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**MADISON MILLS, YAHOO:**

We are going to continue to cover stocks here moving higher after over half of the S&P 500 stocks hit their one-month lows on Tuesday. That is the most since the 2023 banking crisis. And this comes after Fed Chair Jay Powell said that it could take longer than expected to tame inflation. Investors are now reprising the likelihood of rate cuts this year with a 58% probability of rates staying at their current levels in that July Fed meeting. That is according to the CME FedWatch Tool. For more on this, we are joined by Jerome Schneider, PIMCO Head of Short-Term Portfolio Management. Thank you so much for being here with us this morning. I know that you've mentioned that there's a lot of noise in financial markets and that's why we're seeing so much whip sign when it comes to the data, when it comes to Fed speak. What do you make of the reaction that we've gotten to Fed Chair Powell's commentary?

**JEROME SCHNEIDER, PIMCO:**

Yeah, we've come a long way over the past few months and rationally, investors have continued to recalibrate the data that's come into the marketplace with regards to inflation and more importantly, with regard to the higher than expected growth patterns that we've witnessed. From that perspective, we actually are getting an emphatic response from the central bank here. Both Chairman Powell as well as Vice Chairman Jefferson yesterday emphatically said that, “We are simply seeing inflation too high in the data”, that they can't ultimately move to a lower benchmark rate as a result. So the easing bias that many people had expected earlier in the year seems to be evaporating here pretty quickly. The markets have actually digested pretty well this information especially over the last few pieces of not only job data but also inflation data. But from that perspective, we're seeing the markets really digest that we are going to have higher rates for longer. And in doing so, we are finding that risk assets generally have tolerated it, yields have moved higher in calibration, expecting this higher for longer mantra and investors really should begin to think what that means for their portfolios longer term. And ultimately, what we're finding here is that yields are relatively attractive, really attractive compared to where we've been in the longer term. But in the near term, we're finding that there's a lot of fair value to be had in the front end of the yield curve, really the zero to 10 year space to be more precise. And in that construct, what we need to do is construct portfolios, think about the opportunity sets that the Fed has effectively afforded us because of the fact that they're going to be on hold for a little bit longer than they expected. And more importantly, when we ultimately see them begin to cut, put yourself in the position to have some price appreciation in bonds by adding a little bit of interest rate exposure to this point, given the rationalization and recalibration to the higher rate regimes that we've seen in the recent weeks. 30 basis points over the past four weeks or so across the curve is something to really put us into that fair value range. And we think that it's an entry point for investors to begin to consider adding a little bit more to their fixed income component of their portfolios.

**SEANA SMITH, YAHOO:**

Yeah, Jerome, it makes sense just the opportunity that you're seeing here for investors to kind of lock in some of those higher yields. I want to get more specifically to the movement that we've seen higher, especially when you take a look at the move in the 10-year, when you take a look at the move in the 2-year here. How much higher do you think yields are potentially going to at least at the short end of the curve with this concern about this “higher for longer" scenario? I guess how much of that do you think it's priced in at this point?

**SCHNEIDER:**

Great question, Seana. We see we're ultimately seeing a rationalization that there's probably going to be a little bit less than two rate cuts over the course of this year and a handful of rate cuts next year. I think there's, you know, while on one hand we're probably in the vicinity of fair value for both the 2-year and the 10-year point, I think investors are trying to be a little bit too precise in terms of handicapping and they are actually trying to predict what the Federal Reserve is going to do. While there is a negligible possibility that the Fed does not cut rates this year, the reality is they're probably going to signal at least some accommodation along the way, however modest it is. From a practicality perspective, it's probably the 2025 outlook that investors really need to begin thinking about, not necessarily from the fixed income perspective, but what higher rates are longer mean for risk assets around the world. And ultimately, if we don't see as many rate cuts that are forecasted in 2025 come to fruition, that could actually have some type of effects on the pricing of risk assets and the appetite of risk assets in the longer term. So in the near term, we actually expect the Federal Reserve to do two things: Probably continue to push out their expectations of rate cuts in the near term, and then more importantly pivot to a less important asset of the policy effort, which is focusing on their balance sheet and begin to adjust their quantitative tightening, which is in the background and really doesn't necessarily have much impact to rates and risk appetite, but is an important component of monetary policy, as it has been in recent years. So we'll begin to see some modest adjustments in their messaging along the way. But again, Jerome Powell has been emphatic in the near term and will continue to be so about defending inflation as we get longer into his term, and closer to the 2026 expiration of his term, he's going to be really focused on one thing, which is focusing on how inflation has been diminished and approaching that 2% threshold. And he's going to do what it takes to do so, even if it means delaying the rate cuts along the way. Near term, I think that this delayed easing cycle will unveil a series of opportunities, as I mentioned, to really optimize allocations around the investment world, favoring a little bit more fixed income along the way, despite the prognosis that Fed cuts might be pushed out a little bit longer at this point in time.

**MILLS:**

And I'm curious, as we start to wrap up here, our conversation about what we're seeing in the two-year and the 10-year. Are those, is the growth story the same for both of them, is one a growth story, one an inflation story? Are they moving off of the same narrative, or is there a difference there?

**SCHNEIDER:**

It's very possible, but very, very important that growth and inflation are coming in a metric across the curve. But the inflation metric is a little bit more poignant in terms of that 10-year point for several reasons. While the two-year point is more susceptible to Federal Reserve policy changes, specifically benchmark rate changes, which currently are affected by inflation data, longer term, the term premiums that you'll see further out the curve in the 10-year sector and the 30-year sector, are really predicated upon term premiums driven by longer term inflation expectations, as well as supply considerations. And so when you have that in play, you're really thinking about how the shape of the yield curve, which is still negative mind you by about 30 basis points, needs to recalibrate to a more normalized level, where 2 year yields and 10-year yields are equivalent, and eventually reflect a normalized yield curve where 10-year yields are higher than 2-year yields. That will happen over time, but currently doesn't reflect that. And in that case, inflation and term premiums have much more effect on the yield curve, which is why at PIMCO, we're thinking about the yield curve as having a steepening bias over the intermediate term.

**SMITH:**

Jerome, outside of the U.S., are you seeing opportunity in international bond markets and if so, where?

**SCHNEIDER:**

Without a doubt. And I think this is where differentiation and where the U.S. exceptionalism is actually creating opportunities for investors. On one hand, while we think we're pretty close to fair value in some yield determinants in the United States, when we look around the world, we're going to see some more aggressive central bank policies toward easing, reducing benchmark rates in the near term. Those places are such as Canada, Australia, even England in that matter, and the ECB. We could find ourselves in a world where those central banks move more aggressively versus the United States and create an outperformance, meaning their yields will move lower, creating some price appreciation compared to the United States fixed income position. So we are finding some of those relative value opportunities across our portfolios, not only in the short term, as we encourage investors to move out of bills and into some longer-term fixed income, but also more broadly speaking, as we look at to relative value for investors who hold for the longer-term fixed income in their portfolios.

**SMITH:**

Jerome Schneider, we really appreciate your insight. Thanks so much for taking the time to join us here this morning. PIMCO Head of Short Term Portfolio Management. Thanks so much.