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**SRI JEGARAJAH, CNBC:**

Let's bring in Tony Crescenzi, now Executive Vice president, Market Strategist and Portfolio Manager at PIMCO. Tony, thanks very much indeed for your time. “Hawkish hold” seems to be the consensus opinion. Does that change the narrative in fixed income for you?

**TONY CRESCENZI, PIMCO:**

If anything, it should solidify the narrative for fixed income. Investors should be thinking about the Federal Reserve and its actions, and also the actions of other central banks as medicine, because we all know what ills, markets, what ills, economies is high inflation. The medicine, of course, is interest rate hikes. The big surprise, of course Sri, was last year when markets were expecting from the Fed- almost nothing. The markets were thinking 1% for the policy rate; it ended up at 5%. So today, markets are thinking 5 and a quarter, 5 and a half. Not sure if there will be one or two more hikes, or perhaps none at all. But investors shouldn't quibble over that. It's small in comparison to the forecast miss that was seen last year, and it's small when considering what pleasant surprise will be awaiting investors in the long run from the Fed's actions, which is disinflation. So in fact, the Fed is engineering a growth recession, which is a growth rate below potential. The growth potential in the U.S. is about 1.8%. When the economy grows slower than its aid growth, it tends to see supply catching up with demand, that leads to disinflation, which is great news for bond investors in the long run, because disinflation is what helps protect the value of bonds. So I would say, again, take a long-term orientation. Think about the interest rate hikes as something good for markets in the long run.

**JEGARAJAH:**

Tony, does it feel that we have seen the peak in the rates markets, or is there more volatility to come, given all these distortions in the bond market coming from the shutdown effect, the BOJ, and the issuance?

**CRESCENZI:**

It may be that the peak is in, but investors shouldn't try to time the bond market to try to time the peak in yields. Trying to time a diversifier can be a very dangerous game for an investor who has assets that tend to be more volatile. For example, equities, or even real estate, private equity, private credit. Having stable assets in a portfolio today makes sense. Now, think about where the yields are. In an aggregate that most investors, and just again, it's called the Bloomberg aggregate, it's a yield of about 5.2% today. That's substantially above where it was last decade when it was 2.5%. Looking back 20 years, there's 3.25% back 30 years, 4.25%. This yield of 5.25% is pretty attractive relative to that. Finally, I should say Sri, that when we compare yields to where they've been historically, they look very good as I just noted, but they also look very good versus expected inflation, which is in the twos, versus typical volatility, which tends to be about 3% or 4%. The risk adjusted return prospect, meaning taking a look at the yield relative to volatility is quite good, and it's very dangerous to play the game of trying to market time a diversifier, as I said, and so I wouldn't do that today and try to pick the peak and yield.

**AMANDA DRURY, CNBC:**

Given the higher yields that we're on offer from earlier on this year, Tony, a lot of people who we speak to on CNBC said, you know, “Bond is where you want to be. You want to up your allocation to fixed income and bonds.” And naturally, one of the average retail investors goes for something simpler like a bond ETF, and yet the problem is with a bond ETF, they never mature. So essentially, you don't get the same protection for your initial investment as those interest rates rise, and some of those bond ETFs haven't done very well at all. What would you say to the average retail investor who wants to have bond exposure, but wants to do it in a protected fashion?

**CRESCENZI:**

Well, you're right Mandy, of course, an investor has to think about the price movement when they're looking at an ETF or some mutual fund, et cetera, but looking at yields that matters a lot, income matters a lot. In fact, if not for the income side of the equation this year, many bond investors might be down in terms of total return, but the income side is potent and it's kicked in, and it should kick in more as the Fed ends its rate hike. So let me give you a statistic back to 1978, and looking at all periods since then, that the longer duration bonds, call it five, six, seven years, more like an intermediate maturity, and it's a typical style to portfolio, it could be an ETF, a total return type strategy. These types of strategies perform cash, T-Bills, for example, 90% of the time during that near 50-year period, and by a very significant margin, by about three percentage points over a three-year rolling return basis. So in other words, looking at the story three years from now, we'll probably look back if three is any guide, and see that having some duration, some exposure to interest rate sensitivity was beneficial, because the total return, and this is total return time, I would argue, was really helped to break the bike pricings associated with eventual yield declines. And so lots of decisions to make between ETFs, mutual funds, et cetera, but the key is to, yes, perhaps try to avoid catching a falling knife, but catch it while you can, and try to lock in these yields by whatever instrument you can find.

**DRURY:**

What would you also say to people say, who might think, “look, I'm just going to be really cautious here, because we don't really know exactly what the Fed is going to do, there's lots of, you know, potential headwinds out there like higher oil prices, which might keep the Fed a little higher for longer, et cetera. And I'm just going to put my money in the money markets.” What would you say?

**CRESCENZI:**

Well, as I noted, in playing that rollover game, T-bills every 30 days, 60 days, 90 days, it's great. Of course, the yields are better now, and the returns have been better than having, let's say, a five, six, seven-year maturity, but that game can only be played for so long, and what if, in the second half of the year, in 2024, as PIMCO expects, there are rate cuts, and yields begin to decline, there will be no price gain, hardly any, in those short dated instruments, but there will be significant price gains in the longer dated instruments, and then investor will benefit by being there. So again, I would suggest thinking of it from that perspective, number one, on a total return basis, but secondly, in a portfolio context, the investor, and many, tend to have other assets in the mix, including equities, which have volatility, tends to be between 15 and 20%. And so what if, there's movement there, will correlations between bonds and stocks return to normal, where bond prices rise when equity prices fall? We think so, because typically toward the end of a fed rate hike cycle, is when bonds begin to shine, and it's toward the end, if not already, at the end, and it's just not a good time to be quibbling over one or two hikes, the guiding light in the end, Mandy, is do you or do you not have confidence in the Federal Reserve's ability to foster price stability, and keep at it, as Chair Powell has said, quoting in the most famous Fed, Chair in History, Paul Volcker, who conquered severe inflation in the late 1970s, early 1980s, this Fed will keep at it, and we'll get the job done, and the biggest advice I can give is don't fight the Fed. That means today, expecting the inflation story to improve, and bond yields to eventually decline, and for these returns to look pretty good, several years from now.

**DRURY:**

Yeah, well, after the transitory comments, I think they're very sensitive about inflation out there, and they're scratching back their credibility, as much as they possibly can. Tony, hold those thoughts, we'll be with you in a moment's time. Tony Crescenzi from PIMCO is staying with us.

**DRURY:**

Let's also bring back our guest, Tony Crescenzi, from PIMCO Tony. Thank you so much for sticking around with us. A few months ago, after that big debt deal in the US, the markets were really bracing for a deluge of T-bill supplies that have financed those budget deficits. What have we witnessed in terms of that supply and their impact on yields?

**CRESCENZI:**

Well, Mandy, one can look to Japan for an example of what could or may or may not happen as a result of large budget deficits. Of course, yields in Japan have stayed very low for a very long time, despite the large deficits and debt that Japan has. The same can be said for the US, where the debt to GDP ratio is rising to 100 percent and headed higher, and interest payments are headed higher as well. We've seen since the Global Financial Crisis very little impact of budget deficits and worldwide on interest rates, of course, throughout the 2010s, yields were quite low. But we might be reaching a practical limit to the use of debt. There's a clear case example, Mandy, in the UK last year, a year ago today, this month. In fact, we saw Prime Minister Truss announce a budget plan that would have expanded indebtedness in the UK. There was a violent reaction in the bond market, a violent reaction in the foreign exchange markets. It's what I would call, as I wrote a book about, this is a “Keynesian endpoint”. John Maynard Keynes, a famous economist, during the depression era, said, “You having problems? Spend money.”. Well, these days, markets are saying, “no, it's enough" and pushing back. And that's what happened in the UK last year. So, one has to wonder whether such a story is going to play out elsewhere and even in the United States. And I would suggest to you that perhaps, and I'll say this quickly, there may be a “read-my-lips" moment in the US several years from now. “Read-my-lips”, meaning George Bush 1988, the US President, said, “read-my-lips, no new taxes.” Well, he had to raise taxes because interest as a percent of GDP rose to 3.2 percent during his tenure, a record that still stands, but will be breached in a few years as those interest payments go up. So, there will be a moment of truth in a sense, and there are practical limits in the use of debt. And investors might be giving it a leap of faith right now, but after the US election in 2025, they'll decide, where is this debt trajectory headed and make a decision about how to deal with yields.

**JEGARAJAH:**

It's a fascinating conversation, Tony, with regard to the bond vigilantes and whether or not they are back and ready to punish a fiscal indiscipline. Tony, we'll leave it there. Thank you very much for your thoughts today. Tony Crescenzi from PIMCO.. Thank you, sir.

**CRESCENZI:**

Thanks, Sri. Thanks, Mandy.