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**JONATHAN FERRO, BLOOMBERG:**

Andrew Balls, the Global Head of Fixed Income at PIMCO, writing to the following, “After the major economy showed surprising resilience in 2023, we anticipate a downshift towards stagnation or mild contraction in 2024. The standout strength of the US is likely to fade”. I'm pleased to say that Andrew joins us now. Andrew, the new cyclical outlook. Great to catch up, sir, as always, “How to Navigate the Descent”. Can you just put a little bit more meat on those bones? Just how much of a descent are we about to encompass; confront over the next year?

**ANDREW BALLS, PIMCO:**

Yeah, so globally in the US, but in Europe, across most markets, we're expecting interest rate cuts this year. This comes after the very big hiking cycles that we saw, and we see inflation peaking and growth peaking. And then there's a lot of uncertainty as you go into this year. The US has been a standout in 2023, stronger than the consensus expected. A lot of people thought there would be a recession last year. We think that probably the US is going to slow down this year, catching down with what we are seeing in Europe. And then the baseline is pretty benign, I would say. A slow down, but not a deep slow down, a rise in unemployment, but not a really big rise in unemployment. And that should be enough for inflation to come down towards central bank targets. We've had a lot of good news already on inflation. But then just a very big uncertainty about all the different parts of the puzzle and how it comes together. So it's going to be a really interesting year for active managers and a lot of risks to guard against.

**LISA ABRAMOWICZ, BLOOMBERG:**

Andrew, you talk about a slow down and underperforming, or at least a right-sizing of the US economic outlook this year. You talk about things slowing. Do you think right now, investment-grade, corporate credit in the United States with a spread of 92 basis points, 12 basis points away from the cycle lows that we saw just two years ago, three years ago? Do you think that that's overpriced, price to perfection, not something you'd want to buy?

**BALLS:**

So I think in the baseline, investment-grade credit looks OK. And I agree, you're not going to see an awful lot of tightening from here, but you earn the income and very high quality issuers, very default remote. But then you have the risks around the outlook. And when economies are slowing down, you can certainly get a lot more than anticipated, judging the impact of the tightening cycle that we had before is something which is very difficult. So I think investment-grade credit looks fine. But it makes sense to guard against lower rated credit, more economically sensitive, more leveraged parts of the market. And when you have really good prospective returns from high quality fixed income, the returns on sovereigns look pretty good here. The return on investment-grade credit, US agency mortgages. When you can do well up in quality with these high quality fixed income instruments, then you don't need to go down in quality. You don't need to go to the more leveraged, more economically sensitive parts of the market. So good returns are possible and keep your options open as we navigate this year as it goes. As we go through to see the balance in terms of growth and inflation risks.

**ABRAMOWICZ:**

So before we get into outside of the US and where you're sort of shifting instead of the US, I am just curious. I want to sit on the sovereign debt point for a second. You think that that's a steady place to go at a time where we're about to get a refunding announcement from the Treasury Department with potentially $4.1 trillion of Treasury sales. We have a Fed that is unclear in terms of their trajectory. What's the risk there? I mean, do you agree with Bob Michael that there's just a shortage of bonds? And that's really the main issue in the US, or do you think that there is some sort of deficit and structural risk with yields potentially going higher in the US?

**BALLS:**

So I think there's a lot going on. So I think in terms of high quality fixed income, the yields, US 10-year treasuries close to 4%, the yields look attractive and you look at aggregate type bond indices at 5, 6, 7, 8% with more credit type of yield. For high quality bond funds, look, they're very attractive. You have supply. To a reasonable extent, the supply information should be known and it should be priced in. But supply is something which is certainly something to keep an eye on. And you have at the front end of the curve the big uncertainty over the path for the Fed. So a lot going on overall. I think there are definitely medium term concerns on the US fiscal policy. We have a US election coming up this year, obviously, with implications over time for fiscal policy. But when you're getting kind of 5, 6, 7% nominal yields, this is an indicator of future returns; it is one of the best indicators there is. And in that context, high quality fixed income looks very attractive.

**FERRO:**

Andrew, high quality. Let's talk about the rest of the credit. We caught up with JPMorgan asset management just last week. Constructive on credit. Taking credit risks. We heard the same thing from Amanda Lynam at BlackRock. Interest in high yield, not all the way down to triple C's, but interest in the rest of it. Andrew, where are you and the team? Where in high yield credit do you want to be? Where do you want to avoid?

**BALLS:**

So I think in high yield, it's always a case of picking the names, rising stars, the issuers which you see on the path to investment grade over time, were always one of the key things that our analysts are looking for. But I would just take a step back and say that you can get with the high quality instruments if you use government debt, investment grade credit, US agency mortgages, private label mortgages, you can get high quality portfolios which give you attractive yields, 5, 6, 7% type yields without needing to go down in quality. So yes, there's going to be lots of opportunities in high yield. But in terms of asset allocation, that up-and-quality bias I think makes a lot of sense in this economic environment. And if you do get, say that we get worse and expected macro outcomes, equity market outcomes, more being priced in for the Federal Reserve, in that negative tail, which is something you should pay a lot of attention to, there may be really good opportunities later to add to low quality credit in a market where you see repricing. But for now, I think you can achieve a lot of what you want to achieve up in quality.

**FERRO:**

Andrew, let's just finish on the Fed. Just briefly, I want to go back to the secular outlook that you and the team put out in the middle of last year. When you said Chairman Powell would accept “two point-something” on inflation, that was slightly controversial at the time. Less so now, because a lot of people have moved in that direction. We're at the “two point-something” mark after the read of last week. Is that sufficient to say “Let's go”, in March?

**BALLS:**

Well, I think they have optionality. And I know you've talked about this on your show. But the gap between CPI and PCE is something which is important and it gives them optionality. So I think overall, I don't see why they would be in too much of a rush. The inflation data is improving. But the GDP data still remains quite strong. The labor market data remains strong. So our best guess is that they'll certainly keep their options open for March. But it's more likely that they go later in the year. But if the PCE does clearly give cover, given the wedge, given the medical-related costs there, if they wanted to ease earlier, that certainly gives them cover. And inflation coming down below 3%, it gives you the way wherewithal to start easing monetary policy over the year. You don't need to come all the way down to 2.0. But I think that clearly there's enough in the inflation data now that this is a matter of timing for our taste. There's quite a lot of priced in for this year, given the ongoing strength of the labor market data, the broader data, but this could change, obviously, through the course of the year.

**FERRO:**

Andrew, thank you. Andrew Balls, there, of PIMCO.