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**ROMAINE BOSTICK, BLOOMBERG:**

But we do wanna go back to the big story of the day and that, of course, is the big Job Report and the market reaction to it. Jerome Schneider, Managing Director, and Head of Short-Term Portfolio Management and Funding at PIMCO joins us now here in Studio 2. And Jerome, let's get right to it. The number came in, I don't think anyone could say it wasn't a good number. Is the number, when you overlay it with the other data we've gotten, gonna be enough for the Fed to make a meaningful case to the market, that it is indeed gonna follow through with that one more rate hike this year.

**JEROME SCHNEIDER, PIMCO:**

Well, I'm not sure necessarily that the Fed has to make a case to the market. We've seen the market clearly marked a market to the Fed's outcome at that point in time. One of the consequences of the data today, it probably puts at least in the scope the consideration of another rate hike, given how strong it was. And although the household number at only 86,000 was a little bit more tempered, I think what we are seeing is several things. One, you know, inflation, average hourly earnings is a little bit more in check than people had expected, but not exactly in the landing zone that the Federal Reserve wants. Number two, job growth remains strong and we've had that two data points this week, the JOLTS surveys being a little bit stronger than people expected, and again, the headline number today being stronger than expected. What we need to ultimately recognize is that this is a methodical process where the current landscape might take some time to work itself out into the marketplace. And as a result, we have to realize that this is a slow and bumpy deceleration that goes on over a period of time. It's not going to be an immediate process that happens. So one data point is really being reacted to by the market as opposed to the Federal Reserve. The Federal Reserve is going to be at this higher point for a prolonged period of time, as long as they can digest what is going to happen in the medium term. Again, wage pressures are going to be the focal point of 2024.

**BOSTICK:**

Well, I'm curious then what you make of some of the market reaction. I mean, as we speak, we're talking about stocks at session highs and yields, which at one point were up 10 to 15, 17 basis points, have also come down a little bit. So now you're seeing buying in stocks, and you're seeing a certain degree of buying in bonds. What is that telling us?

**SCHNEIDER:**

Well, I think that it says that the market is reflecting that this is going to be a process. The knee jerk reaction at higher yields is simply reacting to the headline. We see a lot of quantitative behavior in that. But longer term, really investors are going to have to rationalize two things. What is their economic outlook? How does it reconcile to where their investment process is? How do investors rationalize a higher cost of capital environment? And that also includes higher real rates, inflation adjusted rates. And while on one hand, that creates opportunity for fixed income investors for capital deployers, that's also a rational examination that they have to do to think about how they want to invest for the future. And that might actually be more delayed or deliberate over a period of time. And so from an investor point of view, what does this create today? Well, it creates an opportunity set where for a decade or more, investors have really focused on the capital appreciation side of the investment metrics. But now it's actually on the other side of total return, which is income generation and yield. And so whether you think the proper yield for the 10-year note is 4.50, 4.75, 5% or even higher, what we are in this environment today is that the yield and income that is at the, it was within the yield curve is actually quite attractive. And more importantly, really a lower volatility contributor to returns than what we witnessed over the past decade or so.

**KATIE GREIFELD, BLOOMBERG:**

Well, to that last point, a lower volatility contributor to returns, I don't think it's lost on anyone that the bond market has been way more volatile than the stock market this year. And when you think about a lot of your traditional portfolio setups, your 60/40, your risk parity sort of portfolios, a lot of people would argue, actually, it's the fixed income side that's at volatility right now.

**SCHNEIDER:**

Yeah, without a doubt. And part of that has to do with the continued recalibration of expectations of where future rate hikes are. But when you survey the landscape where we are today, we're reaching the crescendo of those rate hikes. We're reaching the crescendo of a recalibration of term premiums at this point in time. And sure, the slope of the 2-year versus 10-year can continue to recalibrate closer to a positive level. But fundamentally, what we're finding is that most of those portfolios weren't necessarily at 60/40. They were actually something about 65/35, in favor of equities. Now we're finding that the added income is putting people to dip their toes in the water for the front into the yield curve initially, and then move out and add some interest rate exposure. What we are finding is the balance of people trying to rationalize that is coinciding with the Federal Reserve's perhaps last or near-last action to tighten monetary policy for the foreseeable future.

**GREIFELD:**

And I would imagine if we really are in a “higher for longer" environment, if we don't get the first Fed cut for however long, that only boosts the appeal of some of these very short-dated instruments.

**SCHNEIDER:**

Absolutely, and I think one of the consequences is, investors have a mindset of 2022, which is they see rates move higher, and they recognize that there's a capital loss potentially with that. But where we are today is that the yield and income from the yield curve, predominantly creates a large amount of cushion. So for example, a front-end yield portfolio, we'll yield about six and a half percent, and if a year or two of interest rate exposure, that gives you a lot of cushion for the Fed to go if they should decide to move higher, significantly higher, perhaps to not produce a negative total return. So the fixed-income landscape is dramatically different clearly than a year or two, that's perhaps that's an understatement. But what we rationalize is that the environment for potential rate hikes in the future, substantive rate hikes in the future, is somewhat diminished at this point in time. Now, 2024, 2025 obviously reshuffles the cards a bit, but what we think in the foreseeable future is that the Fed remains on hold, and perhaps they need a rationalized inflation as the headwinds to continue to reduce inflation become slightly more than people expected at that point in time.

**BOSTICK:**

In that time frame, do you think investors will stay committed to whatever side of the trade they're on? I guess this is more of a liquidity question than anything else.

**SCHNEIDER:**

That's a great question. And I think that commitment goes hand in hand with understanding there's a lot of risks in the world right now. We clearly have just meandered around the risk of a government shutdown, we have geopolitical risks, we have obviously higher rates. I think that what we really find ourselves in is a liquidity discussion where investors want to be very cognizant of liquidity, not only from a defensive metric, knowing how much they have in the portfolios and how much cash they can deploy, but also an offensive metric, meaning that when those opportunities reveal themselves, they want to be able to pivot very quickly to do so. So that's one of the reasons you see so much cash sitting on the sidelines at this point in time. But there's a big difference in that regard. The big difference is that being in money market funds, being in T-bills comes with a liquidity cost, meaning you're earning just basically the fixed rate at the Fed, as opposed to earning some of the higher yields that are in the front of the yield curve by being in the one to two year space. And that's about six and a half percent yield. Ultimately, I think this is an investor situation where you think about the entire landscape. You know, the balance of the situation is favoring income for the foreseeable future.

**BOSTICK:**

Jerome, always great to talk to you. I really appreciate you coming into the studio today. Jerome Schneider there over at PIMCO.