Global Fixed Income Weekly

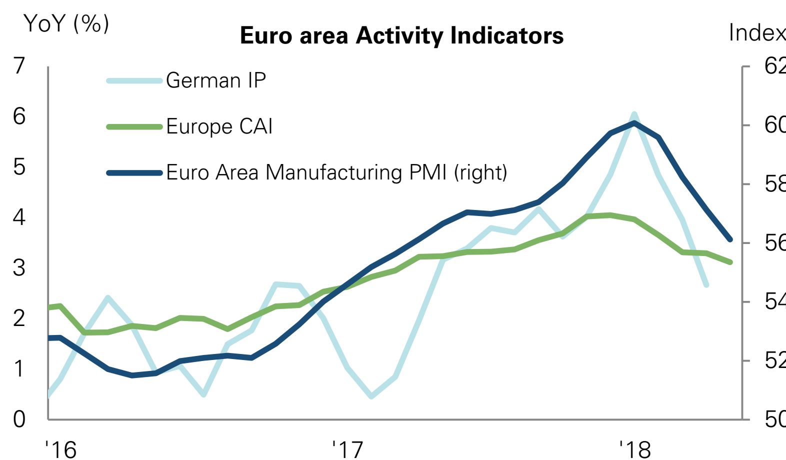
Executive Summary

- Market-implied pricing points to a 25bps rate hike at next week's US Federal Reserve (Fed) meeting, consistent with our expectation. Given consensus opinion on the policy decision, we expect investor focus to be on the Summary of Economic Projections and the median policymaker rate projection. We think growth momentum, firming price and wage data and ongoing strength in the labor market warrants more monetary tightening than market expectations over the next year.

- A hawkish market-read of comments by ECB policymakers has led to a re-pricing for Euro area monetary policy. We think discussion around quantitative easing (QE) tapering at next week's European Central Bank (ECB) is rational given expectations for an announcement at the central bank's July meeting. As discussed in our Mid-Year Outlook, we expect prolonged monetary accommodation in the Euro area given subdued core inflation dynamics.

- An active week for emerging market (EM) central banks saw a 25bps and 125bps rate hike in India and Turkey, respectively, while policymakers in Brazil continued to sell currency swaps in a bid to halt currency depreciation. Recent market volatility has had an indiscriminate impact on EM asset performance, despite pockets of strength.

Chart of the Week: Euro area expansion – past peak momentum?



- German industrial production growth (on a three month moving average basis) moderated to 2.7% year-over-year in April, down from 6.1% in January.

- The Euro area manufacturing PMI has also softened, falling to 55.5 in May from a cycle high of 60.6 last December.

- Activity data remains expansionary but we expect second quarter GDP growth to reflect moderation, as indicated by our current activity indicator which incorporates higher-frequency data to provide us with a timely read of economic activity.

Source: Macrobond, GSAM. Industrial production (IP) as of April 2018, Current Activity Indicator (CAI) and Purchasing Managers Index (PMI) as of May 2018. IP and CAI shown are 3 month moving averages.

Macro Commentary and Strategy

Duration: We are underweight US rates and marginally underweight Swedish rates.

- The ISM non-manufacturing index retraced April weakness and rebounded to a solid 58.6 in May (a value above 50 indicates expansionary activity). The composition of the report was also favorable, reflecting strength in business activity, new orders and employment indices. This follows last week's 1.4 point rebound in the ISM manufacturing index to 58.7.

- Market-implied pricing points to a 25bps rate hike at next week's Fed meeting, consistent with our expectation. Given consensus opinion on the policy decision, we expect investor focus to be on the Summary of Economic Projections in light of strong activity, inflation and labor market data since the last policymaker meeting.

- Discussion around the symmetrical inflation target and the median policymaker projection for the policy rate – which points to three rate hikes in total this year - will also be of interest. We remain bearish US rates and see scope for more monetary tightening over the next year than market-implied pricing suggests.

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. **Past performance does not guarantee future results, which may vary.**

Country: We are overweight rates in Europe versus other Developed Markets (DM).

- A hawkish market-read of comments by ECB policymakers has led to a re-pricing for Euro area monetary policy. We think discussion around quantitative easing (QE) tapering at next week's European Central Bank (ECB) is rational given expectations for an announcement at the central bank's July meeting.
- Our base case expectation is for QE to be extended beyond August through to year-end, with purchases centered on corporate bonds, while sovereign bond purchases draw to a close this summer. A further extension of the QE program would have dovish implications for rate hike timing, given ECB forward guidance points to unchanged rates until "well past" the end of QE.
- We think the ECB will raise rates in the second half of 2019. That said, gradually moving policy rates out of negative territory does not equate to monetary tightening. We expect core European rates to remain underpinned by accommodative monetary policy and we are overweight rates in Europe versus developed markets where we anticipate earlier monetary tightening.

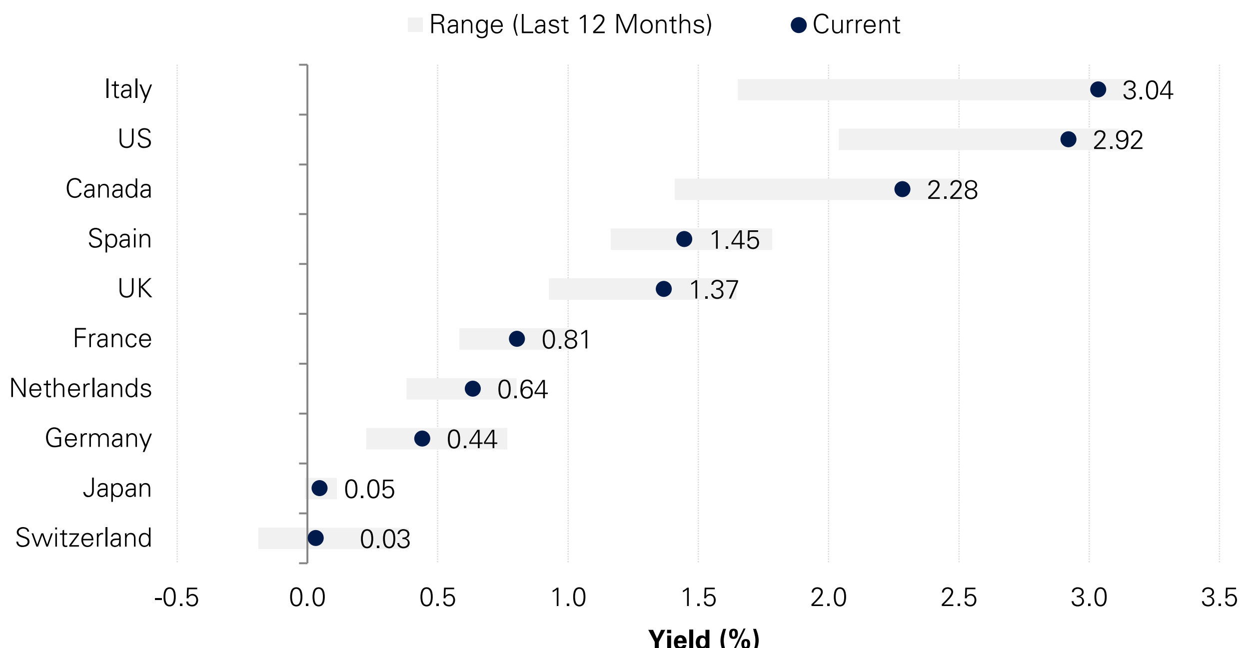
Currency: We are overweight emerging market (EM) and cyclical European currencies.

- US dollar appreciation paused this past week as political headwinds in Europe abated and oil prices stabilised. That said, this did not result in support for all EM currencies.
- Latin American currencies have come under notable pressure, with political and trade uncertainties challenging the Brazilian real and Mexican peso, respectively. We are modestly underweight both currencies.
- Among developed market (DM) currencies, we are overweight the Australian and New Zealand dollars. Both appear undervalued relative to terms of trade and interest rate differentials. We also think extended market positioning has contributed to underperformance, due to investors selling these currencies on concerns of moderating global growth earlier this year. A rebound in global activity data may see these flows reverse course.

Cross Macro: We hold relative value positions across rates, currencies and credit.

- We maintain exposure to EM currencies that we believe are underpinned by solid macro fundamentals and also stand to benefit from price appreciation in key commodities that they export. This includes the Russian ruble and Chilean peso.

Sovereign 10-Year Yield Levels



Source: GSAM, Bloomberg as of June 8, 2018.

Sector Commentary and Strategy

Agency Mortgage Backed Securities (MBS): We are underweight agency MBS.

- Disciplinary actions resulted in several mortgage lenders being restricted from participating in multi-issuer pooling programs. Policymakers are seeking to deter excessive refinancing activity as it boosts revenues for lenders while raising costs for borrowers whose loans are included in the pooled securities.
- The regulatory action saw higher coupon Ginnie Mae securities outperform, thereby supporting our up-in-coupon positioning.

Non-Agency MBS/ABS: We favor short-duration securitized credit with high credit quality and attractive carry, and we are constructive on the non-agency residential mortgage-backed securities (RMBS) sector.

- We reduced exposure to credit card asset backed securities amid recent outperformance relative to short-dated US corporate credit. That said, we maintain exposure to short-duration, high quality securitized credit sectors that have better liquidity and lower volatility relative to corporate credit, while also offering diversification benefits.

Investment Grade Corporates: We are modestly overweight.

- Political developments in Italy saw European spreads widen over the past week, while US spreads were broadly unchanged. Political risk has also weighed on new issuance activity with just €0.4bn of new supply in Europe last week versus $5bn in the US.
- The Financial sector within European credit has experienced notable underperformance on concerns of both Italian political risk, and regulatory news and a rating downgrade of a German bank. Both of the latter actions were anticipated but unfortunate timing meant markets digested the two adverse developments simultaneously. This resulted in outsized weakness in both debt and equity markets.

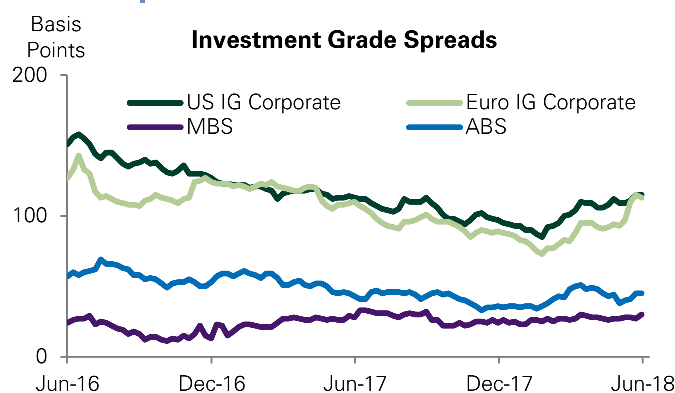
High Yield & Bank Loans: We are modestly overweight high yield spread risk in dedicated accounts, while slightly underweight in multisector accounts.

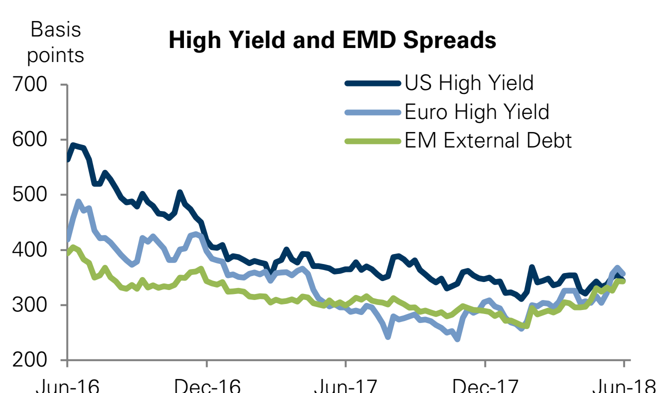
- May marked the lowest monthly new issuance activity since 2010. Two deals were priced last week, amounting to $500mn. Issuance stands at $100bn year-to-date, down -26% year-over-year.
- Lower quality, CCC-rated bonds continue to outperform higher quality portions of the market despite bouts of risk-off market sentiment.

Emerging Markets: We are neutral to slightly overweight external emerging market debt (EMD) in multi-sector fixed income portfolios and have a preference for local-currency EMD in dedicated EMD portfolios.

- An active week for emerging market (EM) central banks saw a 25bps and 125bps rate hike in India and Turkey, respectively, while policymakers in Brazil continued to sell currency swaps in a bid to halt currency depreciation.

Sector Spreads





Source: Bloomberg, Barclays as of June 8, 2018. Investment Grade (IG).

Views are as of June 8, 2018 unless otherwise stated and subject to change in the future.

Important Disclosures:

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

Views and opinions expressed are for informational purposes only and do not constitute a recommendation by GSAM to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice.

This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice. This material has been prepared by GSAM and is not financial research nor a product of Goldman Sachs Global Investment Research (GIR). It was not prepared in compliance with applicable provisions of law designed to promote the independence of financial analysis and is not subject to a prohibition on trading following the distribution of financial research. The views and opinions expressed may differ from those of Goldman Sachs Global Investment Research or other departments or divisions of Goldman Sachs and its affiliates. Investors are urged to consult with their financial advisors before buying or selling any securities. This information may not be current and GSAM has no obligation to provide any updates or changes.

Economic and market forecasts presented herein reflect a series of assumptions and judgments as of the date of this presentation and are subject to change without notice. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client. Actual data will vary and may not be reflected here. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. Goldman Sachs has no obligation to provide updates or changes to these forecasts.

Case studies and examples are for illustrative purposes only.

Index Benchmarks

Indices are unmanaged. The figures for the index reflect the reinvestment of all income or dividends, as applicable, but do not reflect the deduction of any fees or expenses which would reduce returns. Investors cannot invest directly in indices.

The indices referenced herein have been selected because they are well known, easily recognized by investors, and reflect those indices that the Investment Manager believes, in part based on industry practice, provide a suitable benchmark against which to evaluate the investment or broader market described herein. The exclusion of "failed" or closed hedge funds may mean that each index overstates the performance of hedge funds generally.

THIS MATERIAL DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORIZED OR UNLAWFUL TO DO SO.

Prospective investors should inform themselves as to any applicable legal requirements and taxation and exchange control regulations in the countries of their citizenship, residence or domicile which might be relevant.

This material is provided at your request for informational purposes only. It is not an offer or solicitation to buy or sell any securities.

United Kingdom and European Economic Area (EEA): In the United Kingdom, this material is a financial promotion and has been approved by Goldman Sachs Asset Management International, which is authorized and regulated in the United Kingdom by the Financial Conduct Authority.

Switzerland: For Qualified Investor use only - Not for distribution to general public. This document is provided to you by Goldman Sachs Bank AG, Zürich. Any future contractual relationships will be entered into with affiliates of Goldman Sachs Bank AG, which are domiciled outside of Switzerland. We would like to remind you that foreign (Non-Swiss) legal and regulatory systems may not provide the same level of protection in relation to client confidentiality and data protection as offered to you by Swiss law.

Asia: Please note that neither Goldman Sachs (Asia) LLC (GSALLC), nor any other entities involved in the Goldman Sachs Asset Management (GSAM) business maintain any licenses, authorisations or registrations in the People's Republic of China ("PRC"), Thailand, Philippines, or Indonesia nor are any of the GSAM funds registered in the PRC, Thailand, Indonesia or the Securities and Exchange Commission of the Philippines under the Securities Regulation Code. The offer and sale of securities within Thailand and the provision of investment management services in Thailand or to Thai entities may not be possible or may be subject to legal restrictions or conditions. To the extent that GSALLC is providing a financial service in Australia, GSALLC is exempt from the requirement to hold an Australian financial services license for the financial services it provides in Australia to "wholesale clients" for the purposes of the Corporations Act 2001 (Cth). GSALLC is regulated by the Securities and Futures Commission of Hong Kong under Hong Kong laws, which differ from Australian laws. Not all services or products can be made available in Taiwan. Any particular offer of securities may not have been and may not be registered with the Securities and Futures Bureau, Financial Supervisory Commission of Taiwan pursuant to relevant securities laws and regulations and may therefore not be capable of being sold or publicly offered in Taiwan. The Goldman Sachs companies involved in any such promotion may not maintain any licenses, authorisations or registrations in Taiwan. These materials are provided solely for your information and consideration, and are not intended as a solicitation in respect of the purchase or sale of instruments or securities, or the provision of services.

This material has been issued or approved for use in or from Hong Kong by Goldman Sachs (Asia) L.L.C. and in or from Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W) and Goldman Sachs Asset Management (Singapore) Pte. Ltd. (Company Number: 201329851H).

This material is distributed by Goldman Sachs Asset Management Australia Pty Ltd ABN 41 006 099 681, AFSL 228948 ('GSAMA') and is intended for viewing only by wholesale clients for the purposes of section 761G of the Corporations Act 2001 (Cth).

Canada: This material has been communicated in Canada by Goldman Sachs Asset Management, L.P. (GSAM LP). GSAM LP is registered as a portfolio manager under securities legislation in certain provinces of Canada, as a non-resident commodity trading manager under the commodity futures legislation of Ontario and as a portfolio manager under the derivatives legislation of Quebec. In other provinces, GSAM LP conducts its activities under exemptions from the adviser registration requirements. In certain provinces, GSAM LP is not registered to

provide investment advisory or portfolio management services in respect of exchange-traded futures or options contracts and is not offering to provide such investment advisory or portfolio management services in such provinces by delivery of this material.

Japan: This material has been issued or approved in Japan for the use of professional investors defined in Article 2 paragraph (31) of the Financial Instruments and Exchange Law by Goldman Sachs Asset Management Co., Ltd.

High-yield, lower-rated securities involve greater price volatility and present greater credit risks than higher-rated fixed income securities.

Emerging markets securities may be less liquid and more volatile and are subject to a number of additional risks, including but not limited to currency fluctuations and political instability.

The currency market affords investors a substantial degree of leverage. This leverage presents the potential for substantial profits but also entails a high degree of risk including the risk that losses may be similarly substantial. Such transactions are considered suitable only for investors who are experienced in transactions of that kind. Currency fluctuations will also affect the value of an investment.

Past performance does not guarantee future results, which may vary. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur.

Confidentiality

No part of this material may, without GSAM's prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorized agent of the recipient.

© 2018 Goldman Sachs. All rights reserved.

Compliance Code: 133863-OTU-773070