Macro Talking Points

Fixed Income Insights

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In brief

- **The macro backdrop remains robust, with evidence for an imminent recession looking weaker.**
- **Investor cash allocations are coming down.**
- **Global fixed income is off to a sluggish start performance-wise, but the outlook looks brighter.**

Where is my hard landing? Wherever we look, it is getting harder and harder to find evidence of an imminent recession, at least in the United States. To say the least, nonfarm payrolls (NFP) running to +300,000 are not consistent with recession risks.[1] The average gain in payrolls over the past three months stands at 289,000. Let's contrast that with history. For most of the recessions since the 1960s, the NFP average for the three months immediately preceding the beginning of a recession has typically been well below 100,000 before declining once the recession started. So, it's fair to say that NFP doesn't currently signal a high risk of recession. What about productivity, which surprised to the upside for Q4? Same story there. It would be highly unusual if productivity accelerated in advance of a recession. Typically, prior to a downturn, productivity tends to slow markedly or even turn negative. More good news comes from capex expectations. We have updated our capex expectations indicator and, overall, there are no signs that companies in the US intend to cut capital spending. Finally, all the business surveys, be it the ISM or PMI, seem to be ticking up. In fact, the recent ISM new orders number, considered to be one of the most leading of leading indicators, recovered sharply in January. This all seems to suggest that the soft-landing scenario is gaining traction. That's good news for risky assets and fixed income spread products, from a macro perspective.

Cash is no longer king. Cash allocations had been on the high side, reflecting persistent investor caution, but now seem to be declining. To be clear, the data can be challenging. We use two main sources for our cash allocation tracking. The first is produced by the American Association of Individual Investors (AAII) which is geared towards the retail business.[2] The AAII data show that cash allocation is now well off its recent peak and has converged towards its 10-year average. The second data source we keep an eye on is the BofA Global Fund Manager Survey data which looks at asset manager behavior.[3] Again, cash allocations are well off their recent highs, although they still seem elevated by historical standards. The key message here is that cash allocations are going in the right direction — meaning lower — but there may be more room to go as we believe that the macro environment has turned more supportive of risk taking. At the same time, all these central bank rate cuts in the pipeline are inevitably going to undermine cash return expectations in the period ahead. In my view, it's about time investors moved away from cash and bought riskier assets.

Not so happy new year so far, but it will likely get better. It has been a fairly rough start to the year for global fixed income, in contrast to 2023's spectacular close. Virtually all sub-asset classes have suffered negative performance year to date. The Global Agg has printed a loss of 1.97% so far in 2024, the worst performance among the fixed income sub-asset classes we are monitoring.[4] EM local debt and global credit have also registered sizeable negative returns. The key driver of this poor start is clear: Market rates have risen by more than 20 basis points in the US 10yr segment, mainly reflecting pushback on the part of the US Federal Reserve. The good news is that the Fed cut pricing correction over the past week has now put us on a stronger footing with respect to monetary policy expectations, especially as the March rate cut has virtually been priced out. Listening to Fed Chair Jerome Powell, there is still a risk that even a May Fed rate cut might seem premature, but the May odds look solid to us. By May, the Fed would have had the opportunity to observe and analyze three monthly CPI and three core PCE price index releases. In other words, plenty of time, in our view, to gain more comfort with the appropriateness of rate cuts. Despite a sluggish start to the year, we believe that global fixed income remains very well positioned in 2024. The macro environment is robust and supportive of spread products, while rates are likely to benefit from the dovish central bank policy action. Altogether, this should help boost fixed income performance in the year ahead. For investors that have yet to increase their allocation to fixed income, this slow start provides an attractive entry point to do so.

Endnotes

[1] Bloomberg, Bureau of Labor Statistics. US Employees on Nonfarm Payrolls Total MoM Net Change. As of January 2024.

[2] Bloomberg, American Association of Individual Investors. AAII Cash Allocation. Monthly, as of January 2024.

[3] BofA, Global Fund Manager Survey. Data as of December 2023.

[4] Bloomberg. Bloomberg Global Aggregate Index, data as of 2 February 2024.