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**DAVID WESTIN, BLOOMBERG:**

To interpret all these markets for us, we welcome back now Erin Browne, she's Pimco Multi-Asset Strategies Portfolio Manager. Erin, great to have you back with us. So if you start with the jobs numbers, the other economic data we've got this week, how did the markets react to it?

**ERIN BROWNE, PIMCO:**

So I think that the markets actually behaved pretty rationally. We had a significant rally into the end of November, both across equity markets as well as bond markets. And I think probably the bond market got a little bit ahead of itself going into today's number. Keep in mind that prior to today, the market was pricing in about 127 basis points over interest rate cuts next year, which is a really aggressive interest rate cutting cycle that had been priced in, particularly against the backdrop of still elevated inflation, wage growth, north of 4%, and a pretty healthy economy. And so what you saw today, I think, was just some of that optimism of rate cuts being priced out of the market. What's interesting is it didn't really hurt the equity markets. Equity still rallied into the end of the day - did quite well. But the market really is pricing in a pretty soft landing across both equity and bond markets. And I think just some of that enthusiasm was priced out of the bond market, but still a very healthy environment, healthy macro backdrop for stocks.

**WESTIN:**

Erin, we're in December now. It's time to start thinking about 2024. It's not too early. What are you projecting for 2024? And as you talk about those rate cuts, it always strikes me the only reason they cut rates is if maybe things are not going so well in the economy. So I'm not sure if we should wish for that.

**BROWNE:**

Well, there's other reasons why the Fed would price in rate cuts. And the reason for that is right now rates are quite restrictive. You know, the rates are probably 200 basis points over the neutral rate. And that was really necessary given the very elevated levels of inflation. But we're starting to see inflation come down, and as we see inflation normalize, the Fed may want to take out some of that restrictiveness, even absent a recession. So we could still see rate cuts in a healthy macro environment, as long as inflation is lower than where it is today. What was a little bit concerning about the jobs number is we saw wage growth increase again, and it's elevated above 4%. The Fed is probably going to have difficulty cutting rates with wage inflation above 3%. So we need to see that really move lower in order to be in the Fed's comfort level overall to start cutting rates. I think next year we're going to continue to see a gradually slowing economic environment that could stagnate. But right now, at least I'm not pricing in a recession for next year. But I do expect a slow growth environment in the US with the potential for recession risk, particularly outside of the US. That could open the door for rate cuts towards the end of next year, but it's unlikely that we're going to see rate cuts in the first quarter, particularly after today's payroll print.

**WESTIN:**

Erin, I know your job is really monitoring that balance between equities on the one hand and bonds on the other. Now bonds are giving you some real returns. I mean, you're getting some real money. What does that mean about your investment portfolio as you go into 2024?

**BROWNE:**

So I think bonds are in a really unique sweet spot right for investors. Typically, there's three things that you look for in bonds, and I call it the ”trifecta of bonds”. The first is yield. And you want real yield from bonds. If you look at a core US bond portfolio today, it's yielding 4.8% on a real basis, so absent inflation. If you subtract that inflation, that's a positive real return from your fixed income portfolio. That's really elevated versus where we've seen during very slow growth environments and certainly very elevated versus the yield that you were getting from any type of bond portfolio over the last decade or so. The second is the potential for capital appreciation. And just given the really rapid sell-off and the extent of the sell-off that we saw both in 2022 and 2023 across fixed income portfolios, I think you could see the potential for real capital return as well next year as bonds rally as a continuation of what we saw over the last month. And then the third is diversification. And we've seen stock bond correlation go back to inversely correlated with one another, which means that when bonds sell off stocks rally, and when stocks sell off, bonds rally. And that's really important from a diversification perspective for most investors, asset mix, and their core asset allocation across their portfolios. And so you're now getting all three benefits from bonds. Whereas two years ago, you're really only getting potential for diversification, which failed. So I think bonds are in a real sweet spot next year for investors.

**WESTIN:**

Erin, just quickly at the end, give us a tip. Where in bonds? Do you want to give them bonds? Which bonds do you like the most?

**BROWNE:**

So I think that first of all, investors have been really invested in cash. And I think now is the time to start increasing the duration of your portfolio, moving money out of cash so out of the front end and into longer duration assets. I also really like agency mortgage-backed securities, which trade 100 to 150 basis points over the 10-year treasury and our money-good assets. And thirdly, looking at emerging market local bonds as well, which offer a spread to treasuries, which is really attractive, and much more attractive than corporate bonds. So those are the three areas I've concentrated with that.

**WESTIN:**

Erin, great to have you back with us. Thank you so much. That's Erin Browne of Pimco. And this is Wall Street Week on Bloomberg.