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**JULIE HYMAN, YAHOO! FINANCE:**

Well, this earnings season is the latest test for the market's impressive year-to-date rally amid headwinds from near future recessionary fears. So in the face of a possible downturn at some point, what’s an investor to do? Our next guest finds the smart play lies outside equities. With more, we're joined by Sonali Pier, PIMCO Managing Director and Portfolio Manager. Sonali, thank you so much for being here. So investors who are facing down this earnings season and there is a lot of sort of noise around it, right? About concerns over falling profits overall, where should they be looking in the corporate bond stack to take advantage of maybe riding their way out through the earnings season?

**SONALI PIER, PIMCO:**

Thanks for having me, yes, we think that investors can find value in high quality, fixed income, be that secure ties, investment grade and even some parts of the high yield market. So specifically looking at agency mortgages, valuations have become much more attractive, especially as the Fed allows balance sheet roll off there within investment grade. These are high quality companies where bankruptcy is quite remote and offer a good starting yield.

**DIANE KING HALL, YAHOO! FINANCE:**

So speaking of, you say a starting yield, can it beat the return on equities right now?

**PIER:**

No, and that's what's really interesting and I think a key takeaway is that, you know, versus the long-term equity returns, fixed income is looking very attractive, right, with much less volatility. And should we hit a recession, you know, equities would likely bear the brunt of that. So versus a long-term equity valuation, fixed income is looking rather attractive. And as we- you know, given our preference in high quality fixed income, that should outperform in a recessionary environment.

**HYMAN:**

Are there particular areas that you're looking at within particular sectors, for example, within high quality fixed income that are attractive right now?

**PIER:**

Yeah, certainly. So, you know, agency mortgages have really widened and become more attractive in part because of the lesser footprint of the Fed. You know, we do tend to prefer the higher coupons there within investment grade, you know, industries we tend to prefer, you know, some of the non-cyclicals as such as utilities as well as, you know, I think in financials, especially given what we've seen this year with the regional banks and the like. It's much more nuanced in terms of what part of the capital structure and which financials. And then, you know, as we go lower in quality, you know, preferring areas where we think cash flows are much more predictable and avoiding some of the sectors that, you know, have low margins, low multiples and will struggle through an inflationary environment as well as an environment where we may see lower stock market levels.

**HALL:**

So, when you say lower in quality, what does that mean outside of like agency mortgages, like where are we talking about?

**PIER:**

Certainly. So, you know, the health of the high-old market has actually improved over the last decade as some of these risks shifted to the bank loan market or the private credit market. So, you know, that's not to say that, you know, all of, you know, this is definitely an area today with high dispersion. And so, you know, we're certainly taking a keen eye with our research analyst looking for, you know, looking at industry selection, security selection, quite specifically, but you know, what I would say is should we hit a recessionary environment, there will be more opportunities in the bank loan and private credit space, but today, you know, we see the fundamentals of high yield as being a bit more robust.

**HALL:**

And you said “should we hit a recession”, so, should we hit a recession, there is the potential for some defaults, right? Some companies are in debt. So, I guess I would ask, what does the default rate on debt look like, should we hit a recession?

**PIER:**

Yeah, certainly it'll pick up from the low levels that we've had more recently. But, you know, we're still forecasting high yield to have a default rate of, call it three to five percent. And the reason it's relatively low and it includes the long-term high yield default rate is really because, you know, companies have turned out their debt in the, after the Fed had stepped in during the great, during the peak COVID experience that the subsequent 18 months, the back half of 2020 and throughout 2021, there was significant issuance and given the low level of rates at that time, they really turned out to their debt that only 18% of high yield is coming due over the next three years, which certainly helps to do the default rate.

**HYMAN:**

Sonali, there's an interesting story on Bloomberg today that says that this may be as good as it gets when it comes to corporate bonds, that there has been this rally in the first half of the year, but that the spread over government debt is pretty low and there are concerns about how much it can be sustained. Is that why, first of all, do you agree? And do you think then that that means that corporate bond investors are gonna need to be more selective going into the second half?

**PIER:**

You know, from our perspective, it's always about active selection between industries, between securities within the capital structure and we're always looking to take advantage of dislocations. That said, with respect to fixed income, spreads have rallied from a credit perspective. However, even if credit spreads were to widen on the margin, the starting level of income due to these levels of yield helps bear some of that. And so, you know, potentially positive returns, even with some spread widening.

**HALL:**

And Sonali, I wanna ask you about, let's say there's more volatility to come, who's pricing it better, is fixed income- I think you probably have a strong opinion on this; or is the equity market pricing and volatility better?

**PIER:**

Right, so I think with where equities are today and with the potential for a recession, just on a look ahead basis, there's much more downside protection and fixed income than there is in equities, right? So, you know, from that perspective, I- given the current coupon and current yield that you'll generate and fixed income as you “wait” for the recession or as it comes, you know, there's definitely more downside protection and fixed income and still the ability to participate in some of the upside.

**HYMAN:**

All right, Sonali, thank you so much. Sonali Pier, PIMCO, Managing Director and Portfolio Manager, appreciate it.

**PIER:**

Thank you.