

FIXED INCOME MUSINGS

GOLDILOCKS, INTERRUPTED?

Some observers have referred to the current investment environment as "Goldilocks," characterized by **strong growth**, a **Fed likely to continue cutting rates** into early 2025, and **potential US stimulus** on the horizon. However, a key concern is the starting point for financial asset valuations, especially after a robust rally fueled by optimism over a pro-growth policy mix under Trump's second presidency, marked by looser regulations and lower taxes.

This **valuation constraint** has some in the market questioning whether the investment porridge will remain "just right" or cool down. As fixed income investors, we spend as much time considering potential pitfalls as celebrating potential gains, given the asymmetric nature of fixed income returns. We are particularly aware of the risk of slower growth due to potential trade tensions.

That said, **high valuations are not an obstacle to further gains if economic and credit fundamentals remain healthy**, as we have seen in 2024. High yields also preserve **income potential** across fixed income sectors. Accordingly, we maintain moderate exposure to fixed income spread sectors, focusing on security selection and uncovering pockets of value within the market.

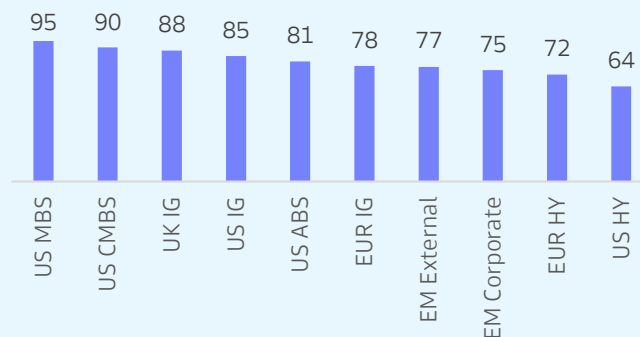
For example, shorter- and intermediate-maturity financial **US investment grade corporate bonds** continue to offer attractive spreads and income potential. Similarly, segments of the **commercial mortgage-backed securities (CMBS)** market present appealing risk-adjusted returns, with valuations not fully recovering from peak concerns

over higher rates' impact on commercial real estate (CRE). We emphasize that not all CRE is created equal, and as active investors, we can distinguish CRE types based on underlying fundamentals. For instance, industrial warehouses and data centers exhibit healthy operating performance. The office sector, facing headwinds from a shift to remote work, is also diverse. While some office CRE segments struggle with this structural transition, prime location offices show resilience.

However, we recognize that financial assets can be sensitive to sudden changes in expectations if downside growth risks—such as broad-based tariffs or other shocks—materialize. The sharp spike in volatility, decline in risk assets, and rally in sovereign bonds and the US dollar in early August serve as a cautionary tale for this sensitivity. To mitigate these risks, we aim to **balance our fixed income spread sector exposures with interest rates**. Additionally, we are **overweight on the US dollar**, which is currently underpinned by both US growth outperformance and policy uncertainty.

Income Potential Remains Near a Decade-High

Last 10-year yield-to-worst percentile



Source: Macrobond, Goldman Sachs Asset Management. As of November 14, 2024. Abbreviations: Mortgage-backed securities (MBS), investment grade (IG), high yield (HY).

Past performance does not guarantee future results, which may vary. The economic and market forecasts presented herein are for informational purposes as of the date of this presentation. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation.

POLICY PICTURE

Tracking Potential Fed Paths

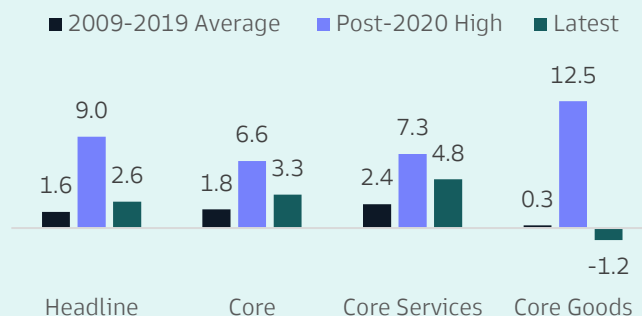
A Fresh Dose of Uncertainty. The ongoing decline in inflation across various economies in 2024 has allowed central banks, including the Fed, to focus more on growth risks and begin lowering policy rates from restrictive levels. The Fed delivered its second rate cut of the cycle [last week](#). With the policy rate still in restrictive territory and inflation measures continuing to retreat from multidecade highs in 2023, we expect the Fed's easing cycle to continue into 2025. However, the outcome of the US election introduces a new element of uncertainty, making our 2025 forecasts less certain and more subject to change.

Economic Health First, Policy Second. In the near term, we expect policy decisions to be guided by the health of the economy. As we progress through 2025, the policy agenda of the incoming US administration is expected to grow in influence. Our central scenario assumes ongoing economic resilience and moderate policy shifts, with a plausible path seeing the Fed cutting rates in December, March, and June, bringing the policy rate from 4.5-4.75% to 3.75-4%, still slightly above neutral.

Adapting to Changing Scenarios. There are various alternative scenarios to consider. Commentary from Fed Chair Powell this week indicates some openness to gradualism given the underlying strength in the economy. Ongoing economic resilience combined with significant pro-growth policy shifts could result in limited or no easing in 2025. Conversely, economic softness along with moderate policy shifts may warrant more easing than our current baseline, taking the policy rate to 2.5-2.75%. Overall, the evolving economic and policy backdrop warrants a dynamic approach to our Fed outlook and US duration exposures. We currently see greater conviction in overweight exposures outside of the US, given greater confidence in more dovish paths for the BoE and ECB relative to market-implied pricing.

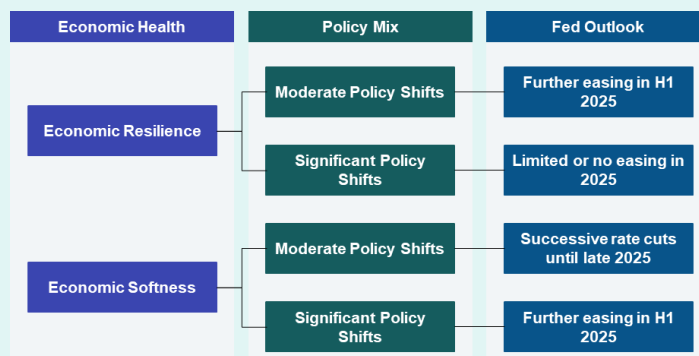
US Inflation Continues to Retreat from Recent Highs

Annual US CPI Inflation (%)



Source: Macrobond, Goldman Sachs Asset Management. As of October 2024. Core services excludes energy services.

US Election Outcome Opens Up Various Fed Paths



Source: Goldman Sachs Asset Management. As of November 15, 2024. For illustrative purposes only. Source: Goldman Sachs Asset Management. As of November 12, 2024. **Economic resilience:** Defined as the unemployment rate peaking at 4.5% and annual real GDP growth staying above 2%. **Economic softness:** Defined as the unemployment rate rising above 4.5% and annual real GDP growth dropping below trend. **Moderate policy shifts:** Defined as an extension of expiring TCJA tax cuts alongside targeted rather than broad-based tariffs on Chinese goods and other imports. **Significant policy shifts:** Defined as additional tax cuts beyond an extension of the expiring TCJA tax cuts alongside 60% tariffs on Chinese imports and a broad-based 10% tariff on imports from other countries.

LEARNINGS FROM EARNINGS

The Q3 earnings season has provided several key insights for the investment grade (IG) corporate bond market:

- **Trend-Like Growth:** This season showed trend-like earnings growth for US companies, with positive guidance. Banks, a sector we favor, performed particularly well. We think election uncertainty may have held back activity in select sectors like industrials, while weakness in China continued to have a negative impact on earnings for companies with exposure to this market.
- **Capital Discipline:** Companies, including those with BBB ratings that we see investment potential in, have continued to demonstrate financial discipline, retaining cash flow after capital spending, dividends, and buybacks. There has been an increase in AI-related investments, primarily driven by cash-rich large technology platforms. Energy investments are also on the rise despite uncertainties in oil prices, and utilities have continued to increase capital expenditures. Share buyback activity remained stable compared to a year earlier, and election uncertainty may have held back investment plans for companies in the industrial sector.
- **Sectoral Divergence:** Credit metrics for Utilities continue to decline as they seek to meet capital expenditure needs linked to the energy transition. This reaffirms our cautious view on the sector. Additionally, the automotive and consumer sectors are experiencing weaker pricing power, which is pressuring profit margins. However, companies are seeing relief in input costs as wage growth appears to have peaked.
- **Regional Performance:** Muted domestic growth and slower growth in China are affecting earnings prospects for European companies, particularly in the luxury goods, chemicals, and automotive sectors, leading to some cutbacks in headcount. A potential increase in US tariffs in 2025 may reinforce the headwinds to European firms from an already subdued economic growth environment. Accordingly, we favour US over Europe in our global IG portfolios. Among European banks, loan growth is relatively weak amid declining industrial activity, but profitability is at a decade high due to the departure from negative interest rates.
- **Stabilisation in Company Sentiment on the Consumer:** Consumers remain value-seeking, often trading down to private-label goods, but overall company management team sentiment on consumer sentiment remains constructive. The first quarter appears to have been the peak for concerns.



Overall, key credit metrics, such as leverage, remain in good shape, and profit margins are relatively firm. Looking ahead, it will be important to monitor the evolution of key credit metrics, including earnings revision trends, capital allocation, and the impact of tariffs.

Stephen Waxman, Head of Global Investment Grade Research

FROM POLLS TO PORTFOLIOS

US IG Credit and the “Three R’s Roadmap”

Bottom Line: Under the new US Administration in 2025, policies such as tax reductions and regulatory relaxations may boost corporate earnings and sentiment, reinforcing the strong starting point for IG credit fundamentals. However, we are cautious about the potential negative effects on global and US growth from broad-based tariffs, as well as a possible increase in corporate bond supply to fund activities like M&A, driven by a revival in “animal spirits”¹. Overall, our analysis suggests that companies in the investment grade credit market can remain resilient in 2025, much like their [resilience to higher rates](#). This supports our continued overweight exposure.

1. **Reduction in Taxes.** The US election outcome raises the prospect of lower corporate tax rates, which may boost after-tax earnings for US companies and support healthy credit fundamentals. In 2017, The Tax Cuts and Jobs Act (TCJA) marked the largest tax adjustment in three decades, lowering the statutory corporate tax rate from 35% to 21%. Industries with a high proportion of US-derived earnings, such as railroads and telecommunications companies, would benefit the most from further reductions in corporate tax rates.
2. **Relaxation of Regulations.** As credit investors, we are particularly focused on the implications of scope for relaxed anti-trust legislation which may revive “animal spirits” and lead to increased M&A activity. This could benefit weaker companies that are acquired by stronger ones. However, we are cautious about a potential increase in corporate bond supply if M&A activity is funded by debt. In the current cycle, we think elevated rates and high equity valuations have promoted more financial discipline. We expect most companies to remain disciplined regarding debt expansion to maintain their investment grade ratings.
2. (continued) Other potential regulatory relaxations are likely to be sector-specific and may create greater performance dispersion, highlighting the importance of active security selection. Proposals include easier approval of energy projects and the expansion of LNG exports, which would impact the energy sector. Meanwhile, easing capital and liquidity requirements may benefit companies in the financial sector. However, we expect these regulatory shifts to take time to implement.
3. **Rise in Tariffs.** Tariffs on China, and possibly other countries, are anticipated. The economic impact on US growth and inflation is expected to be modest, with larger growth headwinds for the targeted economies. We believe US credit fundamentals will remain resilient overall, though certain industries with supply chain exposure to or end demand in China, such as luxury goods and technology, may be affected. However, we are cautious about the risk of more broad-based tariffs and a global trade war, which could lead to a sharper rise in inflation and a larger impact on global and US growth. Autos, consumer retail, and diversified manufacturing could be among the most impacted sectors from broad-based tariffs on imports, while smaller, domestically-focused companies are likely to be less affected. A reassuring factor for credit markets is the strong starting point for key credit metrics and healthy cash levels relative to assets.

¹In simple terms, “animal spirits” refers to the emotions and instincts that influence behavior in economic decision-making. It’s a concept used to describe how confidence, optimism, and feelings can drive economic activities like spending, investing, and business decisions, often beyond what can be explained by pure logic or financial calculations.

NAVIGATING FIXED INCOME

Bottom line: We believe the risks to UK growth from increasing US protectionist policies are underestimated, while the OBR and BoE's growth and inflation projections considering the expansionary Autumn UK Budget are overly optimistic. Consequently, we have a more dovish outlook on the BoE Bank Rate compared to market expectations and are overweight on short-term UK gilts.

Deciphering Recent Gilt Moves

We think the recent rise in UK gilt yield, driven by two key drivers, is misguided:

- **Driver 1: Follow-through from US Treasury yields**

Expectations for US growth stimulus and higher tariffs have lifted US Treasury yields, and UK gilt yields have moved higher in tandem due to the typical co-movement of developed market bond markets.

Our take: The UK's direct exposure to US tariffs is limited, but as a small open economy, its exports are highly sensitive to global growth and trade cycles. If global growth faces downside risks from protectionist measures, the UK may also face downside growth risks, putting downward pressure on UK gilts.

- **Driver 2: Optimistic post-Budget projections**

The [UK Autumn Budget](#) was more expansionary than expected, with significant increases in government spending. The Office for Budget Responsibility (OBR) estimates this will boost GDP by 0.75% and inflation by 0.5% at its peak next year. The BoE adopted these projections in its [November Monetary Policy Report](#).

Our take: We hold a more cautious view on the budget's macro impact. A key area of divergence is the rise in employers' national insurance contributions (NIC). The OBR and BoE assume firms will raise prices, accept lower profits, improve productivity, and make small employment changes to deal with the NIC rise. We think employers are more likely to limit new employment rather than pass on the costs. Some retailers have indicated they will raise prices, but this is anecdotal, and we believe most companies lack the pricing power they had a few years ago. Additionally, government investment may take longer to implement.

The Case for Gilts

The UK economy has faced a larger energy shock and tighter financial conditions than other major advanced economies. The BoE began raising rates in December 2021, delivering a total of 14 hikes, including a 0.75% hike and five 0.5% adjustments. Financial conditions tightened abruptly in October 2022 when unfunded tax cuts were announced, unnerving investors. This led to higher borrowing costs, which were passed on to mortgage rates, reinforcing the higher cost of financing for UK firms and households, already significant due to a higher share of shorter fixation mortgages.

Given the significant cyclical and structural challenges faced by the UK economy, we expect the BoE to cut rates again in February and at each of the further three meetings in 2025 where a Monetary Policy Report is released. We also anticipate a rate cut in June when any global growth impact of US tariffs may be felt. This would lower the policy rate from 4.75% to 3.5% by the end of next year, still above neutral estimates of 3%. The market prices a more hawkish policy path, with the policy rate ending next year at 4%, above the 3.5% expectation pre-budget and pre-election.




Our divergence in views informs our overweight exposure in front-end UK rates. We are more cautious on the long end of the curve, considering expectations for high new Gilt supply. In the near term, we will be closely monitoring business surveys to gauge the potential economic impact of the Budget, including underlying components based on forward-looking demand and employment trends. The full impact of the budget will not be felt until 2025, and our proprietary macro toolkit, including our Current Activity Indicators and Inflation Pressures Indicators, will help us discern the economic impact.

CENTRAL BANK SNAPSHOT

	INTEREST RATE POLICY	BALANCE SHEET POLICY	OUTLOOK	OUR OUTLOOK RELATIVE TO MARKET-IMPLIED PRICING
Fed	<p>Federal funds rate: 4.50 – 4.75%</p> <p>Last change: November 2024 (-25bps), September 2024 (-50bps)</p> <p>Hiking cycle duration: 17 months</p> <p>Rate at the start of latest hiking cycle: 0.25%</p>	<p>The Fed has been reducing its balance sheet passively since June 2022. The FOMC decided to decrease the pace of this reduction starting in June 2024, with the monthly runoff scaling down from \$60 billion to \$25 billion.</p>	<p>We anticipate a 0.25% Fed rate cut in December. In 2025, we think additional cuts in March and June are plausible, but we are vigilant to various potential scenarios.</p> <p>Expected rate at end-2024: 4.25 – 4.5%</p> <p>Neutral rate estimate: 2.5 – 3.5%</p>	Neutral
ECB	<p>Deposit facility rate: 3.25%</p> <p>Last change: October 2024 (-25bps), September 2024 (-25bps), June 2024 (-25%)</p> <p>Hiking cycle duration: 15 months</p> <p>Rate at the start of the latest hiking cycle: -0.5%</p>	<p>The ECB started reducing its balance sheet in March 2023 and ceased reinvestments from its APP in July 2023. The reinvestment of proceeds from maturing securities under the PEPP will gradually decrease starting July 2024 and conclude in December 2024.</p>	<p>We believe the ECB will conduct consecutive 0.25% rate cuts until the terminal rate reaches 1.5%.</p> <p>Expected rate at end-2024: 3.0%</p> <p>Neutral rate estimate: 2.0 – 3.0%</p>	Dovish
BoE	<p>Bank Rate: 4.75%</p> <p>Last change: November 2024 (-25bps), August 2024 (-25bps)</p> <p>Hiking cycle duration: 21 months</p> <p>Rate at the start of the latest hiking cycle: 0.1%</p>	<p>The BoE has actively been reducing its balance sheet since November 2022. At the September 2024 meeting, the MPC voted to maintain the pace of gilt stock reduction at £100bn. Given higher redemptions, this implies a notable reduction in the pace of active sales.</p>	<p>We believe the BoE will cut rates at each Monetary Policy Report meeting in 2025 (February, May, August, November), and possibly in June.</p> <p>Expected rate at end-2024: 4.75%</p> <p>Neutral rate estimate: 2.50-3.0%</p>	Dovish
BoJ	<p>Policy deposit rate: 0.25%</p> <p>Last change: July 2024 (+15bps), March 2024 (+20bps)</p> <p>Duration of negative rates: 98 months</p> <p>Rate at start of the latest hiking cycle: -0.10%</p>	<p>The gradual reduction plan for JGB purchases will be from around ¥6tn per month to around ¥3tn over 18-months. Reduced bond buying will initially concentrate on intermediate maturity bonds.</p>	<p>We anticipate additional rate hikes in 2025 and think a hike in December 2024 is plausible.</p> <p>Expected rate at end-2024: 0.25%</p> <p>Neutral rate estimate: 1.0-1.50%</p>	Hawkish

Source: Goldman Sachs Asset Management. As of November 15, 2024. Abbreviations: Quantitative Easing (QE), Quantitative Tightening (QT), Pandemic Emergency Purchase Program (PEPP), Japanese Government Bond (JGB). The economic and market forecasts presented herein are for informational purposes as of the date of this document. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this document. The neutral rate estimates come with a degree of uncertainty. They are derived from a combination of fundamental, market, and model-based assessments. The ranges for the Fed, BoE and BoJ reflect the diversity of these estimates. For the ECB, the range represents the spectrum of policymakers' estimates, which has been adjusted based on our discretionary perspective. Estimated neutral rates by central banks are as follows: BoE 2-3%, BoJ 1-2.5%, Fed 2.4-3.8%, ECB 1.5-3%.

OUR INVESTMENT INSIGHTS

 Read	Fixed Income Musings	Weekly views on the global economy, economic policy and fixed income markets.
	Navigating Fixed Income	Perspectives on investment opportunities across fixed income markets.
	Quarterly Fixed Income Outlook	Outlook on the economic landscape and key investment views.
	Fixed Income Espresso	Quick-take insights on market-moving events.
	Asset Management Perspectives	Explores today's risks and tomorrow's solutions across public and private markets.
	Asset Management Outlook	Overview of investment opportunities and key market trends across asset classes.
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Insight Highlight



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SOVEREIGN BOND YIELDS (%)

	Latest (%)	Year-to-date Change (bps)	1-Year Change (bps)	Last 10-year Percentile
US 2 Year	4.3	11	-68	84
US 10 Year	4.4	55	-20	95
US 2-10 Slope	0.1	44	48	24
US Treasury 10-Year Inflation-Protected	2.1	38	-22	94
Germany 2 Year	2.1	-29	-98	82
Germany 10 Year	2.4	33	-37	91
Japanese 10 Year	1.1	43	18	99
UK 10 Year	4.5	89	8	99
Chinese 10 Year	2.1	-46	-56	0

Source: Macrobond, Goldman Sachs Asset Management. As of 15 November 2024.

EXCHANGE RATES

	Latest	Year-to-date Change (%)	1-year Change (%)
Euro (€ per \$)	0.95	4.5	1.1
British Pound (£ per \$)	0.79	0.3	-3.6
Japanese Yen (¥ per \$)	155.95	10.6	2.8
Chinese Yuan Renminbi (CNY per \$)	7.23	2.1	-0.8

Source: Macrobond, Goldman Sachs Asset Management. As of 15 November 2024.

FIXED INCOME SECTOR YIELDS (%)

	Latest (%)	Last 10 year average (%)	Year-to-date change (bps)	Last 10 year Percentile
US Investment Grade	5.3	3.7	11.5	85
European Investment Grade	3.2	1.6	-35.8	78
UK Investment Grade	5.5	3.3	41.0	88
US High Yield	7.2	6.7	-42.9	64
European High Yield	5.7	4.4	-62.4	72
EM External	7.8	6.3	-8.8	77
EM Corporate	6.3	5.4	-39.3	75
US Agency MBS	5.2	3.0	44.6	95
US ABS	5.3	2.9	-37.0	81
US Munis	3.6	2.4	23.7	88
US CMBS	4.7	2.8	22.1	90

Source: Macrobond, Goldman Sachs Asset Management, ICE BofAML and J.P. Morgan. As of 15 November 2024.

FIXED INCOME SECTOR SPREADS (BASIS POINTS)

	Latest (bps)	Last 10 year average (bps)	Year-to-date change (bps)	Last 10 Year Percentile
US Investment Grade	78	129	-26	0
European Investment Grade	98	123	-37	23
UK Investment Grade	101	149	-33	0
US High Yield	273	438	-61	0
European High Yield	320	403	-75	18
EM External	335	381	-48	16
EM Corporate	224	335	-64	0
US Agency MBS	39	37	-9	61
US ABS	89	97	-33	51
US CMBS	39	53	-12	11

Source: Macrobond, Goldman Sachs Asset Management, ICE BofAML and J.P. Morgan. As of 08 November 2024.

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MUSINGS

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The risk of foreign currency exchange rate fluctuations may cause the value of securities denominated in such foreign currency to decline in value. Currency exchange rates may fluctuate significantly over short periods of time. These risks may be more pronounced for investments in securities of issuers located in, or otherwise economically tied to, emerging countries. If applicable, investment techniques used to attempt to reduce the risk of currency movements (hedging), may not be effective. Hedging also involves additional risks associated with derivatives.

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Sector Spread Indexes

US Investment Grade Corporates: ICE BofAML US Corporate Index

US High Yield Corporates: ICE BofAML US Corporate High Yield Index

European Investment Grade Corporates: ICE BofAML Euro Corporate Index

European High Yield Corporates: ICE BofAML Euro High Yield Index

ABS: ICE BofAML US Fixed Rate Asset-Backed Securities Index

MBS: ICE BofAML US Agency Mortgage-Backed Securities Index

CMBS: ICE BofAML US Fixed Rate Commercial Mortgage-Backed Securities Index

EM External Debt: J.P. Morgan, EMBI Global Diversified Face Constrained Index

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