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**BRAD SMITH, YAHOO FINANCE:**

Also the market is pricing in a near certain pause at the Fed's upcoming September meeting. But as policymakers grapple with stubbornly sticky inflation and a robust job market, the Fed's next steps beyond this month are far less certain. And where is that recession that we've heard so much about? Well, with so many unknowns, the safest investments may lie outside of equities. So what should folks keep in mind as they look for more secure shores? With us now to discuss, we've got Sonali Pier, who is the PIMCO Managing Director and Portfolio Manager. And Chris Rupkey, who is the FWDBONDS Chief Economist. Great to have both of you here with us this morning. Sonali, I want to begin with you there, perhaps. Where is this recession that we've been talking about for the better part of a year? And is it off the table?

**SONALI PIER, PIMCO:**

Data has come in better than expected so far. Inflation has come down and unemployment has been relatively low. So that really helps the outlook for the broader US economy and delays the potential even for a recession. And really, I would say at this point, many are discussing that it may not be in 2023. That said, we do have some growth headwinds that we're monitoring for the second half of 2023, such as with the student loan prepayments starting, tightening credit conditions and monetary conditions, as well as decline in consumer savings. That said, I will highlight that to date, we have seen a relatively resilient economy and it could just lead to some stagnant growth and not necessarily a recession.

**JULIE HYMAN, YAHOO FINANCE:**

Interesting there. Chris, what do you think is the biggest risk to this growth optimism or at least not recession optimism that has come back into market perception here?

**CHRIS RUPKEY, FWDBONDS:**

Well, I'm a little bit worried that geopolitics or at least politics down in Washington are going to come back and bite us on the behind before we get through the end of the year. Let's not forget, I don't think a federal government shutdown is off the table at the moment and there could be some adverse headlines about that coming forward. Other than that, economists’ track record at forecasting recession are pretty dismal to say the least. The problem with the recession is that all of a sudden the economy just goes vertical. Everything looks like it might be a recession, but all of a sudden these things, it just falls away and there's no indication at the moment trying to peer around the corner that we're going to see massive job losses that would mean the economy was falling away quickly.

**SMITH:**

Well, Chris, that's been one area that we haven't seen too much of a turnover, although we did see a slight move higher in the unemployment rate in this most recent monthly jobs report. A lot of economists are saying that that needs to get to upwards of 5 percent in order for us to really say or signal that a recession is either something that we're in the midst of or something that is impending, and so with that in mind, where is the Fed continuing to monitor for cracks in the labor market right now?

**RUPKEY:**

Well, sitting around on a trading desk decades ago, we didn't have much to do as a trading floor economist. And one of the things we noticed that for a recession to be a recession is the unemployment rate has to rise 0.5 percentage point from the low, and that pretty much almost every time except one since the 70s meant we were in recession. Job losses define a recession, so I know I said we can't see a recession coming at the moment, but that's a little ironic after the unemployment rate lifted from 3.5 to 3.8. Anyway, at the moment, the low for unemployment was 3.4, now we're 3.8, we're at 0.4 percentage point, we're really only a tenth away from indicating a recession, but there's reasons to believe that 3.8 last month won't stick.

**HYMAN:**

And Sonali, there's what we think and say about whether a recession is coming, and there's what people are actually doing with their money. You told us that you're seeing clients de-risk to some extent. Why are they doing that, and what does that look like?

**PIER:**

Equities have performed very well year to date, and when you look at the starting level of yields and the income that it produces and fixed income, when looking at that asset class versus equities, we're at a point where we haven't seen this relative value in some time, and bonds are looking very attractive, given where the 10 year rate is, for example, in treasuries, but then also even adding on some credit spread to enhance yield, this level of income can lead to long-term equity like returns through fixed income investing.

**SMITH:**

Okay, and so with that in mind, are there other areas where investors should be keeping an eye on for, or perhaps rotating out of with some of the risks that are present right now, Sonali?

**PIER:**

Yeah, I think there's still uncertainty out there, even if recession timing and probabilities have either declined or extended, the reality is that within fixed income, there's a lot of opportunity to have high single-digit returns and doing so, for example, in agency mortgages. This is an area which is highly liquid and is providing opportunities that we haven't seen in quite some time as a result of the Fed no longer being the key investor there in terms of, especially, we find more attractive the high coupons that are versus the low coupons that the Fed was in. Other areas include high-quality returns in investment grade where default is quite remote, even some high-quality parts of high yield look still attractive when you think about, call it the yield that we have today and reasonable technicals as at least at the moment and fundamentals where, while we have seen some deterioration, they've started from pretty robust levels.

**HYMAN:**

Chris, I want to circle back to something that you said at the beginning about keeping

an eye on Washington. I know you're not a political scientist, you're an economist, but we have to figure out if there's going to be a government shutdown, what effect that could have on the economy. How are you sort of modeling that at this point?

**RUPKEY:**

Not really trying to model it here, I don't know, it's something that could just come out of nowhere. All the talk sounds like a handful of Republicans aren't happy with the agreement they already got. Almost every year that I've been an economist for decades now, the Republican Party thinks we have a spending crisis, so I'm very afraid that they might take more dramatic moves to try and bring down the deficit, which of course is a risk for 10-year Treasury bonds. There's a reason 10-year Treasury bonds are above 4% now, and I think that's the supply deluge that's still coming. The U.S. Treasury borrowed 1.5 trillion each of the last two years. This calendar year, they’re saying it's going to be 1.5 trillion and now 3 trillion. 3 trillion is a big number, and if the Fed's going to keep rates higher for longer, maybe that's not the only thing that's going to keep rates higher for longer, because the Treasury has a massive borrowing requirement.

**HYMAN:**

Yeah, this is a great point, Sonali. Because of that and that supply coming to market, how high do you think yield say on the 10-year could go?

**PIER:**

I think yields at this stage are a reflection of significance. The Fed has hiked rates quite significantly over a short period of time. That said, I think we are towards the higher end of a range for where the 10-year could be, call it through year end, but the reality is there's a lot of uncertainty out there, as we mentioned, in terms of second half growth headwinds, in terms of potential for government shutdown. While we do think it will be resolved, it's a time frame question and expectations, and of course, as Chris has mentioned, also geopolitical risk. So do I think that fixed income is attractive at these starting yields? Yes, but it could mean some volatility along the way.

**HYMAN:**

Thanks to you both so much, Sonali Pier, PIMCO Managing Director, and Portfolio Manager, and Chris Rupkey, FWDBONDS Chief Economist. Have a great day to you both.

**PIER:**

Thank you.