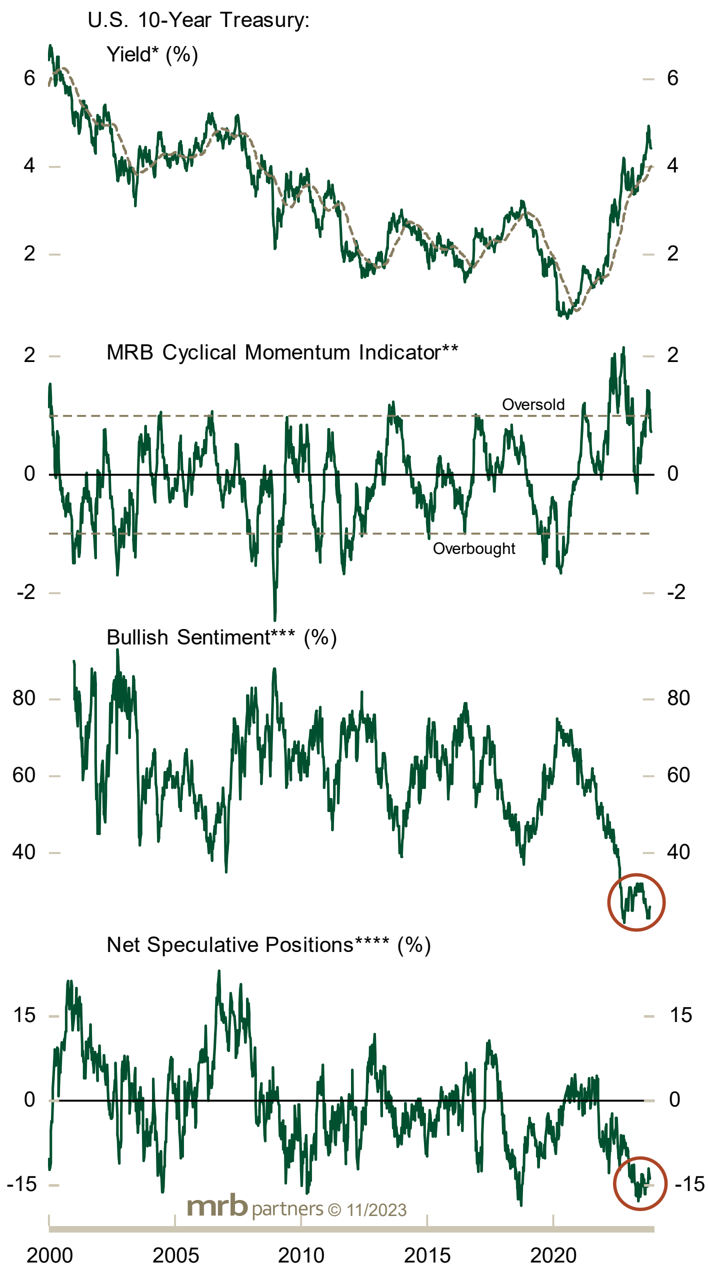
Conversely, the global cost of capital has now risen to a level that has become threatening to the weak-link economies, particularly those with housing bubbles and excess household sector debt burdens. Unless mortage rates fall significantly , recessionary forces will take hold in these economies in 2024 as they progress towards a full-fledged housing fallout and deleveraging cycle by 2025. Their central banks will cut policy rates to provide the necessary offset and may be forced to abandon their inflation objectives.

Investment Strategy

❍ **Government Bonds & Duration:** U.S. and G7 government bonds yields are undergoing another pullback and extended consolidation following their recent upwave. The benchmark 10-year U.S. Treasury became extremely oversold a month ago, with bond sentiment extremely bearish, and speculators heavily net short (**chart 19**). We expect the current consolidation phase to persist well into next year since G7 core inflation is edging lower and central banks contemplate cutting policy rates. However, interest rates and bond yields have not yet reached levels that are threatening to most of the global economy. Therefore, we expect higher-for-longer G7 bond yields with risk still skewed to the upside as inflation bottoms next year, unless there is sufficient global contagion from a fallout in the weak-link economies beforehand. Netting out these forces, we recently shifted our recommendation from being materially below benchmark duration to being closer to neutral, which reflects the contrast between appealing cash rates and the maturing economic cycle.

❍ **Regional Positioning:** The trend in government bond yields will be directionally similar due to global forces, but economic divergences should appear with widening spreads. At this point, we prefer bonds in the weak-link economies that will experience notably weaker growth in 2024, including Australia, Canada, New Zealand, Norway, and Sweden within a global (currency hedged) fixed-income portfolio. We will now upgrade U.K. gilts from neutral to overweight in our recommendations. At some point down the road, investors may demand a higher risk premium for some of these bond markets with weaker public finances (such as Canada and the U.K.), but it is premature to bet on this outcome. Conversely, we remain underweight U.S. and euro area within a currency-hedged government bond portfolio.

Chart 19 U.S. Treasurys Are Consolidating After Becoming Oversold



* Source: Bloomberg
** Standardized
*** Source: Marketvane
**** Net longs minus shorts as share of open positions; source: CFTC Commitment of Traders
Note: - - - 40-week moving average in panel 1

❍ **Yield Curve:** We leaned heavily against the inverted yield curve earlier this year and bet on a bear steepening, which has generally panned out[16]. Looking ahead, we expect a mild ***bear*** steepening in the U.S. and euro area, and possibly a ***bull*** steepening in many of the weak-link economies.

❍ **Inflation Protection:** Longer-term inflation-protected bonds still offer good relative value, given that the market is not priced for durably higher inflation this decade. However, we are maintaining a neutral allocation until inflation bottoms out in the developed world.

❍ **Corporate Bonds:** At this stage of the economic cycle, we recommend staying up in quality in terms of corporate bonds, with a preference towards investment grade (IG) over high yield (HY), despite the latter's 300+ bps yield advantage. Spreads are likely to hold tight throughout at least the first half of 2024 in response to resilience in the U.S. and euro area economies (and corporate profits). However, U.S. nonfinancial corporations have borrowed substantially, and many will be forced to refinance at much higher yields in 2025 (**chart 20**). This may start to concern investors as next year progresses.

❍ **U.S. Mortgage-Backed Securities:** We do not have a formal allocation to U.S. MBS but we find this asset appealing on a 12-month horizon. The 30-year mortgage yield is currently at 7.45% or a spread of nearly 290 bps above Treasurys (**chart 21**). This spread should compress significantly now that the Fed is finished hiking rates and we expect the housing market to remain stable.

[16] MRB ***Global Fixed Income:*** "Snapping Weak Links", March 29, 2023

Chart 20 **U.S. Nonfinancial Corporate Debt Resets Are Coming, But In 2025**

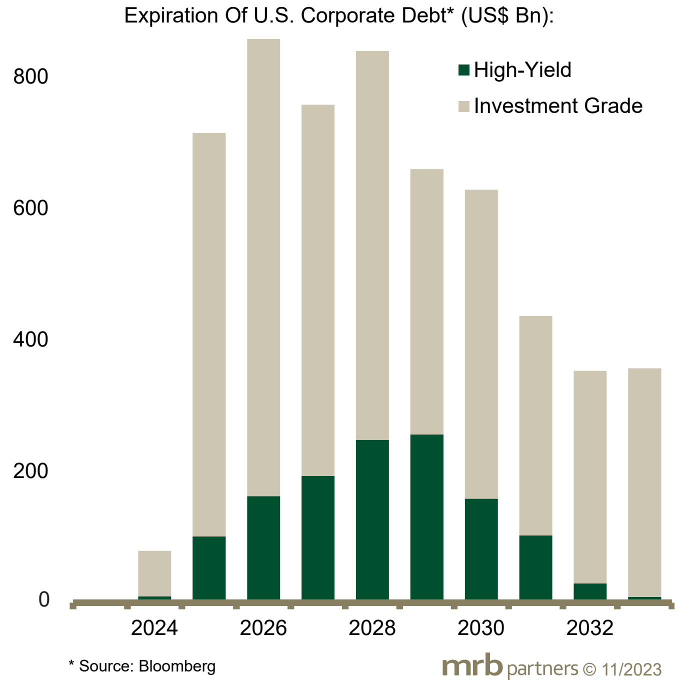


Chart 21 **U.S. Mortgages Spreads Should Narrow Significantly**

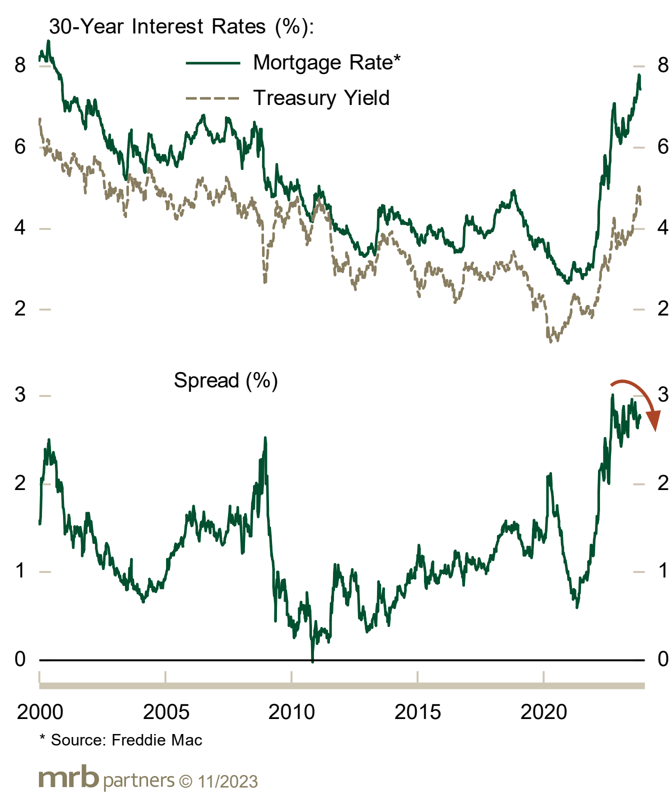
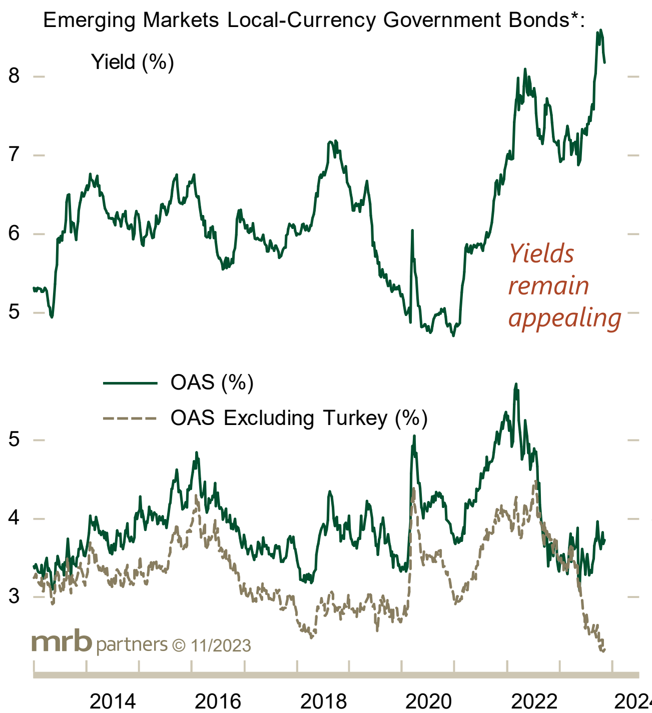
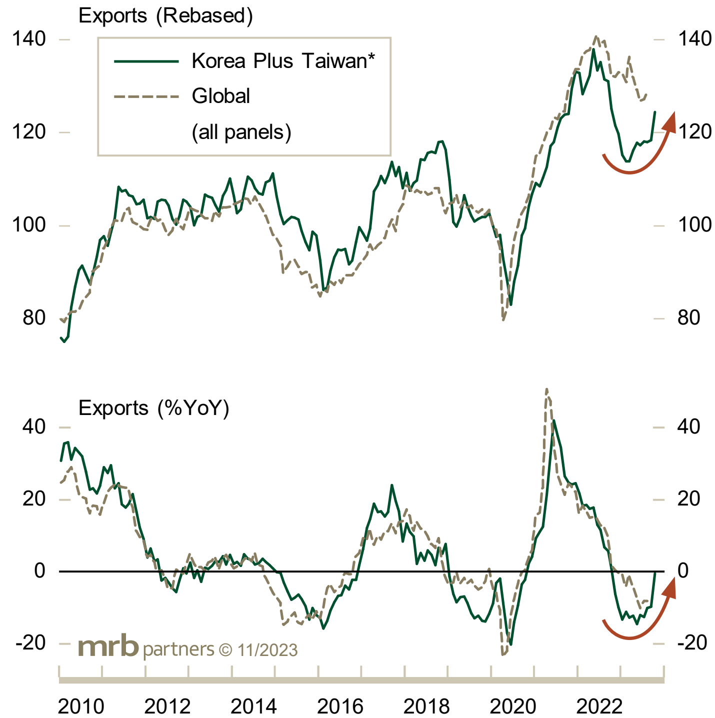


Chart 22 EM Local-Currency Debt Still Has Tailwinds



* Simple average of 16 countries; source: Bloomberg, MRB calculations

Chart 23 Korea And Taiwan Point To A Pickup In Trade



* U.S. dollars; national sources
** Nominal exports; source: Netherlands Bureau for Economic Policy Analysis

❍ **Emerging Market Debt:** We remain overweight EM sovereign debt, with a clear bias in favor of local-currency issues (EMDLC). Spreads on EMDLC debt are tight by historical standards, but the asset class should be supported by further EM central bank rate cuts, a growth advantage versus DM economies, and potential for EM currency appreciation[17] (**chart 22**). EM debt and currencies should be supported in 2024 by the realization that the Chinese economy is more durable than currently perceived by investors[18], which reduces a risk factor for EM assets. The Chinese economy is unlikely to receive a major fiscal stimulus package or reaccelerate materially next year, but it should continue to expand around 5% (our estimate of underlying trend growth). Crucially, the global trade cycle is also showing evidence of improving, which has been a key driver of outperformance of EM assets[19] (**chart 23**).

Phillip Colmar I Managing Partner, Global Strategy

[17] **MRB *Emerging Markets Fixed Income:*** "EM Debt: More Tailwinds", October 17, 2023

[18] **MRB *Research Highlight:*** "China Growth: Half-Full, Or Half-Empty?", November 9, 2023

[19] **MRB *Global Economy:*** "Is Global Trade Reviving?", November 10, 2023

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