**MEDIA: Television**

**STATION: CNBC**

**MARKET: National**

**DATE: 2023-08-10**

**TIME: 11:01 AM ET**

**PROGRAM: Squawk on the Street**

**SUBJECT: Jerome Schneider - Markets**

**PAGE COUNT: 5**

**MIKE SANTOLI, CNBC:**

Well, joining us now, PIMCO Managing Director Jerome Schneider, here, post-9. Good to see you, Jerome.

**JEROME SCHNEIDER, PIMCO:**

Great to be here. Thank you very much.

**SANTOLI:**

New data, anything change in your outlook about it? The bond market seems pretty forgiving of it.

**SCHNEIDER:**

Yeah, I think really we're looking through to the fact that the market, as well as PIMCO expects, that of course, the API is going to be in that 3 to 3.5% range over the near term as we approach the year end. Is it meaningful? Yes, it's meaningful because of the fact that the Fed isn't necessarily going to achieve its target ratio at that point in time. We're not necessarily going to have the trajectory to make the Fed comfortable to potentially pivot to that dovish. That's clearly with the probabilities, as you highlighted here, put the lessening of rate hikes. But it doesn't also necessarily suggest that the Fed's going to put on the brakes now and pivot drastically to a dovish response. In fact, one of the things we're thinking about at PIMCO right now is the fact that inflation, while you're seeing some healthy returns to some inflation, means lower inflation in terms of used car prices, shelter, things like that. On the flip side, one of the things that is very worrisome is wages and wage pressures. And that is not subsiding. In fact, we actually see that as a potential source of increased inflationary pressures as we get into 2024. So the friction, and perhaps sources of volatility as we get later in the year ended in 2024 is that reconciliation of what are the components of inflation? How do wage pressures and specifically the wage negotiations we've seen over the past few weeks get translated into inflationary expectations going forward? And is that enough to actually give a longer pause to that Fed over this point in time as opposed to the rate cuts that we are forecasting in later 2024 and 2025 that the market proceeds? That tension is actually going to be foreseeable. So we might actually see this more favorable higher yield environment, specifically the front and the yield curve, globally for quite some time making that yield perspective much more attractive.

**SANTOLI:**

It's interesting. I mean, clearly the Fed's not going to declare victory, say that all is clear, but they seem to be messaging that they want some sort of time to do its work and we're going to keep rates up here. Maybe we have to snug them up a little bit more from here. Markets seem like they've been okay with that type of an idea. Also, some Fed officials mentioning, there is a risk of overtightening ,so they don't want to move too quickly in either direction. And it's interesting you say that we could have these short-term yields at these elevated levels for a while because I've started to hear people say, “listen, you have reinvestment risk if you just sort of lock in on the short end and then all of a sudden we're going to be seeing the Fed cut rates pretty soon.” You don't think that's an issue?

**SCHNEIDER:**

You make two great points. One, the Fed has continued to have collaborative conversations. And what I mean by that is that you're trying to find a way to balance the opportunities that the Fed sees and the positive news with the reality that inflation, the trajectory for inflation and other good data may not actually come as quickly as people expect. And that in and of itself is quite telling. And then when you layer onto that, the outlook for corporate earnings, profitability, things like this. It actually creates an environment where there could be a little bit more uncertainty than the markets are pricing it right now. So that volatility in itself is important. The second thing which I think is important is that what we do can take and take a certain degree of favoritism from PIMCO from the higher yields right now, I do think that the opportunity set is one where you need to be- create optionality, understand that liquidity conditions in the broader marketplace do remain tight relatively, and might get titers we continue to see excess reserves removed from the system. And then finally, the opportunity set in terms of yields while not trying to be too myopic in terms of determining where the Fed's going to go, probably lends itself to a more pensive, thoughtful Fed that doesn't necessarily have a reaction that suggests you're going to see rate cuts anytime in the immediate future.

**CARL QUINTANILLA, CNBC:**

So March doesn't seem reasonable to you?

**SCHNEIDER:**

Well, there's a lot of data between now and then. And if you're a data dependent Fed, you're going to take every opportunity to have those collaborative conversations; articulate to the market that you're considering all the data but not necessarily have to react to the data. And that's where the market tension will come in and we're going to see that, especially as we approach year end. You're going to see weakness in the economy that might become another factor, but not necessarily elicit a double response from the Fed at that point in time.

**QUINTANILLA:**

If wages are top of mind for you, how do you answer those who say work weeks are getting cut, productivity's great, corporates will figure out a way, ZipRecruiter is saying we're getting paid less for postings, things like that.

**SCHNEIDER:**

There's obviously some positive inertia. The productivity numbers are a simple function of a lot less people doing what they are actually doing. So those are inflated numbers from that point of view. But I think from the longer term perspective, you have wage pressures that are quite substantive in these labor negotiations. 20, 30% wage contract increases, yet those haven't been factored in the expectations and we haven't really seen it in the forward break-even in the TIPS markets or Michigan sentiment indicators. But we do see it and we will begin to see it in reality in real time as we get into 2024. That's the tension that people are playing between the markets and the soft landing crowd that we see. It's still a great opportunity. It's a great opportunity to create differentiation and risk. But it's not necessarily an environment where you want to expect that the Fed be relying upon a Fed that has traditionally a dovish sentiment because this time around may not necessarily be fully encompassed in that.

**SANTOLI:**

All that being the case, does that mean that the 10 year back under 4% is in the wrong spot? I mean, there was a lot of talk last week that this could break out finally above the highs. Now if you look at the chart, it feels like the upper end of the range held. Every time you get yields at that level and you have positive real yields, it seems like in aggregate the market says that's going to do my job to hedge my portfolio again.

**SCHNEIDER:**

It's a great point, Mike. But don't be too myopic here. And I'm suggesting there's a great point for us at PIMCO to look day-to-day in terms of the moves. But if you take a longer view, we had recent supply announcements, both in the short term space as well as the long term space. And that just takes time to digest. It takes time for people to react to the new supply coming and it probably lends itself to an environment of higher yield curves, steeper yield curves, and specifically, and so the appetite for yields at 4% is quite attractive, especially where we've come from. But you might find that to be a little bit less attractive in the future, especially if things which gear toward that longer term interest rate expectation, meaning the term premiums and inflationary expectations, actually end up being a little bit higher than people expect. But this seems sort of a fair value in terms of where we are right now, in terms of yield. And again, the relative sense of where we are in yields makes it that much more attractive from an income point of view.

**QUINTANILLA:**

Finally, is meaningful relief in shelter fanciful, overdone right now by the doves?

**SCHNEIDER:**

Yeah, it's a little bit overdone by the doves, but I think you also have to look at it as there's a structural impediment here. You have a supply issue in terms of shelter, which has to be overcome at some point in time. And that will take time to work its way through the system. So you do have a natural tension that through the epidemic-inspired inflationary situation, we are moving away from those impulses and moving to other impulses. So, bigger term, take a longer view, the shelter number has a little bit of residency because of the fact that there is a supply demand mismatch.

**SANTOLI:**

Jerome. Great talk to you. Thanks so much.

**SCHNEIDER:**

Thank you very much.

**SANTOLI:**

Appreciate it. Jerome Schneider of PIMCO.