**MEDIA: Television**

**STATION: Bloomberg**

**MARKET: National**

**DATE: 2023-10-12**

**TIME: 05:08 AM ET**

**PROGRAM: Bloomberg Brief**

**SUBJECT: Nicola Mai - Markets**

**PAGE COUNT: 4**

**DANI BURGER, BLOOMBERG:**

Joining us now is Nicola Mai, Sovereign Credit Analyst at PIMCO. Nicola, great to have you on the program. So you and the team just put out some really fantastic research about where we are in this cycle. You're cyclical outlook in that. You said, “recession risks appear to be higher than the market is pricing.” What then needs to catch up or catch down?

**NICOLA MAI, PIMCO:**

I think you summarized it well. I think markets are way too sanguine about the economic outlook. I think risk assets are pricing an “immaculate disinflation” type outcome, in which growth remains solid, and inflation falls towards the target. In our mind, the picture is darker than that. We think that the fiscal sugar rush that has been supporting growth will fade. Monetary tightening will kick in. And we think recession risk is quite a bit higher. So risk assets really look vulnerable here.

**MANUS CRANNY, BLOOMBERG:**

Nicola, good morning. That's a fairly malevolent landscape to paint. With that in mind, how does that bear on the rate cut narrative? The Fed has guided the two rate cuts next year. If the landscape is as malevolent as you paint, will we see more accelerated rate cuts than we are presuming at the moment? They're telling us “higher for longer”, you're telling me something different.

**MAI:**

I think a couple of rate cuts by the Fed, which is what's priced in the market, is probably a reasonable assumption. I think the key point here is that I think rates have peaked, not only in the US, but also in Europe. And I think inflation is going in the right direction. Growth is moving down. And I think that that should be very much anchor bond yields, which we find really attractive here. So I don't think it's as much a view about the Fed cutting more than the market. Really the peaking rates anchoring fixed income valuations.

**BURGER:**

The conversation, though, from the Fed, even though some of them are talking about peaking rates has been higher for longer, though. They're kind of pushing back still against the market narrative of cuts. Does that mean they're heading for a policy mistake if they're keeping rates restrictive or longer?

**MAI:**

Well, I think central banks are really willing to accept the economic weakness that is coming because inflation has been a scare. It's been higher than it's been in decades. And I think central banks don't want to make the mistake of easing policy too quickly. And so I think higher for longer will last for the next few quarters. But obviously, the economic risks are going to be rising. And I think the possibility of a hard landing on tight monetary policy and fiscal support fading are significant. And that's, again, where bonds offer good value.

**CRANNY:**

OK, so they’ll eventually work as the hedge that they're supposed to be. They haven't done quite what they're supposed to do for the past couple of years. Contrast that with, I mean, you're a buyer of bonds, but you are wary of credit. But I look at what Howard Marks is saying to me at Oaktree, and he's saying, “credit gives me equity-like returns. It probably represents a substantial, or should represent a substantial portion of the portfolio.” Of course, he's speaking about his book. I get that. But you are a little bit more wary on corporate credit given the recession risk. So are you de-crediting the book, or are you just taking less risk across the spectrum?

**MAI:**

Well, I think if you think about credit, the duration component within credit, the risk-free component is attractive. If you look at the spread, meaning how much you get on top of the risk-free rates or the duration component, to me, that looks quite compressed. Equity valuations are obviously very elevated, but also corporate credit spreads are quite tight given the economic outlook. So we do want to take risks, but in a real and a defensive way, in credits where we feel we are protected. I mean, think about agency mortgages in the US, for example, government guaranteed, really interesting spreads, and also a lot of structured products, securitized assets, senior financials to some extent. So you really want to take risks in a defensive way from our perspective.

**BURGER:**

When you are looking at some of the riskier spreads, I mean, as you said, they haven't blown out, like they have in prior recessions. Do you expect this to be a typical cycle in that way to see spreads? I don't know, getting to 2000, a pretty hefty default type cycle?

**MAI:**

So our baseline is not a deep recession. It's a mild recession, or stagnation, slash mild recession. And the reason is partly that household and corporate balance sheets are in pretty good shape, and partly because financial stability policies have been very proactive. I mean, think about the UK LDI response or the FDIC in the US guaranteeing bank deposits. So not a deep recession, but still a recessionary environment, and I think spreads will widen from here. It doesn't mean they will go to very wide levels, but I think market to market investors should be cautious here.

**CRANNY:**

I'm kind of torn between China's stimulus and Japan, but I'm going to go with my gut, which is Japan, because we've had everybody on going, “Max bull, Japan, Max bull equities in Japan, bull Yen”, because they believe YCC will be ripped apart sooner than we all think. How much of Japan should be in the portfolio now? What is your starting point for YCC being removed and how much allocation upping are you doing to Japan? Are you taking more exposure to Japan?

**MAI:**

I think that's a really good question, and one of the themes we mentioned is monetary policy divergence, and really Japan is going to be diverging. Most central banks are going to be cutting rates. We think that in the coming quarters, Japan will fully exit YCC, and also they will raise the policy rate in our baseline outlook. And as a result, I think our inclination is to be underweight Japanese duration. As I said, we like the duration in the US, in Europe. Also in places like Australia, New Zealand, Canada, where rate sensitivity is high. Japan, I think you want to go in the opposite direction.

**BURGER:**

Nicola, thank you, unfortunately, we have to leave it there. Thanks for joining this morning. That is Nicola Mai, of PIMCO.