

SECOND QUARTER 2023

# Fixed income perspectives

Themes, outlook, and investment implications across global fixed income markets

## Looking ahead to 2Q 2023: Economic turning points

With the first quarter of 2023 behind us, some economic tides are starting to turn.

1. After a year of aggressive central bank tightening, the peak policy rate for the cycle is likely on the near-term horizon, which has important implications for fixed income investors.
2. Historically, a pause in the hiking cycle marks a turning point in duration, creating a tailwind for fixed income.
3. As peak policy rates come into focus, risk assets may enjoy a relief rally initially, but spreads are likely to come under renewed pressure later in the year as recession fears grow.

### What's inside

<b>Investment grade credit</b>	<b>6</b>
<b>High yield credit</b>	<b>7</b>
<b>Securitized debt</b>	<b>8</b>
<b>Municipals</b>	<b>9</b>
<b>Emerging market debt</b>	<b>10</b>
<b>Private credit</b>	<b>11</b>

# Macro outlook

## U.S. outlook

Over the first quarter, U.S. economic data (nonfarm payrolls, retail sales, inflation) indicated a resilient economy with several factors contributing: seasonal adjustments (which have become more challenging due to pandemic volatility), favorable weather (fifth warmest January on record in North America), Social Security cost-of-living adjustments (+8.7%, strongest in 40 years with statements hitting retirees in December 2022 and checks increasing in January 2023), and some payback for soft data to end the year.

As we head into the second quarter, we believe it's very likely that economic data will moderate which would be welcome news for the Federal Reserve (Fed), supportive of their effort to achieve a "soft landing" and "combat inflation". Prior to the rebound in economic data over the first quarter, the Fed's message had evolved to signal their hiking cycle was nearing its completion:

- Step down in the pace of hikes from 75 to 50 to 25 basis points (bps)
- Federal Open Market Committee (FOMC) statement replaced the term "pace" of future hikes with "extent," suggesting the remaining question was how many 25 bp hikes were yet to come
- Median FOMC summary economic projection "dot" at 5.125%, and the following rhetoric suggested a terminal rate "a little above 5%", which suggests we are within one hike of a pause
- Recent turmoil in the banking sector will tighten lending standards and slow economic activity, leading to the following addition to the March FOMC statement: "As a result, we no longer state that we anticipate that ongoing rate increases will be appropriate to quell inflation. Instead, we now anticipate that some additional policy firming may be appropriate."

Reaching a terminal rate has important implications for interest rates/duration and credit spreads.

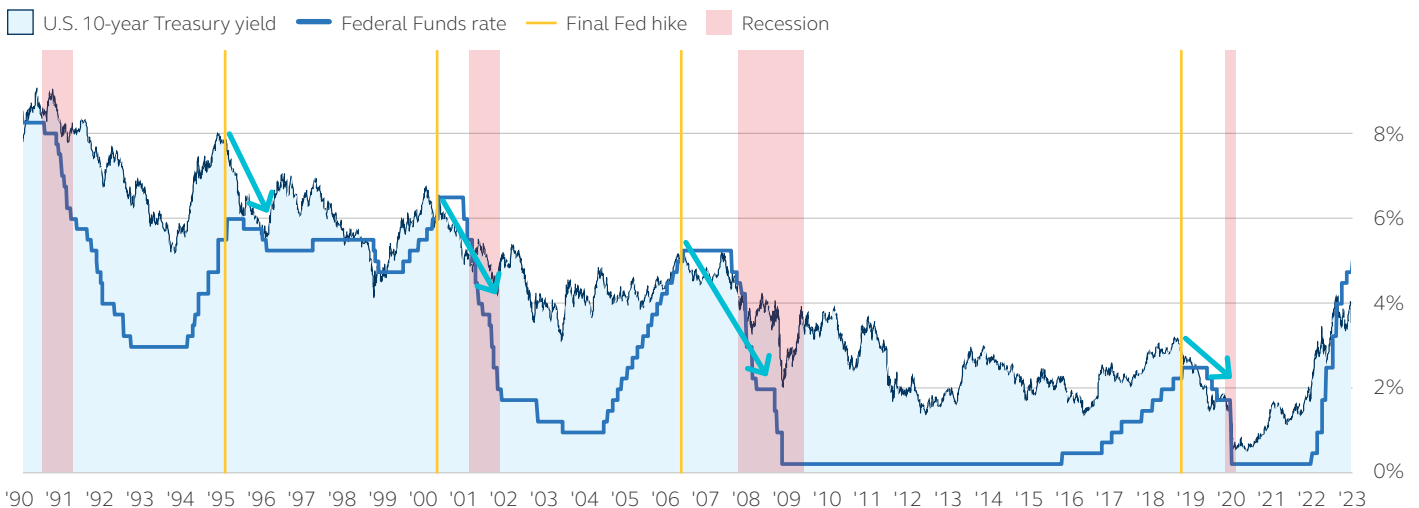
### Investment implications: Duration

Duration has been a significant headwind to fixed income performance since the FOMC began its tightening campaign in 2022. Over the last 50 years (before 2022), for example, the Bloomberg Intermediate Government Index only delivered negative total returns in four calendar years and the worst drawdown was in 2021 at -1.69%; in 2022, the drawdown was -7.72%.

Entering 2023, the Intermediate Government Index offered much healthier yields—4.21% on December 31, 2022 versus 1.05% on December 31, 2021. 4.21% is the highest yield to begin a year in over 15 years, providing investors an income cushion if the Fed continues to hike above the current 5.25% guidance. Historically, the final hike of each Fed cycle has been near a turning point for duration, transitioning from a headwind to a tailwind for fixed income investors (final hike for each cycle highlighted in yellow):

#### EXHIBIT 1

#### Proximity of final Fed hike to crossroads for duration



As of March 22, 2023. Source: Bloomberg.

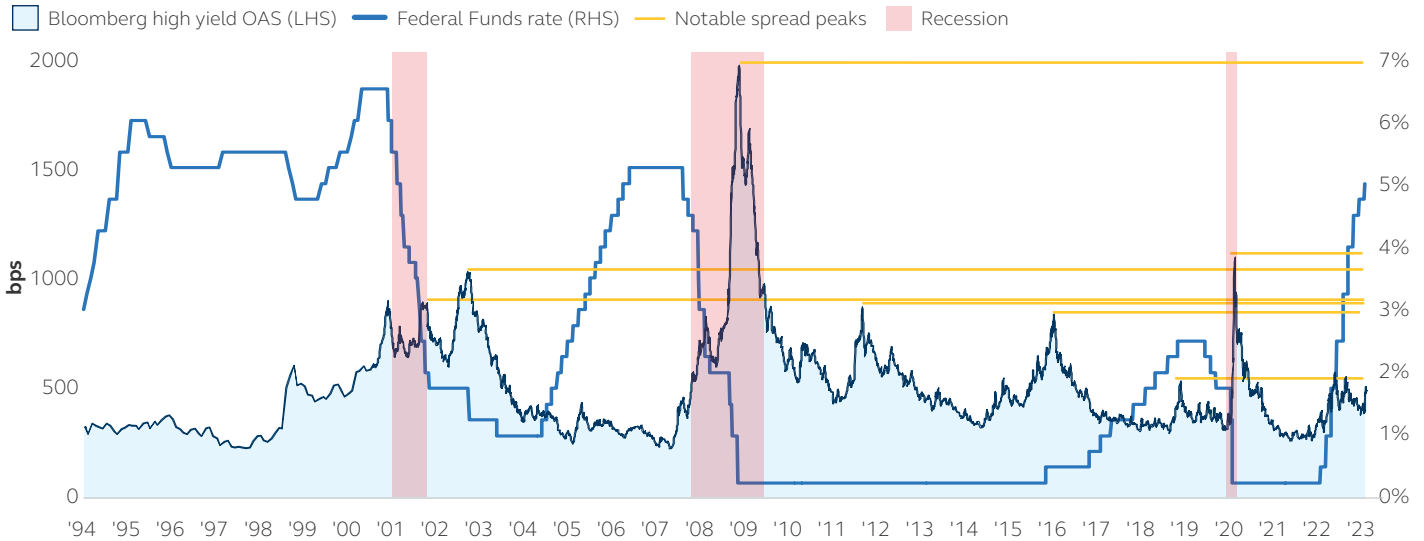
Buying duration at the terminal hike and selling duration in the late stages of a recession has been a cyclical rule-of-thumb and is likely to be again in our view.

## Investment implications: Risk assets

U.S. credit spreads continue to be highly correlated to market pricing for the terminal Fed Funds rate. Recently, credit spreads have tended to rally as the market anticipates a Fed pause and widen as peak rate expectations are repriced higher. As a Fed pause becomes more evident over the second quarter, we believe risk assets will enjoy another relief rally (similar to July 2022). As Exhibit 2 demonstrates, credit spreads often perform well following the conclusion of several rate hikes.

### EXHIBIT 2

#### Historical U.S. high yields spreads, Fed Funds rates and recessionary periods



As of March 22, 2023. Source: Bloomberg.

The “calm after the storm” period typically gives way as evidence of a recession grows, and spreads tend to widen until near the end of a recession. We anticipate that we’re amidst a similar pattern today.

### Recession remains more likely than soft landing

All told, we believe the odds of a successful soft landing remain unlikely, and a recession continues to be our base case. Soft landings are not the norm after a tightening cycle, and this cycle has been far more aggressive in a belated attempt to arrest unexpectedly stubborn inflation. The ultimate impact of the most aggressive Fed policy since the 1980s is yet to be fully realized due to anticipated transmission lags, further quantitative tightening, as well as tightening in bank lending standards and regulation. With the peak Fed Funds forthcoming and a recession following, we believe it’s time for investors to prepare for a transition in duration. The opportunity over the intermediate term appears very attractive; tactical opportunities in fixed income risk assets are likely in the near term, while recession risk looms over the longer term.

## Global outlook

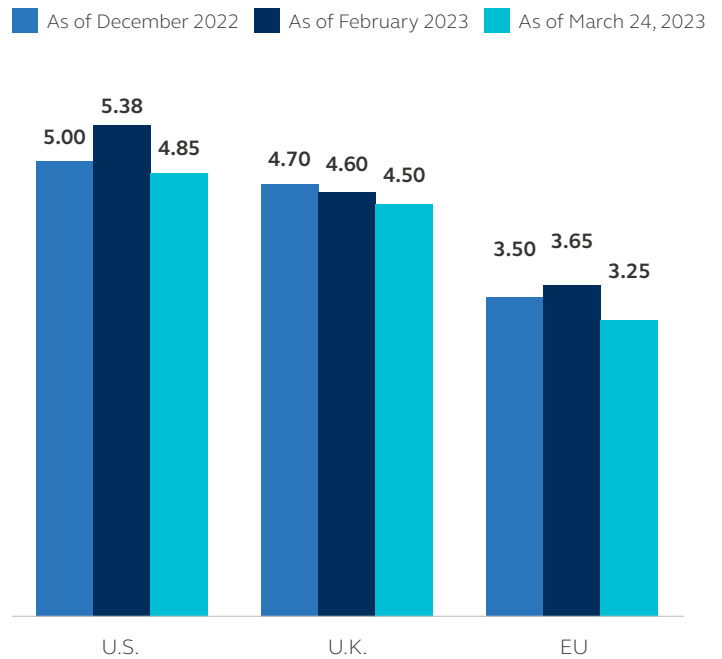
Global fixed income markets experienced a volatile quarter reminiscent of the global financial crisis (GFC). Investors got a warm welcome to start the year, delivering returns of more than 3% in January as the market rushed to deploy cash amidst expectations of an imminent pause in monetary policy tightening and hopes of lower interest rates. Following upside surprises in economic data, however, these expectations proved premature; instead of the Fed pivoting toward market expectations, the market pivoted toward the Fed. As interest rates were repriced towards the Fed’s earlier guidance, repercussions rumbled across global fixed income and currencies markets. This move proved to be the final straw for the weakest banks in the U.S., as belated reports of their capital shortfall due to losses on their securities books were made public and the market in the middle of repricing the Fed was unable to tolerate more losses. Concerns soon spread to European banks as the market made its rounds to seek out the weakest players. The ensuing volatility also caused many macro strategies and hedge funds to close as they suffered outsized losses as rates volatility approached GFC levels. To their credit, regulators, as well as banking industry leaders, seasoned by the GFC, were swift to provide resolution by shutting down vulnerable institutions, forcing mergers, moving deposits, and providing ample liquidity.

## What's next for global fixed income markets?

As we enter the second quarter, global fixed income markets remain volatile. The dollar “smile” is still intact, as concerns surrounding European banks have renewed dollar strength following a brief respite due to Fed cut expectations. Meanwhile, global policymakers are trying to find a balance between safeguarding financial stability and price stability, effectively removing upside risk to policy hawkishness. In fact, the actions taken by both the Fed and the Swiss National Bank arguably provided the market with sufficient liquidity to temporarily unwind the policy tightening taken over the past three months. Despite widening credit spreads (due to falling government bond yields) and firms postponing bond issuances (as volatility made pricing difficult), there are no signs of funding stress. The Fed’s USD swap lines were also barely utilized, indicating no shortage of USD funding globally. The globally systematically important banks’ (G-SIBs) actions to shift deposits back to troubled banks showed that liquidity remains abundant in the system even as individual institutions faced stress. That said, the probability of a recession is higher now due to banks tightening their belts in the face of more expensive capital. This has indirectly helped central banks achieve their objective to ease price pressures by curbing demand. Looking beyond the current volatility, this likely sets up a remarkably positive technical and fundamental environment for the global fixed income market.

### EXHIBIT 3

#### Central Bank terminal rates repriced



As of March 24, 2023. Source: Bloomberg.

### EXHIBIT 4

#### GFC again?

— MOVE index (LHS) — U.S. Dollar Currency (RHS)



As of March 24, 2023. Source: Bloomberg.

## Summary of investment implications

While challenges remain, including the growing threat of recession and continued economic volatility, expectations for softening economic data and a likely Fed rate policy shift should create opportunities in fixed income.

### **INVESTMENT GRADE CREDIT**

Though investment grade corporate spreads have tightened from last year's wide levels, corporate bond yields remain prime for investment, providing bond investors with a compelling risk/return profile. Rate volatility stemming from an uncertain Fed policy path and duration concerns may restrain demand at times.

### **HIGH YIELD CREDIT**

The fundamental strength of the high yield sector has the asset class well positioned to weather potential recessionary pressures. The sector may face headwinds over the near-term, but investors willing to endure short-term turbulence should achieve attractive long-term results.

### **SECURITIZED DEBT**

Short AAA consumer asset-backed securities and government-guaranteed mortgage-backed securities continue to offer attractive yields and tend to outperform through recessions; the Fed's eventual pause in rate increases should result in much lower rate volatility and directly benefit mortgage-backed security spreads.

### **MUNICIPALS**

The taxable U.S. municipal bond sector remains near the top of U.S. investment grade fixed income sectors in terms of performance (absolute and relative). Opportunities are growing in the municipal market's sustainability-linked sector as demand for ESG-labeled munis increases.

### **EMERGING MARKET DEBT**

Emerging market debt started the year off strong, fueled by China's reopening and the market's expectation for peak U.S. inflation. However, economic ripples from pandemic slowdowns and decreased market access have weighed heavily on many emerging markets; particularly, frontier economies.

### **PRIVATE CREDIT**

Loan yields should remain at very attractive levels throughout the year with risk premium spreads elevated. Improved call protection, greater original issue discounts, and higher income should support attractive and persistent returns.

# Investment grade credit

The rapid ascent in risk-free rates last year left an indelible mark in investors' minds. The tripling in Treasury yields left corporate bond yields prime for investment. More recently, investment grade corporate (IG) spreads have widened due to heightened risk premia tied to some isolated and idiosyncratic bank issues. Notwithstanding the wider spreads, IG yields remain a ballast for bond investors. Indeed, institutional investors can chart their course more capably as they meet yield targets at current levels. Asset allocators yearn for yields as they must invest somewhere, and the risk/return profile for high-grade corporate bonds (considered from a yield perspective) appears compelling.

Simply put, higher yields make navigating uncertainty easier – and one could argue that wider spreads augment that thesis as they offer more cushion against credit risk. With greater certainty now around the future Fed path, rates have likely settled into more of a rangebound state. This has, in turn, made yield the beacon for bondholders and should draw stability-seeking investors toward high-grade corporate credit.

At 5.5% at the end of February, investment grade yields were approaching last year's highs and closing in on levels last seen in the financial crisis. Demand for higher yields was driving this technical tailwind for bonds. Even at levels slightly lower now, compared to current equity valuations, corporate bond yields at 5.2% (as of 03/31/23) appear attractive.

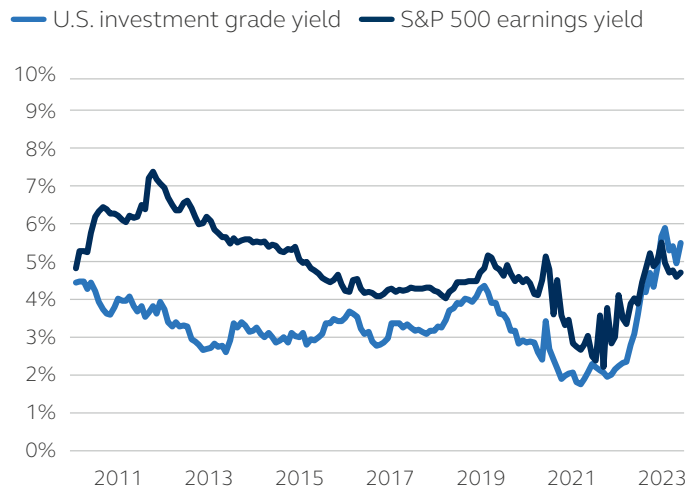
Investors focused merely on spread may find that the higher levels prevailing now are more enticing than a month or two before. Still, they may hold out a little longer before piling into corporate bonds. Fortunately, market forces have tipped the scales in yield buyers' favor. These investors comprise a majority of the total in the IG market—insurance companies, pension funds, and overseas investors make up more than 60% of the mix. Combined with enticing yields, this substantial demand base should underpin the market and lend structural support.

Yields have ridden a roller coaster ride recently, but still stand as appealing. Even as total return turned negative in February, rising yields—driven by higher rate expectations—sustained inflows into IG credit, underscoring the strong retail/mutual fund demand for investment grade corporate bonds. After rallying down to 4.83% in early February and matching the lowest level since last August, the Bloomberg high-grade yield closed at 5.5% just three weeks later. This nearly 15% jump in just as many trading days followed a slew of inflationary economic data points and prognosticating of more Fed tightening. Then, as issues related to a couple banks surfaced in March, yields fell in a flight-to-quality trade. Yields to close the quarter, however, have bounced back somewhat, standing solid at 5.3% (as of 03/29/23), while, at the same time, spreads have priced in more of an appropriate credit risk premium.

From another angle, IG corporate bond spreads now comprise just under 27% of the total yield, low in absolute and relative terms, and before the recent widening in March, the lowest percentage of the total since 2007. This should give yield buyers confidence as over 70% of the yield from corporate bonds is risk-free (i.e., U.S. Treasuries). As these higher yields attract buyers, the spread should remain relatively resilient and contained. That fortuitous factor should sit well with investors considering corporate bonds and serve to anchor demand.

## EXHIBIT 5

### Corporate bond yields vs. equity yields



As of February 28, 2023. Source: Bloomberg, Nasdaq, S&P 500 Earnings Yield, Standard & Poor's. Earnings Yield = trailing 12 month earnings divided by index price (or inverse PE) Yields following September 2022 (including current yield) are estimated based on 12 month earnings through September, 2022 the latest reported by S&P.

## EXHIBIT 6

### IG corporate spread as a percentage of yield



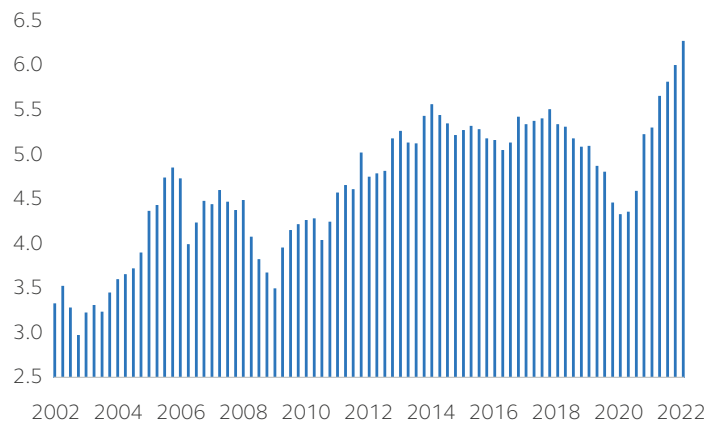
As of March 30, 2023. Source: Bloomberg.

# High yield credit

To reiterate the theme introduced last quarter, we believe the probability of a recession in the U.S. this year remains high, and the recent events in the banking sector have only increased the probability even more. However, despite the banking sector being more closely tied to IG, the spillover effect of a crisis of confidence could lead to less availability of capital in the quarter ahead. It's true that risk assets, like high yield, have generally experienced challenged performance during historical economic slowdowns; however, we believe the fundamental strength of the high yield sector entering this expected slowdown has the asset class better positioned to weather recessionary pressures than in the past. As we look to the second quarter of 2023, there are three key factors supporting the fundamental picture for high yield:

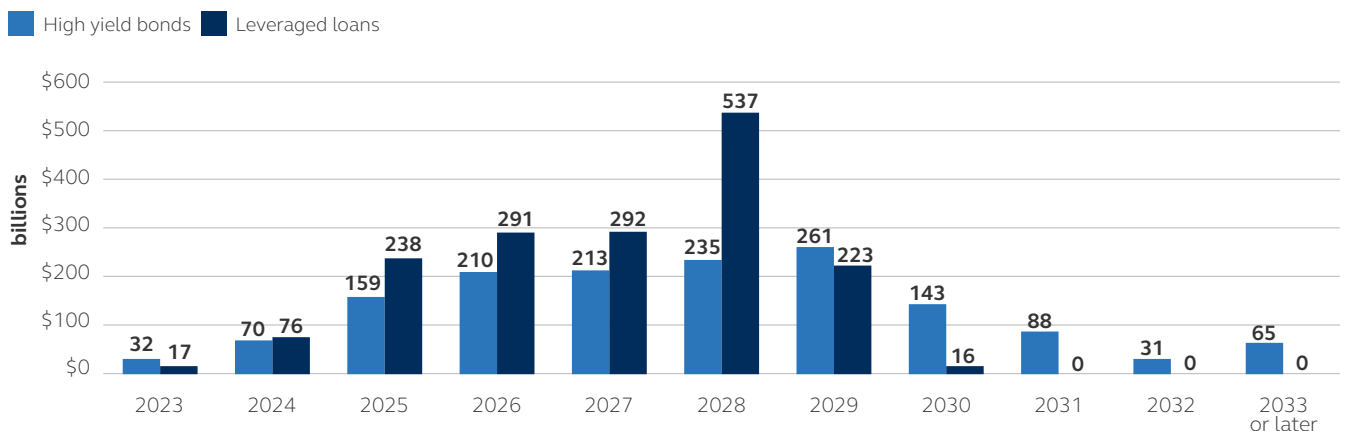
- 1. The credit quality of the high yield index today is well above its historical average.** Leverage and interest coverage are stronger than ever for the asset class (see Exhibit 7), and the ability to service debt is not a pressing concern for the asset class. BBs currently comprise over 50% of the benchmark when that number was closer to 40% a decade ago.
- 2. In previous economic downturns, a high yield sector typically experienced tremendous pressure; we don't see that sectoral pressure building today.** In the late 90s, it was the dot-com bubble; in the early 2000s, it was the telecom debacle; over the last decade, it was the energy bust. At present, no major sector in the high yield index faces such severe secular challenges. Even with recent back failures/mergers, high yield has very limited direct exposure to the bank sector and will be less immediately impacted than other asset classes. We believe prudent active management can help avoid those issuers that are currently challenged.
- 3. The lack of a looming maturity wall.** For the remainder of 2023, only \$32B of high-yield bonds and \$17B of bank loans are set to mature (see Exhibit 8).

**EXHIBIT 7**  
High yield interest coverage



As of November 1, 2022. Source: Morgan Stanley Research, Bloomberg, Capital IQ, the FTSE Fixed Income LLC

**EXHIBIT 8**  
Maturity wall for high yield is manageable



As of February 15, 2023. Sources: J.P. Morgan; IHS Markit.

In sum, we don't believe that fears of a probable recession should scare investors away from the high yield asset class, particularly investors with a longer-term investment horizon. With yields near 9% for U.S. high yield and prices well below their historical average (index price of \$87 vs. an average of \$98 over the last five years ending March 31, 2023), the asset class offers significantly more income today than it has over the last decade, when the average yield was closer to 6.5% (as of March 31, 2023), and a very attractive entry level from a valuations standpoint. With the prospect of a recession elevated, the asset class will undoubtedly face headwinds over the near term. Still, for those investors willing to ride through some short-term turbulence, we anticipate a unique opportunity to achieve attractive long-term results.

# Securitized debt

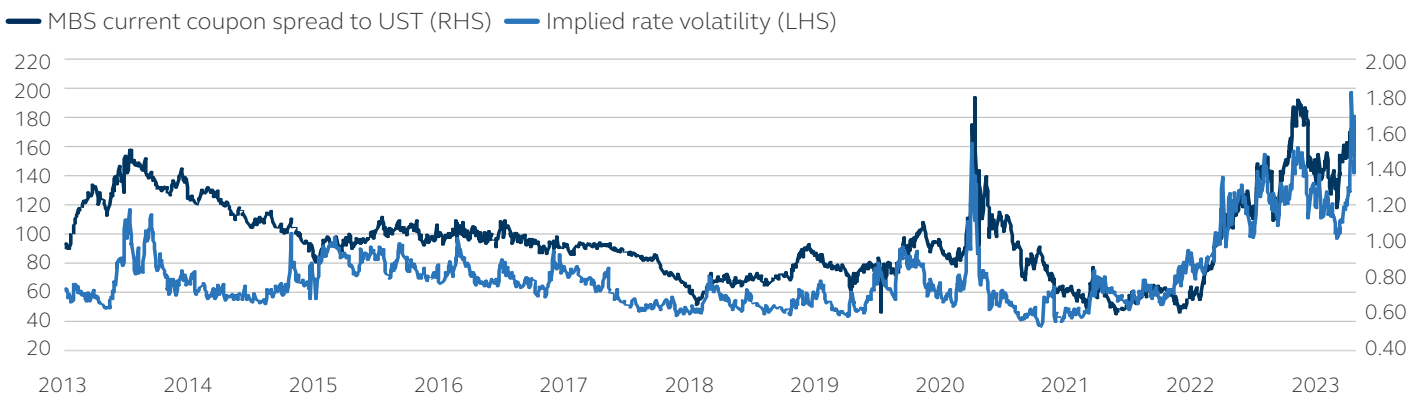
## U.S. agency mortgage-backed securities

In last quarter’s outlook, we noted that U.S. agency mortgage-backed security (MBS) spreads had reached attractive levels relative to investment-grade credit. We continue to find the MBS sector attractive. The spread relationship between investment grade credit and MBS still holds as we look to the second quarter of 2023; with current coupon spreads for MBS trading in-line relative to investment grade credit option adjusted spread (OAS).

The fundamental and technical environment within the MBS market remains stable as there is little-to-no financing risk (even if the market faces a large rally in interest rates), and slowing house price appreciation/housing activity continues to reduce organic net supply. Through most of the Fed hiking cycle, MBS spreads closely followed implied volatility (see exhibit 9), peaking in March 2023 as the MOVE index also peaked near 200 bps over the period. Rate volatility increased in February and March as the market “re-priced” future Fed actions (i.e., a lower chance of rate cuts and a higher terminal rate) and as markets digested recent issues surrounding the banking sector. With rate volatility at local highs, favorable valuations relative to investment grade credit, and MBS being the spread product of choice during recessionary periods, we believe the asset class provides the best risk/reward opportunity across securitized debt.

### EXHIBIT 9

#### MBS coupon spread and implied rate volatility



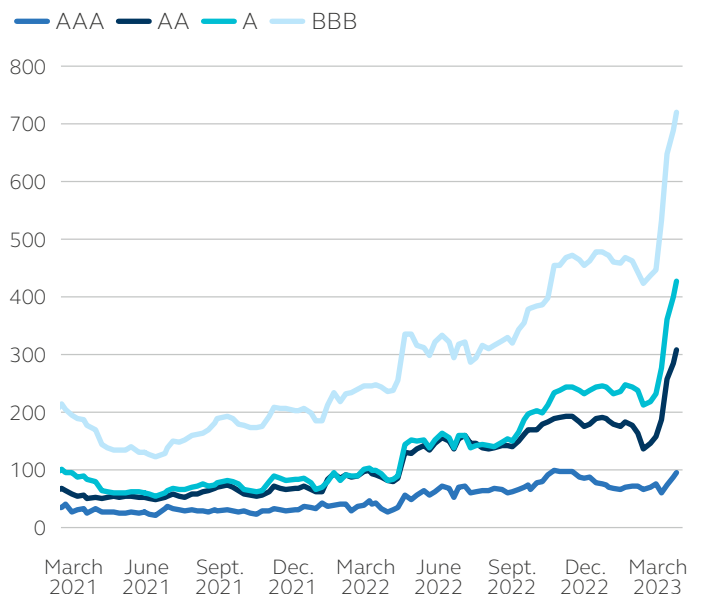
As of February 28, 2023. Source: Bloomberg.

## Commercial mortgage-backed securities

Commercial mortgage-backed securities (CMBS) have dislocated from broader credit markets (see Exhibit 10) in response to fundamental concerns around office properties and constrained availability of capital. Regional banks hold a significant share of outstanding commercial mortgages and are likely to scale back on future lending which could exacerbate a drop in real estate values. CMBS pricing is reflecting this stress with fixed rate AA spreads ~130 bps wider year-to-date and ~275 bps wider since the beginning of 2022. We believe this volatility offers opportunities for investors who understand the drivers of commercial real estate performance and appropriately apply a nuanced credit outlook to the bond structure. CMBS loans are secured by income producing properties and have recently been underwritten to conservative metrics averaging 53% loan-to-value ratio (LTV) and 2.6x for fixed-rate bonds issued in 2022. In the current market, we favor floating rate AAA bonds for defensive carry, fixed-rate AAA/AA and select A bonds based on relative value and the steepness of the credit curve, and interest-only STRIPS due to their shorter duration, high current yield, and portfolio diversification characteristics.

### EXHIBIT 10

#### CMBS excess spread vs. corporates



As of March 24, 2023. Source: J.P. Morgan Dataquery, Principal Real Estate. CMBS: J.P. Morgan CMBS New Issue On-the-Run AAA/AA/A/BBB Indices; Corporates: J.P. Morgan JULI AAA/AA/A/BBB Indices.



# Municipals

Stubbornly high inflation and macroeconomic headwinds continue to adversely impact financial markets. Though far off its record performance at the start of 2023, the taxable U.S. municipal bond sector remains near the top of U.S. investment grade fixed income sectors in terms of performance when measured on an absolute and relative basis. The combination of stable-to-improving credit conditions across state and local governments, a favorable technical backdrop of tepid supply, and increasing demand have been highly supportive of valuations. Two such beneficiaries of this credit environment (and among the largest issuers in the asset class) have been Illinois and New York City, both receiving credit upgrades from S&P and Fitch, respectively.

In the quarter ahead, we see an opportunity growing in the municipal market's sustainability-linked sector which is drawing increasing investor demand and issuance. ESG considerations are particularly important for municipal bond investors interested in investing in bonds that align with their values and contribute to positive social and environmental outcomes. So far, there has not been a discernible difference in pricing or performance of ESG-labeled municipal bonds compared with non-ESG-labeled municipals. If investor interest continues to generate more ESG client mandates in the asset class, we believe ESG-labeled bonds could outperform their counterparts simply from a supply/demand perspective. 2022 ESG-labeled issuance of \$40.9 billion was down 11% from 2021, compared to a 21% decline in total municipal bond issuance in 2022. With demand for ESG-labeled munis increasing, we expect ESG-labeled issuance of over \$50 billion in 2023, representing 12-15% of all municipal issuance.

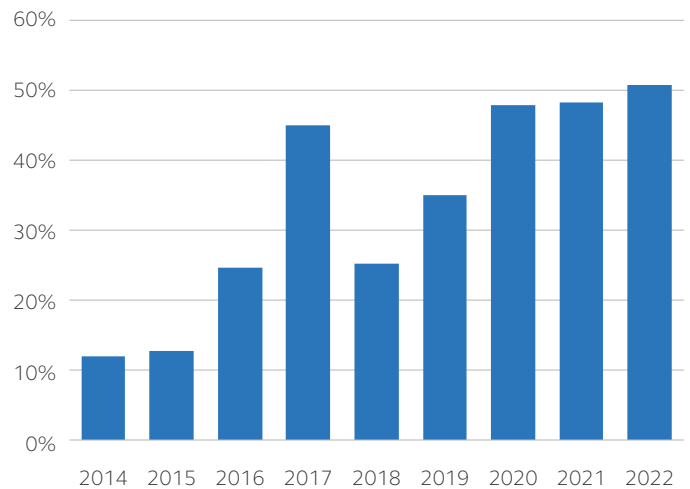
While ESG investing has gained significant popularity in recent years, there are still some challenges associated with the investment approach. Both political interference and ambiguous aspects of ESG investing have led to headlines on the topic. Some complaints regarding ESG investing include a lack of standardization, greenwashing, and that high ESG quality comes at the expense of lower returns and higher fees for investors. We believe that the positives of the approach will ultimately outweigh the negatives.

Overall, we expect the taxable U.S. municipal sector to continue to perform favorably versus taxable alternatives as we head into the second quarter of 2023. If we're correct in forecasting a downturn in 2023, stable municipal rating transitions and better historical default metrics add to the appeal of the asset class, as has been particularly evident in past recessionary periods.

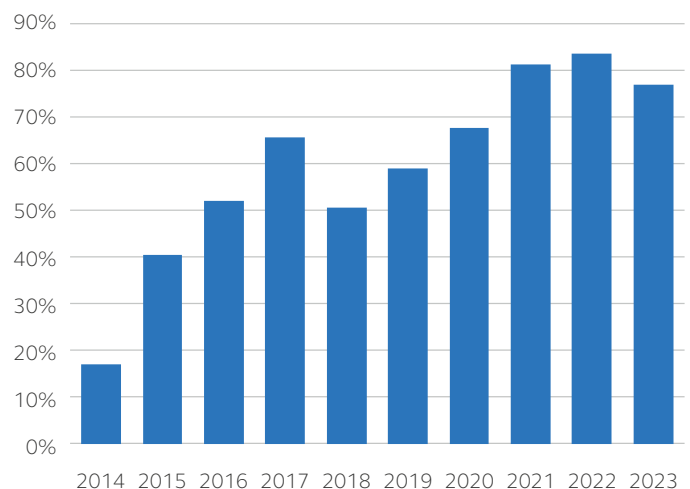
## EXHIBIT 11 Effort to go green

State and local governments put effort behind ESG push

### % of ESG munis with outside verification



### % of ESG munis with ongoing reporting



As of January 2022. Source Bloomberg. Note: Long-term muni bond sales with green, social, or sustainability indicators.

# Emerging market debt

## China

Fueled by China's reopening story and the market's expectation for peak U.S. inflation, performance was strong for emerging market debt (EMD) to start the year. As the first quarter progressed, we saw the risk rally subside, as markets reassessed the impact of China's reopening on Chinese assets as well as the prospective beneficiaries in Asia and globally. While the policy momentum supporting the economy in China has been strong, fundamentals remain soft, and we believe it will take time for the market to fully recover from the protracted lockdown. Further, the durability of pent-up consumer demand will be tested given the slow recovery in China property prices, impacting consumer sentiment as households continue to repair their balance sheets. Overall, we expect that the Chinese economy will gradually recover over 2023, unlike most EMD economies that face strong monetary policy headwinds across the developed world.

## Mexico

One emerging market (EM), Mexico, has managed to largely avoid inflationary and rate pressures due to structural considerations, shifting geopolitics, and supply chain. Among Latin American peers, Mexico features the increasingly rare combination of relative political stability and fiscal probity. Longer-term, Mexico stands to benefit from the bipartisan U.S. demand for nearshoring of supply chains. Geopolitics, competitive wages relative to Asia, and pandemic-induced strains on the supply chain should lead to more manufacturing in Mexico. Mexico's large manufacturing base and the reworked

USMCA trade agreement further support the outlook for growing exports. That said, Mexico is not without its challenges; despite robust credit metrics, the country scores below BBB peers on governance indicators partly due to endemic violence and corruption. Investor sentiment, buoyed by the President's commitment to a sound fiscal framework, should ebb and flow with his centralization of power.

## Frontier

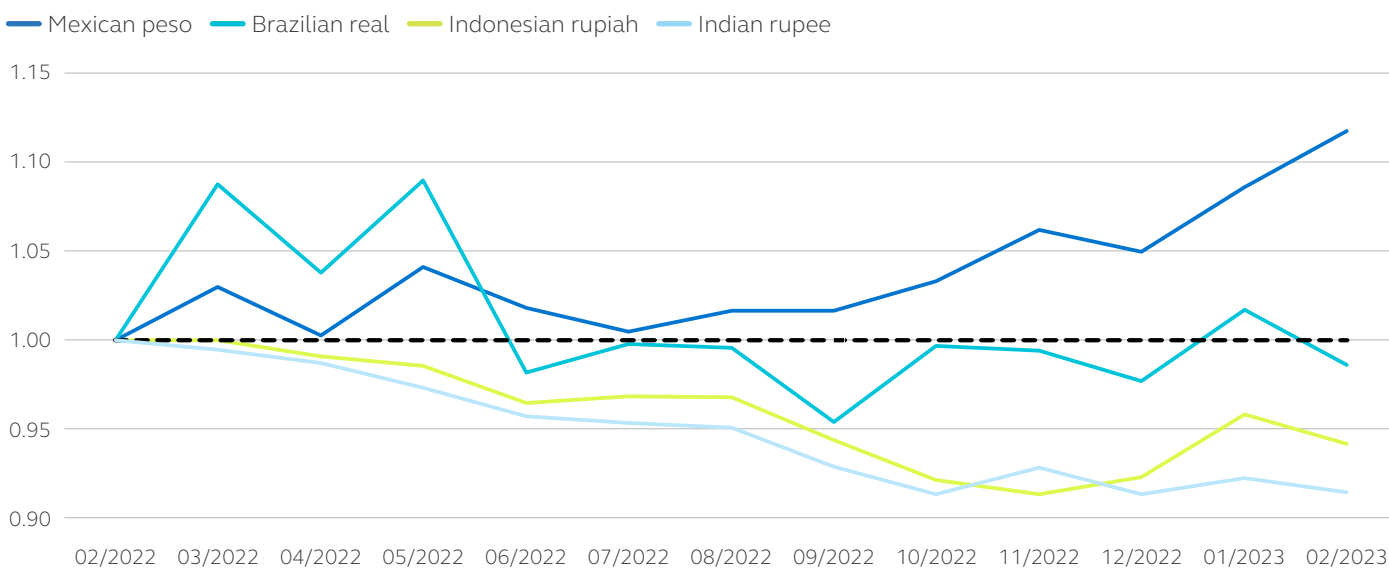
Several EM frontier economies have faced pressure given rising rates, higher commodity prices, and high debt levels. Moody's recently stated that of the 105 EM sovereigns that they rate, 26 currently have ratings of Caa1 or below, indicating a high probability of distress. The economic ripple from the pandemic slowdown and the lack of market access has quickly pushed frontier EM into the default group, especially with public debt at ~100% of GDP, external debt at ~65% of GDP, and interest costs vs revenues at ~75%. With the most recent being Ghana, seven of the 26 are currently in default.

Also in default, Sri Lanka exhibits similar metrics with public debt above 100% of GDP and interest costs above 65% of revenues. Pakistan, however, holds a slightly different profile; while debt is elevated at ~70% of GDP, its larger economy has been hit by floods which have stressed its limited liquidity and lack of fiscal buffers. As global financial conditions tighten, we continue to see several frontier sovereigns struggling to address both domestic economic conditions as well as domestic/external debt loads. Greater coordination between multi-lateral lenders and external debt investors is needed in restructuring this debt.

### EXHIBIT 12

#### Mexican Peso relative value to USD vs. selected EM currencies value to USD

Normalized against February 2023



As of February 2023. Source: Principal Fixed Income, Bloomberg.

# Private credit

## Direct lending

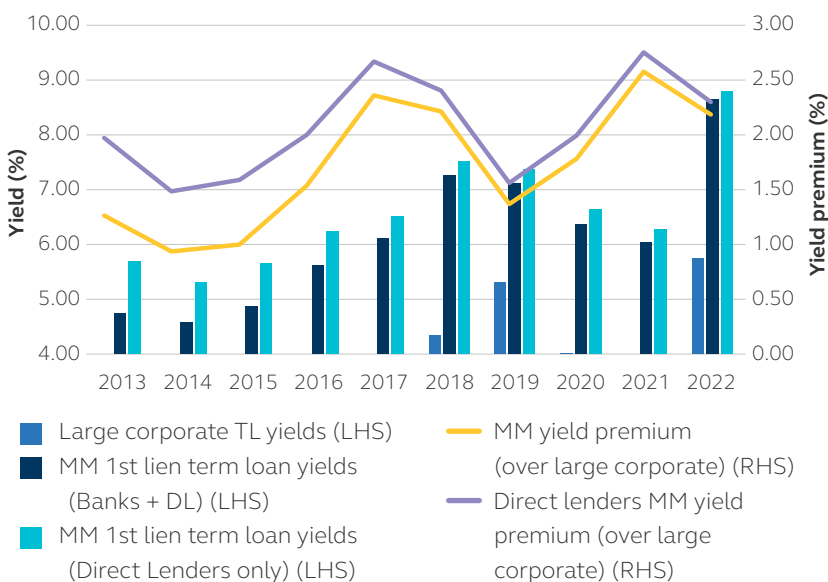
Even as public markets continue the year-end 2022 rally into 2023, opportunities remain attractive for investors in middle market private credit. Initially in the new year, credit conditions temporarily eased in the broader markets, but lenders in the private middle market continue to insist on more lender-favorable terms and pricing. Now that credit conditions are less certain with events around regional banks and significant public market spread volatility, the discipline of direct lenders will be as important as ever. This lender discipline is centered around assessing the actual underlying credit risk of prospective borrowers and overlaying expectations for more challenging economic conditions on the horizon. At the same time, public credit markets are being revalued based on market liquidity, sentiment, and the hope of a Fed pivot. Private credit lenders are focused on more resilient industries and borrowers while requiring relatively low leverage on newly originated transactions along with tighter credit terms and attractive pricing for investors. Though recessionary fears, persistently high inflation, rising interest rates, and public market volatility may cause investors to pause when considering a new or incremental allocation to middle-market direct lending, we believe the loans originated during the current and upcoming period will deliver unique value. The combination of lower valuations, lenders reducing hold sizes, and higher borrowing costs have made larger deals a bit more challenging in the current market. In addition to lenders being very selective, private equity sponsors are focused on pursuing financing for companies they expect to realize attractive financial performance through more challenging economic conditions. Having less cyclical industry exposure and generally lower leverage than the public market, the private middle market should offer the opportunity for attractive absolute and relative performance, as has been the case during many prior economic cycles and periods of market volatility.

## Investment grade private credit

The issuance slowdown in 2022, gave way in early January as several large deals launched in the private IG credit market, putting 2023 volume on a record pace. Some early 2023 deals offered opportunities to invest in large (\$1B+) structured transactions guaranteed by highly-rated public bond issuers at spreads 45-70 bps wider than their public bonds. Much of this early issuance was completed prior to the Private Placement Industry Forum (PPIF), the IG private credit market's premier conference. This year's PPIF hosted more than 850 attendees, making it the best attended PPIF conference historically. To us, this is an indication that the IG private credit market is returning to pre-pandemic activity levels which should support issuance volume.

Since the conference, issuance has moderated as issuers are trying to develop strategies to obtain investment grade private financing. Given elevated rates and expectations of moderation over the year, we anticipate seeing a mix that favors short maturities, allowing for refinance without prepayment. The public corporate bond market saw a jump in issuance in the first week of March (after a slow start to the year), and we expect a continued strong pipeline for private placements as companies must address their refinancing needs despite higher rates.

**EXHIBIT 13**  
1st lien term loan (TL) yield and middle market (MM) yield premium, annual



As of December 31, 2022. Source: Refinitiv. Above are the current views and opinions of Principal Global Investors and are not intended to be nor should they be relied upon in any way as a forecast or guarantee of future events regarding particular investments or the markets in general.

**EXHIBIT 14**  
Private placement spread matrix

A/L	NAIC-1 Designation		NAIC-2 Designation	
	Spread values (in bps)		Spread values (in bps)	
	23-January	22-September	23-January	22-September
<b>3</b>	130-175	175-225	160-200	200-275
<b>5</b>	130-175	130-200	160-200	225-300
<b>7</b>	150-175	130-160	175-225	225-250
<b>10</b>	150-175	150-180	200-225	210-250
<b>12-14</b>	170-185	175-200	200-225	215-260
<b>15</b>	170-185	175-250	200-250	225-275

Source: Private Placement Monitor.

## Forward-looking sector views

	Underweight		Neutral	Overweight	
	--	-	=	+	++
<b>Investment grade</b>					
U.S. agency MBS	●	●	●	●	●
CMBS	●	●	●	●	●
ABS	●	●	●	●	●
Mortgage credit	●	● ←	●	●	●
U.S. credit	●	●	● ←	●	●
European credit	●	●	●	●	●
Asia credit	●	●	●	●	●
Municipals	●	●	●	●	●
<b>High yield</b>					
U.S. credit	●	●	●	●	●
U.S. bank loans	●	● ←	●	●	●
European credit	●	●	●	●	●
Asia credit	●	● ←	●	●	●
<b>Emerging market debt</b>					
Hard currency	●	●	●	●	●
Local currency	●	●	●	●	●
Corporates	●	●	●	●	●
<b>Alternatives</b>					
Direct lending	●	●	●	● ←	●
Investment grade private credit	●	●	●	● ←	●

As of March 31, 2023. The above views reflect the relative value of the sectors shown based on forward-looking return expectations over the next 12 months. Arrows represent the quarter-over-quarter change in forward-looking views.

## Conclusion

While the first quarter of 2023 indicated a resilient U.S. economy, we expect economic data will moderate in the second quarter which would be supportive of a decelerated pace of Fed rate hikes. We believe the odds of a successful soft landing are unlikely as the ultimate impact of the Fed's aggressive tightening has yet to be fully realized.

Looking ahead, a mixed bag of economic factors including moderating inflation pressures, a softening global labor market, duration headwinds, and a peak policy rate within reach will likely result in an initial relief rally followed by a recession. Still, fixed-income opportunities exist for investors willing to endure short-term turbulence in exchange for long-term results.

# Principal Fixed Income: A leading global fixed income platform

Principal Fixed Income is the fixed income investment management platform of Principal Asset Management and manages US \$133.9 billion in assets under management as of December 31, 2022. Principal Fixed Income has capabilities that span all major fixed income sectors. Our globally integrated platform with investment centers worldwide and over 110 investment professionals, helps to directly access global fixed income markets and deliver a diversity of investment perspectives. Our structure and proprietary investment tools foster collaboration across sector-specialty teams, whether the sector is explicitly integrated into a portfolio or not. In our view, this diversity of insight helps each sector-specialty team formulate richer investment theses and make better-informed investment decisions on behalf of our clients.

## Investment Strategy Group

The creation of the fixed income outlook is a collaborative effort led by the Principal Fixed Income Investment Strategy Group. The Investment Strategy Group is comprised of the senior-most investment professionals from across the platform and is responsible for identifying key macroeconomic factors that are most likely to drive investment performance across global fixed income markets. Output from the Investment Strategy Group is formalized through Principal's proprietary Macro Risk Outlook framework and informs investment processes across the platform, acting as a top-down complement to the platform's bottom-up fundamental research capability.

### Investment Strategy Group members

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