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**ANNA EDWARDS, BLOOMBERG:**

Joining us now is Geraldine Sundstrom, Asset Allocation Portfolio Manager at PIMCO to give us her thoughts on Treasury markets. Geraldine, thanks for joining us this morning. So we saw higher yields on these auctions yesterday. Now we have been pre-occupied by the higher yield story through the month of August it seems, even if today looks a little bit different. I mean, Bank of America this month has been talking about 5%, while, Bill Gross, Larry Summers talking about 4.5, 4.75% in the US 10-year. How high do you think we get on this particular round, this push higher on yields?

**GERALDINE SUNDSTROM, PIMCO:**

That's very difficult to say and I wish I knew. One thing though and that has to be said that this level of yield is that time is your friend and carry is going to absorb a lot more of the volatility compared to before, especially in the front end of the curve where the duration is lower. So increasingly, we feel that these bonds in the front end, if you have a little bit of patience and nerve, it should provide a very good return. I’ve written that it should be able to compare to equities, especially if you're willing to take a little bit of high quality credit risk.

**MARK CUDMORE, BLOOMBERG:**

Geraldine, good morning, so can I selectively interpret that message, your preference for the front end? As backing my theory that we're going to seek steepening in the yield curve no matter what, it's either going to be a bear steepening or a bull steepening depending on which camp you’re in, but because the front end is much better anchored, that's where you might get some some edge. What's your kind of view on the yield curve? Steepening or flattening from here?

**SUNDSTROM:**

I'll say the sort of front end and a little bit beyond is probably- first of all, the yield is higher and the volatility could also be somewhat lower on the upside. So this feels a bit more attractive, especially if you put some high quality spread on that like agency and other high grade paper. That might be helpful. Then of course the back end has other things like supply, which has been unnerving markets lately.

**EDWARDS:**

Okay, so supply part of the conversation as well. Does that move forward in investors' sort of thinking, Geraldine? Does it become more important? What is the role of that supply concern at the moment in terms of the way bond markets are pricing?

**SUNDSTROM:**

I think supply is important at the moment because demand is not really there, but if you were to have a good slowdown and potentially a recession towards the end of the year in the fourth quarter, then demand would overwhelm supply once again. So it's really a question of how the economy is behaving, how resilient it is, so far it's been pretty resilient, so demand, if anything, has been on the lower side. But at the same time, the market could completely cope with that kind of supply, should there be a substantial slowdown in the economy towards the end of the year.

**CUDMORE:**

Just actually to test that a little bit further. I mean, it's a general consensus view out there that as soon as we get a recession, demand would overwhelm supply. But if we get a recession, especially going into the election year, you can imagine US fiscal deficits getting even worse and the fiscal pumps going to be applied again, which is going to just increase supply even further from a pretty drastic situation. So is there a chance that maybe we're overestimating the ability of all that demand to come back and really mop up that even more increased supply in the back end of the curve?

**SUNDSTROM:**

It’s possible, but when you look at valuation in the equity market and you look at equity risk premium, which is at roughly 20 year lows, they are, you know, it's probably one of the safer places to be and you get paid relatively decent yield, especially if you believe in the disinflation over time, the real yield that high-quality fixed income assets offer are pretty high and something that we haven't seen in decades.

**EDWARDS:**

Yes, and so you conclude that the risk reward is better for treasuries than for stocks, based on what you've said there about treasuries, Geraldine, but also about what many people call “lofty valuations” in stocks?

**SUNDSTROM:**

Yes, it would seem so.

**CUDMORE:**

And which, if you're more worried about stocks, which region for stocks are you most concerned about?

**SUNDSTROM:**

Well, valuations are the richest in the United States, but as we know, being the bellwether, it would be foolish to think that other stock markets can go up when the U.S. might be having a tough time. So I think in general, what we prefer to do is to own quality stocks. These have, in some cases and in some sectors, have underperformed year to date and being somewhat a little bit underweight on equities, yes.

**EDWARDS:**

Underweight on equities, but to Mark’s point, is there any geography or does it never come down to geography, Geraldine? I guess I'm also interested in this. Given the focus we've had on China of late; Chinese stocks, obviously the concerns around the Chinese economy dominates in lots of economists downgrading expectations there, the Chinese authorities piecemeal throwing iterations of support at Chinese stocks and wondering whether that makes any difference. Is that on your radar?

**SUNDSTROM:**

Yes, so of course, you find the highest quality in the United States, but it also happens to be the richest market. So it's a little bit of a contentious thing here, but things in health care, for instance in the U.S. or pharmaceuticals, there are a lot of things that are actually on the cheaper side relative to history, whereas some other sectors might be more expensive. Europe is not that expensive at all, however, it's very much cyclical as a market, very linked to export, very linked to China. And with the lack of confidence around China growth at the moment, it's proving a little bit more difficult to perform. So geography is not so much of an issue, I’d say its quality at a reasonable price is where one should go.

**CUDMORE:**

Yeah, because you're saying geography is not an issue, but I'm noticing a kind of bias generally across fixed income for the yields offered by Treasuries and in equities you're talking about the quality that is in U.S. stocks. So you're showing a bias for U.S. assets. Does this mean that you think the dollar has quite a bit of upside still?

**SUNDSTROM:**

In terms of if- it all depends, if there's a flight to quality or things of the kind, the market at the moment is a little bit relaxed. So some emerging market currencies with high carry have done well. This is attractive in a portfolio. We still think even though some emerging markets have started to cut interest rates, but yeah, it would look like at the moment, especially in terms of economy, Europe is not behind the U.S. in terms of recession and slowdown, it’s ahead of the United States. So if anything, this would have a tendency to maintain a certain bid on the U.S. dollar.

**EDWARDS:**

Geraldine, thanks so much for your time this morning. Thanks for speaking to us. Geraldine Sundstrom, Asset Allocation Portfolio Manager at PIMCO taking the world of Treasuries and fixed income, but also stocks, of course, as well.