

INVESTMENT OUTLOOK

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By Craig Burelle, VP, Macro Analyst



GROWTH AND INFLATION WITHIN THE WORLD'S LARGEST ECONOMIES SHOULD REMAIN NEAR CURRENT LEVELS, KEEPING THE POSITIVE OPERATING ENVIRONMENT FOR COMPANIES INTACT.

The credit cycle is progressing, but we find spreads unlikely to widen materially if revenue and earnings continue to grow at a healthy pace. Risk premiums appear fairly tight across US credit and equity markets but modest total returns look attainable. Emerging market valuations have been slipping since January, perhaps more than fundamentals warrant.



MACRO DRIVERS

Most major economies appear to be gradually advancing in the expansion phase of the credit cycle.

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CREDIT

Credit spreads are likely to trade in a fairly tight range, but we believe excess returns over government bonds are attainable.

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FOREIGN EXCHANGE

Valuations appear attractive, but it may take another catalyst to spark a sustainable rally across emerging markets and other foreign currencies.

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EQUITY

Earnings growth can still drive global equity markets higher without multiple expansion.

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POTENTIAL RISKS

An increasingly hawkish Federal Reserve (Fed) paired with unexpected weakness in the Chinese economy could disrupt the broadly positive macroeconomic backdrop.

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ASSET CLASS OUTLOOK

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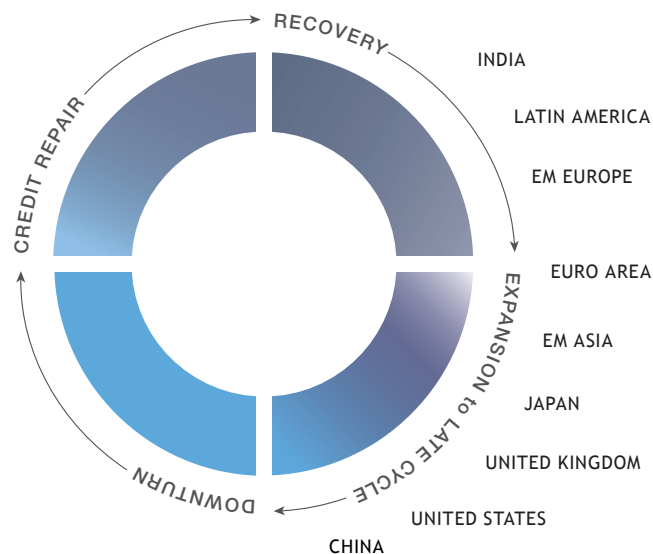


MACRO DRIVERS

The US and China Could See Nominal Growth of 5.2% and 8.8%, Respectively, in 2019

- The US and China are the world's two largest economies and represent nearly 40% of global economic activity as measured by GDP. Though China may be slowing, these two engines of growth should propel global growth forward in the quarters ahead.
- There is evidence of moderate inflationary pressure within developed and emerging economies, but we view slightly higher inflation as nonthreatening to the expansion.
- The US is entering a mature phase of the credit cycle, while most other countries are in a much earlier position. Countries can progress in the expansion phase for long periods of time, especially if growth and inflation remain stable.
- The global economy remains tightly linked by trade and complex supply chains. Trade negotiations and tariffs have thrown some sand into the wheels of global trade but we do not expect trade disruptions that would change the global growth outlook materially.
- A modest acceleration of economic activity in China could be highly supportive of emerging markets, especially if trade rhetoric softens later this year.
- Stronger momentum in the US economy relative to the rest of the world should keep the Fed on its current path to higher short-term interest rates, while other developed market central banks remain accommodative.

THE MAJORITY OF THE WORLD IS IN RECOVERY OR EXPANSION, WITH NO SINGLE COVERED COUNTRY IN A DOWNTURN



Source: Loomis Sayles. Views as of September 30, 2018.



CREDIT

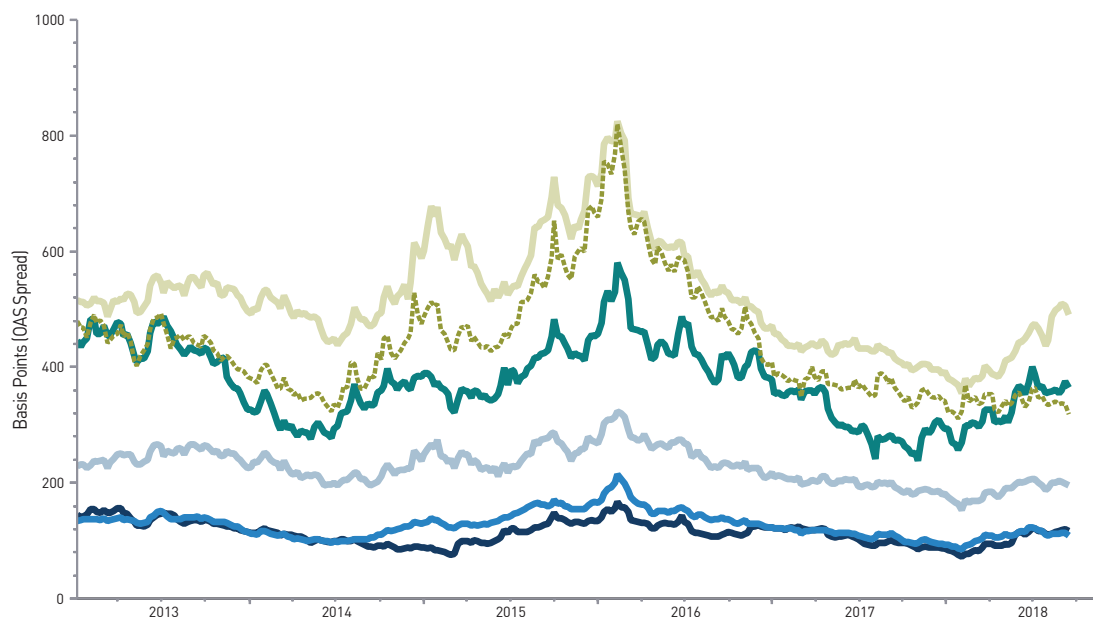
Growing Corporate Profits Have Been the Lifeblood of the Cycle

- With the exception of the US and a few emerging markets, global credit conditions appear fairly stable. In the US, credit conditions have been growing less accommodative as the real federal funds rate approaches positive territory.
- US high yield spreads have been solid, backed by excellent corporate earnings growth and strong investor demand for the asset class. Demand is unlikely to abate given the stable domestic outlook and the asset class's relative yield advantage.
- US investment grade spreads have backed up, but still reflect the positive operating environment. The asset class should provide a meaningful excess return over Treasuries in the quarters ahead.
- Pan-euro high yield spreads have been slowly widening all year, but still may offer a fairly compelling yield relative to developed market government bond yields on the European continent.
- Emerging market valuations had become somewhat rich prior to the recent correction, but the risk premium has been restored. While we see value in the asset class, we are looking for another catalyst to spark a lasting rally.
- Credit markets are not immune to political uncertainty, broad market volatility or late-cycle yield curve dynamics. Therefore, we think a certain degree of caution will be warranted as the cycle progresses.

GLOBAL CREDIT SPREADS HAVE LEAKED WIDER YEAR-TO-DATE WITH ONE EXCEPTION—US HIGH YIELD

Global Credit Spreads

- Corporate EMBI HY
- Pan-Euro HY Corp
- US HY Corp
- Corporate EMBI IG
- Euro Agg IG Corp
- US Aggregate IG Corp



Source: *Thompson Reuters Datastream, Bloomberg, data as of September 27, 2018.*



FOREIGN EXCHANGE

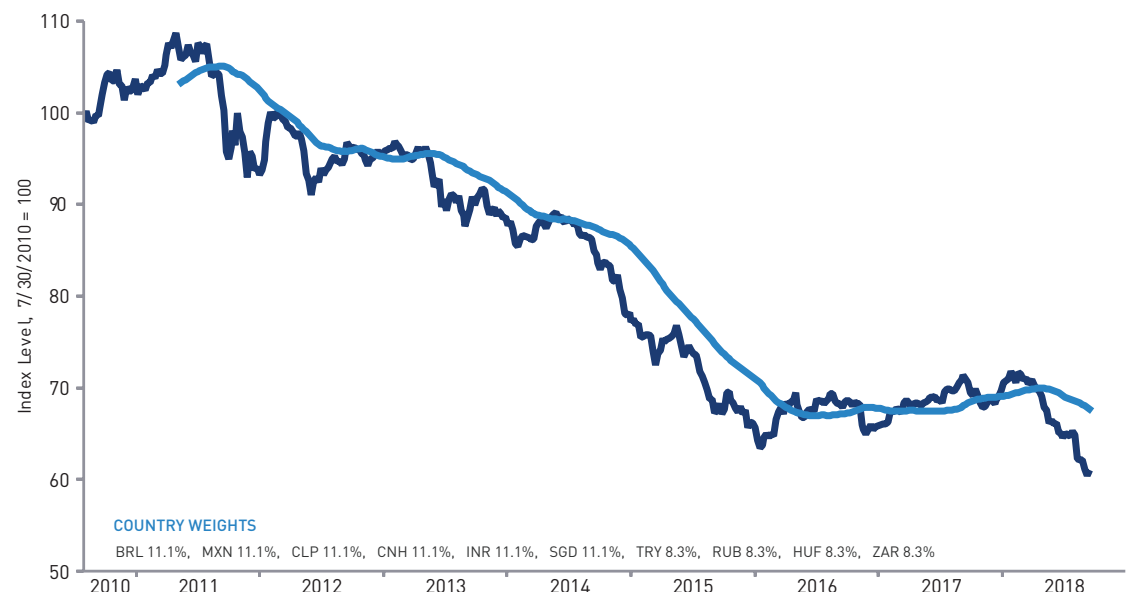
The US Dollar Has Been Driven by Strong Cyclical Tailwinds

- Stronger US economic momentum relative to most other countries looks likely to stick; therefore, we expect additional Fed rate hikes while other developed central banks maintain accommodative monetary policies.
- We expect the US dollar to remain firm for the next few quarters, given growth and interest rate differentials. However, there is a low-probability but high-impact risk that the Fed surprises with a more dovish tone, which is not currently priced into most markets.
- We believe foreign currencies, including those of emerging economies, now offer attractive long-term valuations relative to the dollar, but cyclical and technical factors are not nearly as favorable.
- We believe US interest rates present an attractive opportunity for investors, particularly unhedged foreign investors, which may drive flows into US dollar assets. We are also watching for shaky investor sentiment and bouts of risk-off trade, which tend to nudge risk-averse investors into US dollars.
- Increasing global trade tensions have pressured emerging market currencies. This trend may continue in the near term since both US political parties have an interest in improving the country's position amongst its trading partners.

EMERGING MARKET CURRENCY VALUATIONS HAVE IMPROVED BUT THEIR TECHNICAL POSITION REMAINS CHALLENGED

JP Morgan Emerging Market Currency Index

— JP Morgan Emerging Market Currency Index
— 200-Day Moving Average



Source: Thompson Reuters Datastream, JP Morgan, data as of September 27, 2018.



EQUITY

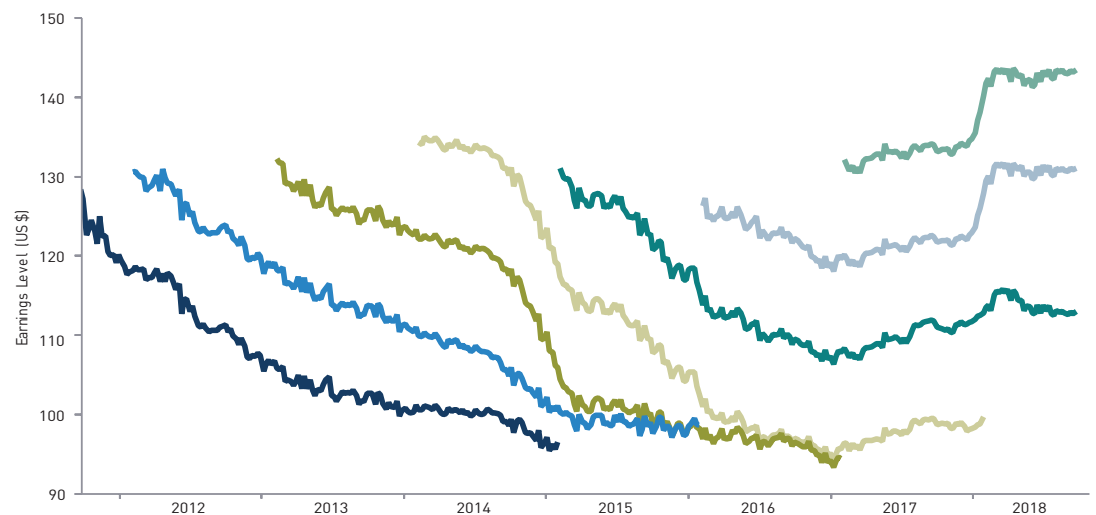
Global Earnings Estimates for 2019 Have Shown Great Stability

- The MSCI Emerging Markets Index, based in US dollars, is the only major asset class with negative earnings revisions year to date, largely due to foreign currency weakness. Expectations for corporate earnings in local currency terms have not declined at the same rate.
- Despite nearly flat year-to-date performance, the MSCI Japan Index has seen valuations improve and earnings estimates revised higher. A solid forward outlook and attractive valuations may lead the MSCI Japan Index to outperform global peers.
- A similar dynamic is taking place in Europe, but the forward outlook is not as bright. From a valuation standpoint, the MSCI Europe Index appears inexpensive relative to history, but persistent political risks within the European Union are likely to keep a lid on optimistic sentiment.
- For the S&P 500® Index, we expect 2018 calendar year earnings to be up over 20%, with less than half of the gain due to lower tax rates. The pace of earnings growth will likely slow next year, but we anticipate strong domestic fundamentals to support near double-digit year-over-year growth.
- Consensus earnings estimates for 2018 and 2019 have been revised higher, supporting global equity valuations and the generally positive global equity outlook.

ESTIMATES OFTEN BEGIN TOO OPTIMISTIC AND GET REVISED LOWER, BUT THAT'S NOT THE CASE FOR 2018 AND 2019

Estimates for MSCI All Country World Equities Earnings Per Share

- 2013
- 2014
- 2015
- 2016
- 2017
- 2018 est.
- 2019 est.



Source: Thomson Reuters Datastream, IBES, data as of September 27, 2018.



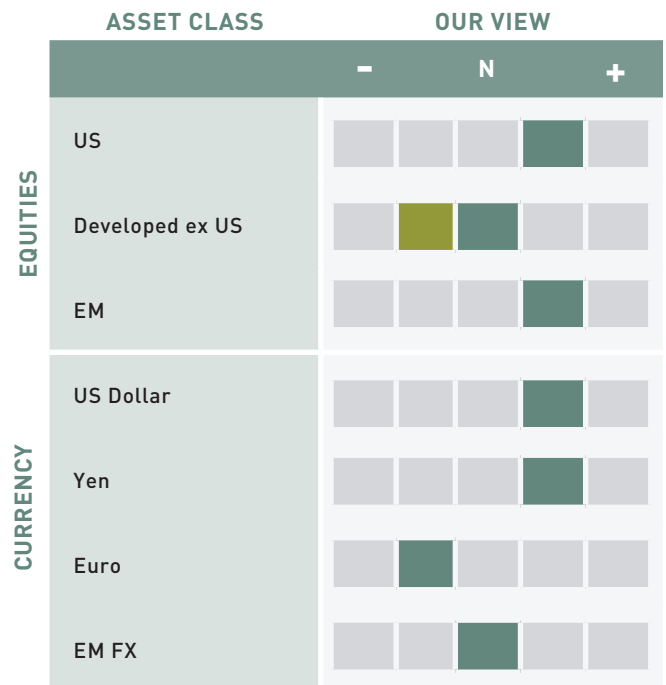
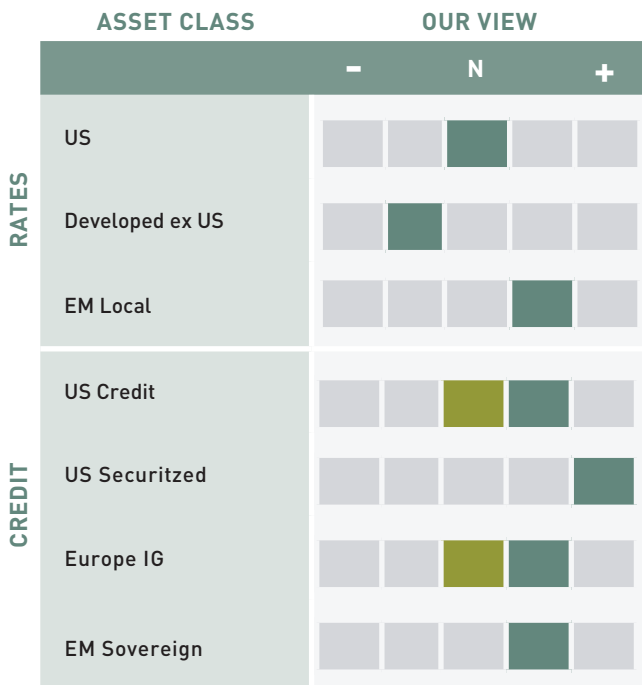
POTENTIAL RISKS

An Increasingly Hawkish Fed and Unexpected Weakness in the Chinese Economy Could Be Disruptive

- Overly aggressive Fed tightening would likely invert the yield curve, spur credit spread widening and create broad risk asset volatility while slowing the domestic economy. We think the Fed is likely to continue hiking, but should remain cognizant of the potential risks, including recession.
- Any disruption substantial enough to cause downgrades to China’s economic outlook could dampen investor sentiment, especially toward emerging markets.
- Earlier this year, when trade negotiations and tariffs on Chinese goods were announced, the Chinese yuan began to weaken relative to the US dollar. While not in our base case outlook, substantial yuan depreciation would likely be taken as a sign of policy instability in China and could rattle risk assets.
- Material global trade disruptions could slow the pace of global growth and shift most of the world closer to the downturn phase of the cycle. The market has largely discounted known events, but further escalation would dim our bright outlook.
- Investors would likely view any resolution of the above risks as an upside surprise, providing additional support to our positive outlook.

ASSET CLASS OUTLOOK

■ Current View ■ Previous View



AUTHOR

CRAIG BURELLE
 VP, Macro Analyst

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