



BNY MELLON ASSET MANAGEMENT NORTH AMERICA

# Insurer Investment Forum XVIII

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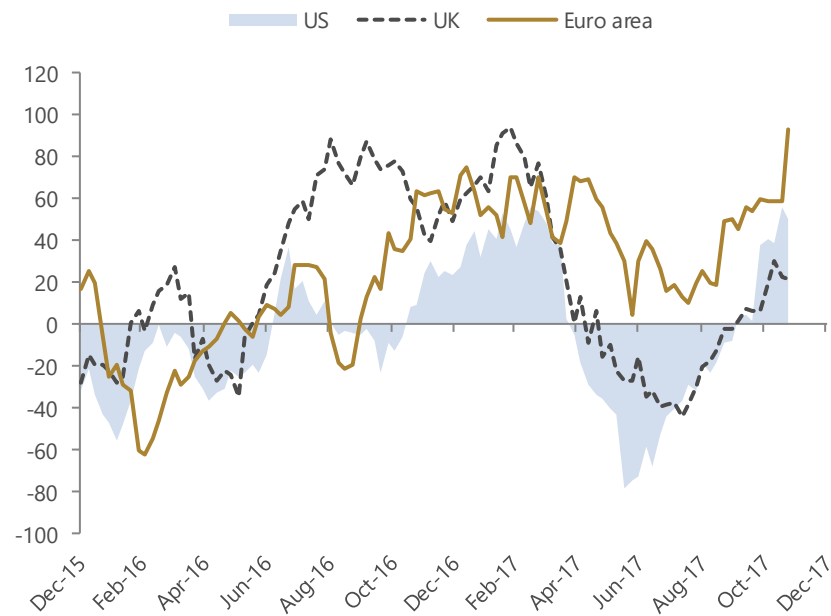
BNY Mellon Asset Management North America

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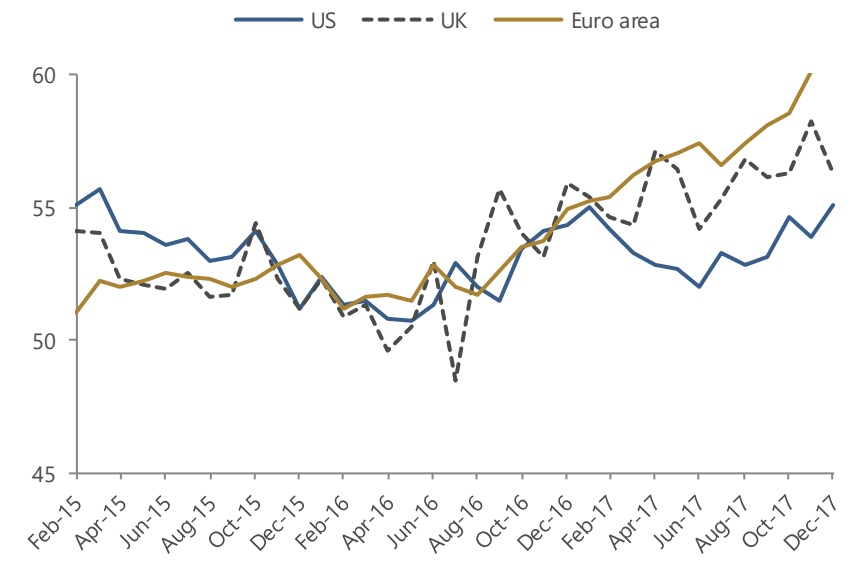
# Across Advanced Economies, Economic Data Have Been Positive and Firms Expect to Spend

### Economic Surprise Indexes



### Markit Manufacturing Purchasing Manager Intentions

Diffusion Index, Unchanged = 50

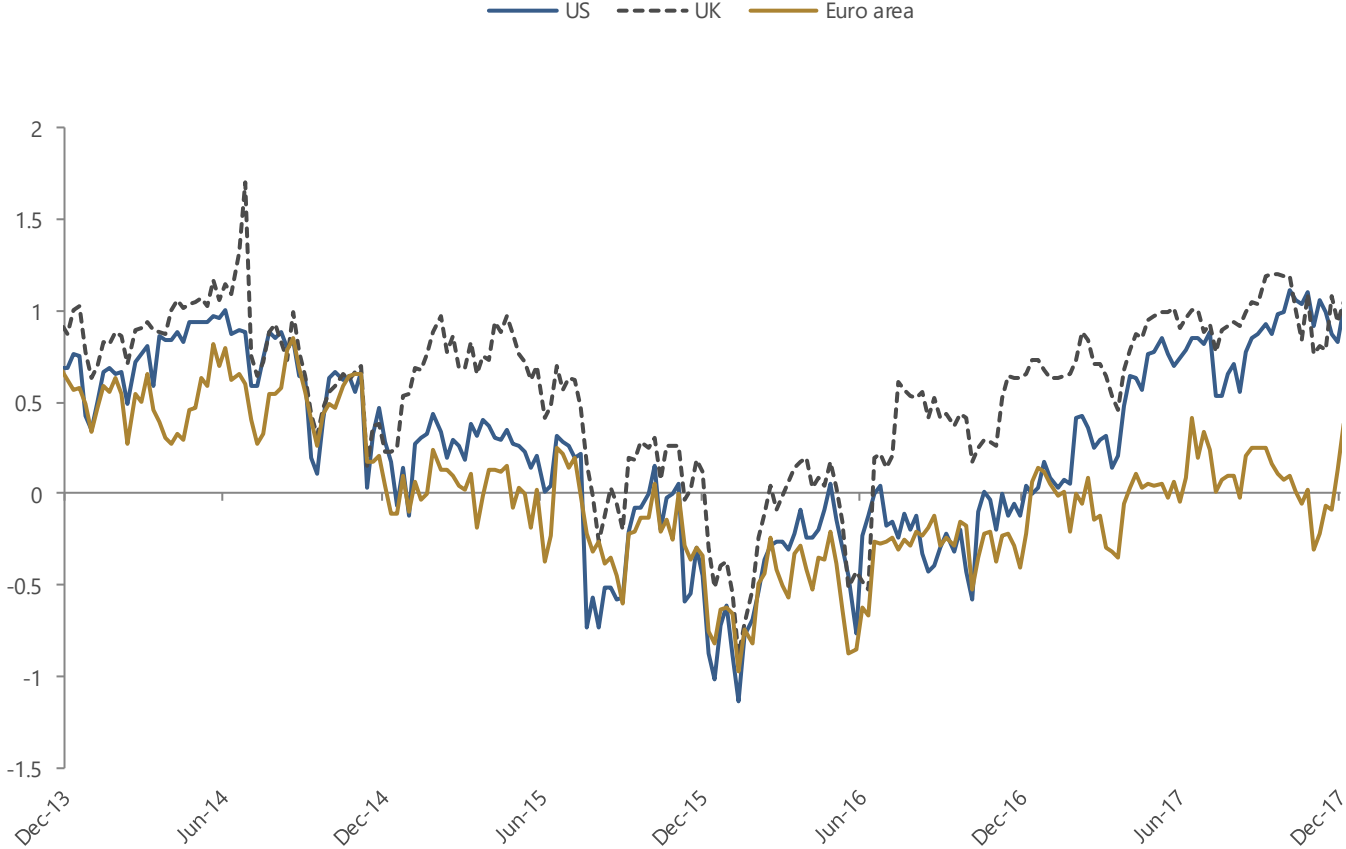


Source: Citigroup Markets (left-hand side) and Markit (right-hand side), accessed via Bloomberg 1/16/2018.

# Financial Conditions Are Accommodative

## Financial Conditions

Index, Neutral = 0

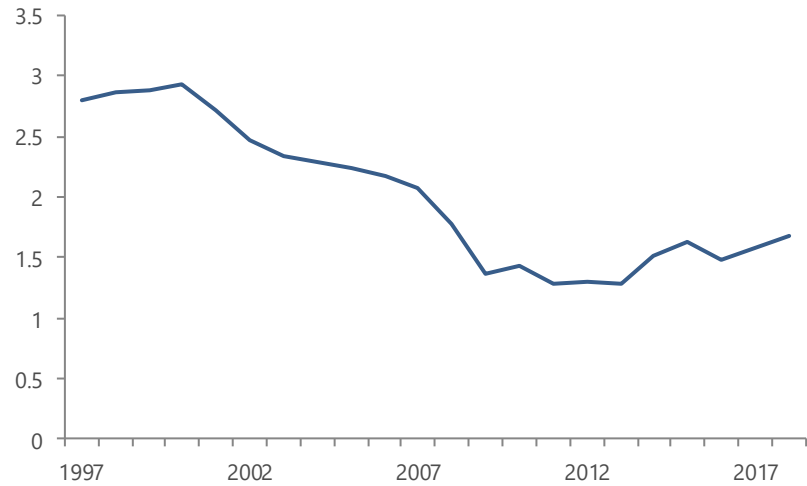


Source: Bloomberg, accessed January 16, 2018

# The Growth of Potential Output Is Slow In Advanced Economies, and Resource Slack Is Mostly Used Up

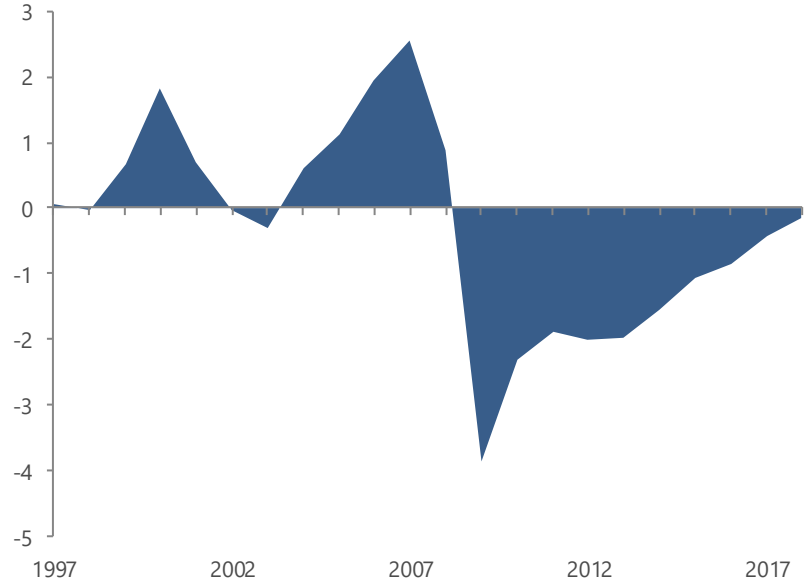
### Advanced Economies: Real Potential Output

Annual Change, Percent



### Advanced Economies: Output Gap

Percent

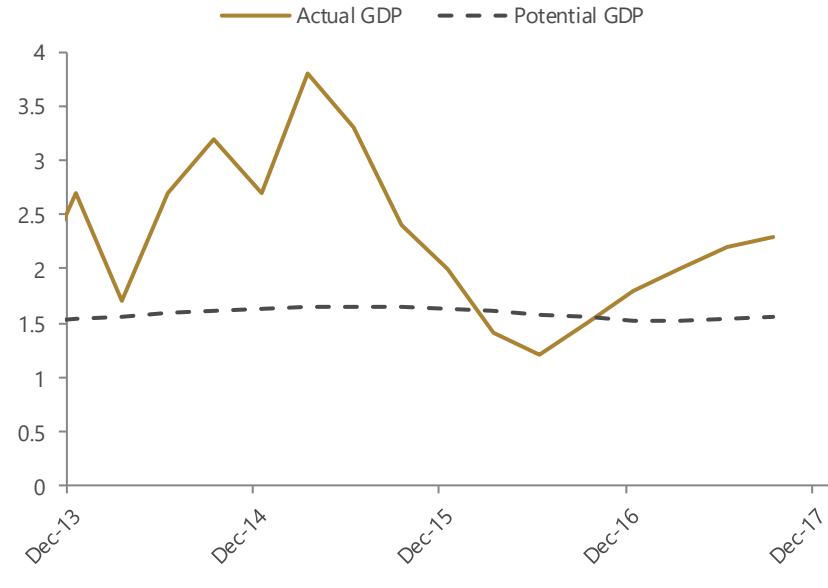


Source: International Monetary Fund, World Economic Outlook (October 2017).

# In The U.S., Slack Is Exhausted

## U.S. Real GDP

Growth, Percent



## U.S. Civilian Unemployment Rate

Percent



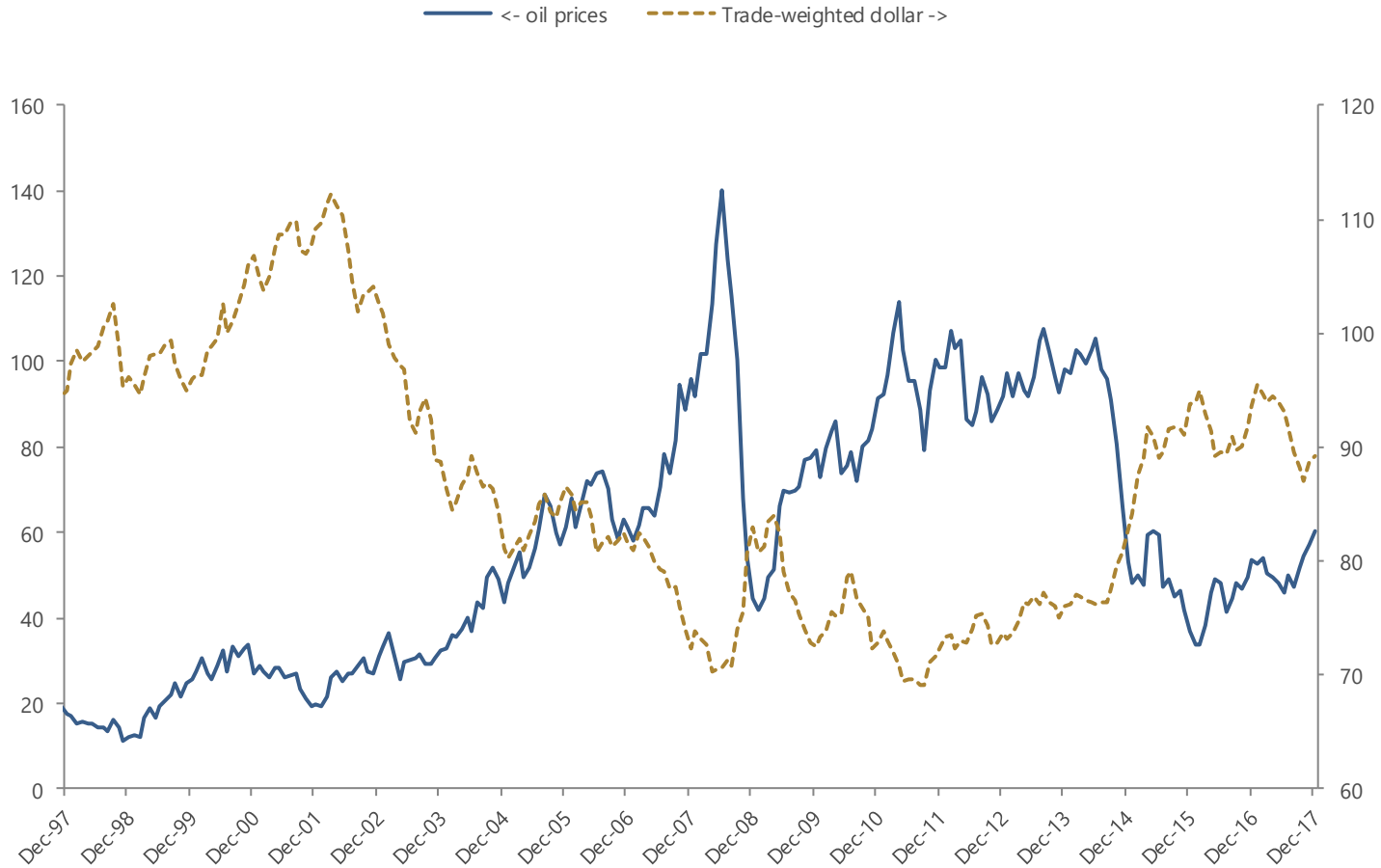
Source: BEA and CBO (left-hand side) and BLS (right-hand side), accessed via Bloomberg January 16, 2018



# The Recent Dollar Depreciation and Oil Price Increase Will Add Impetus to Domestic Inflation

## WTI Oil Price and Trade-Weighted Dollar

\$/bbl and Index

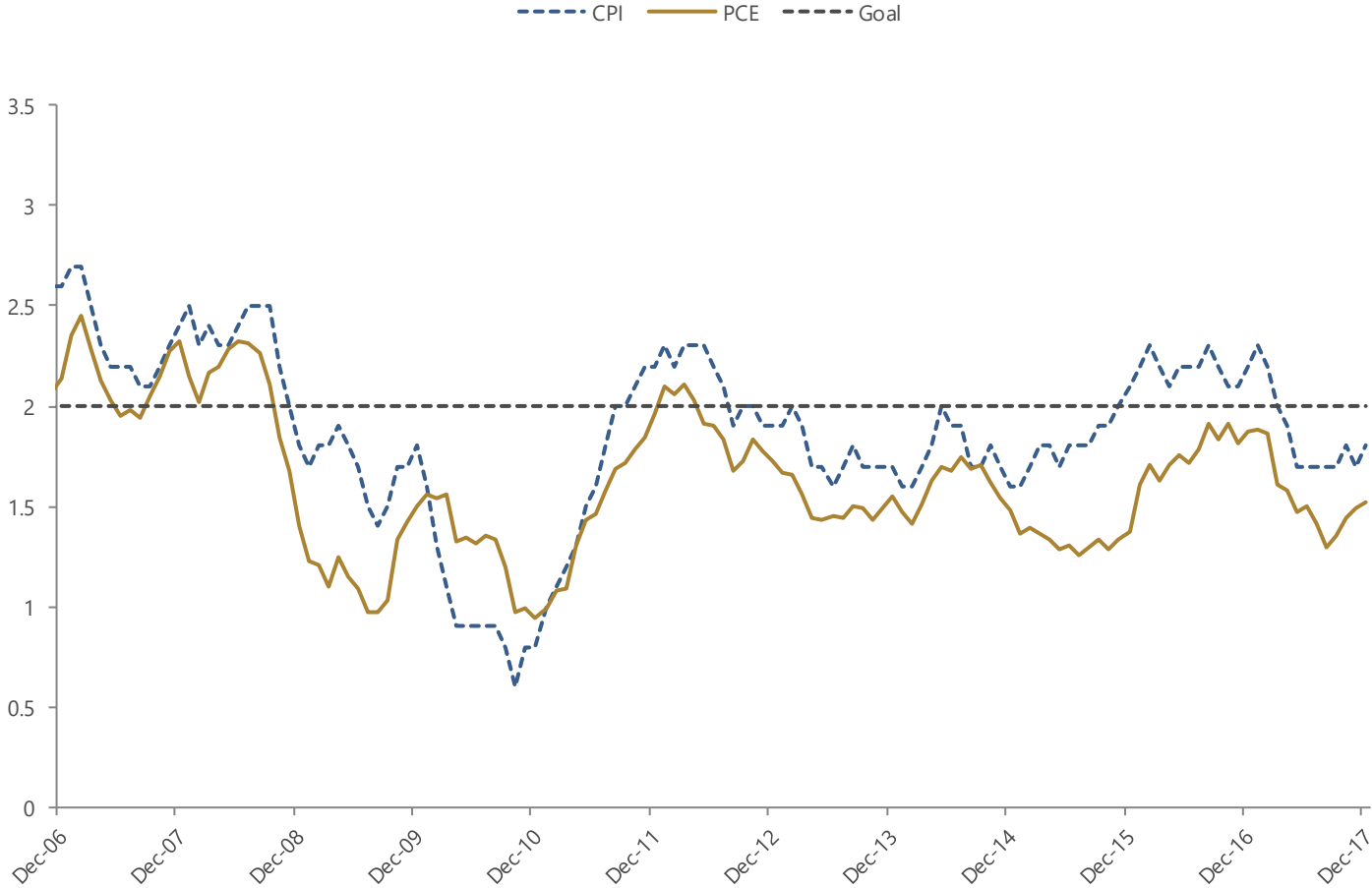


Source: Bloomberg, accessed January 16, 2018

# Inflation Will Tick Higher

## U.S. Core Consumer Price Inflation

12-Month Change, Percent

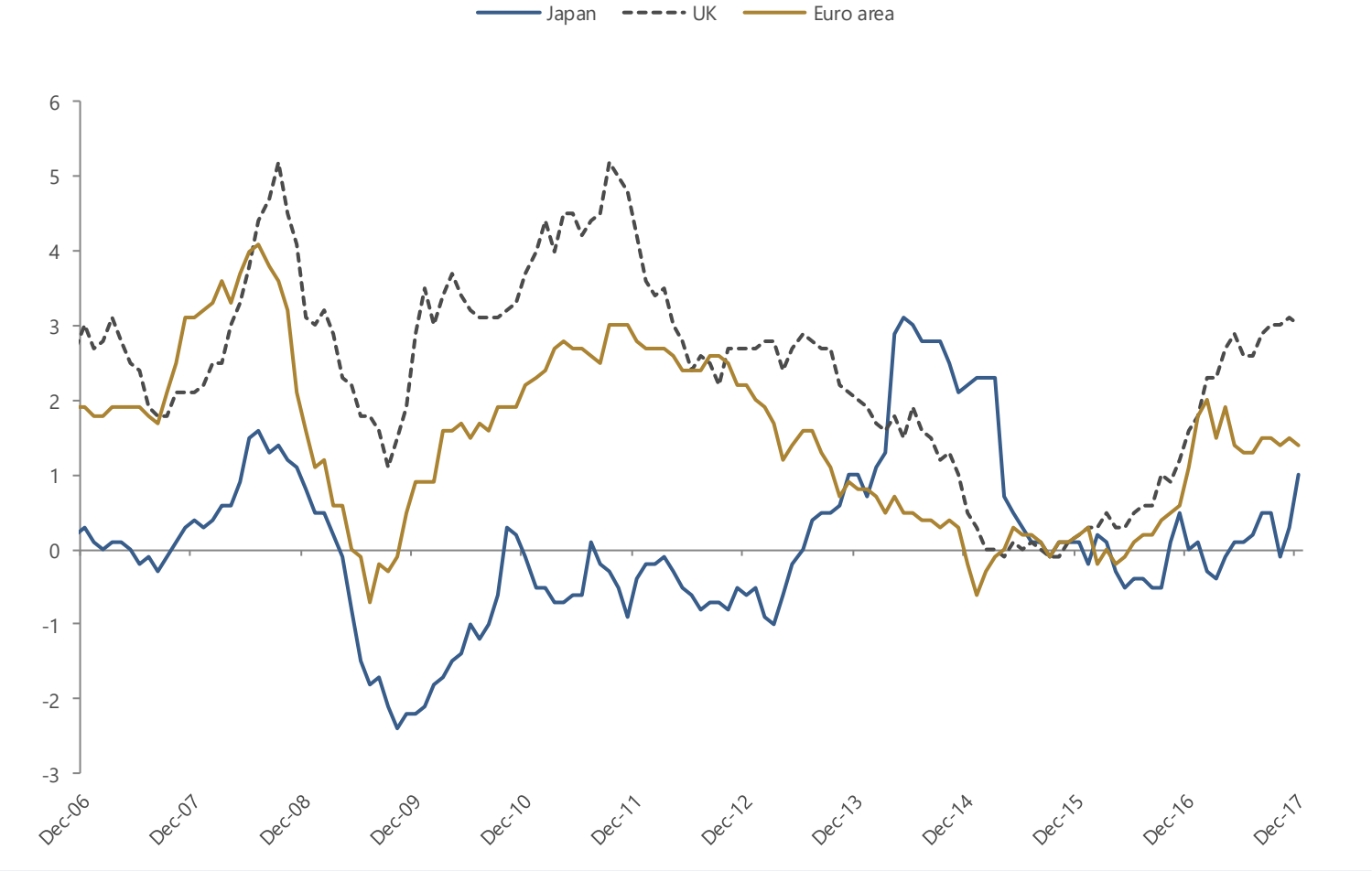


Source: Bloomberg, accessed January 16, 2018 and BNYM AMNA calculations.

# Inflation Will Also Move Higher in Some Other Advanced Economies

## Other Advanced Economies Consumer Price Inflation

12-Month Change, Percent



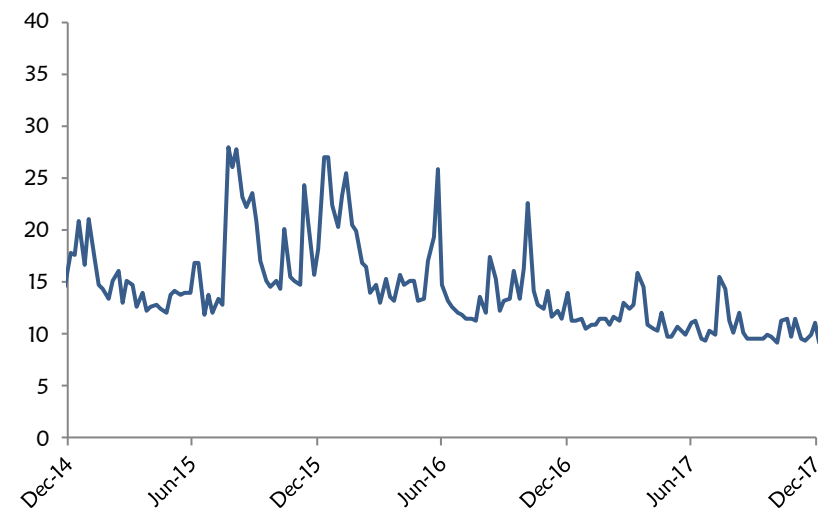
Source: Bloomberg, accessed January 16, 2018



# As For Monetary Policy

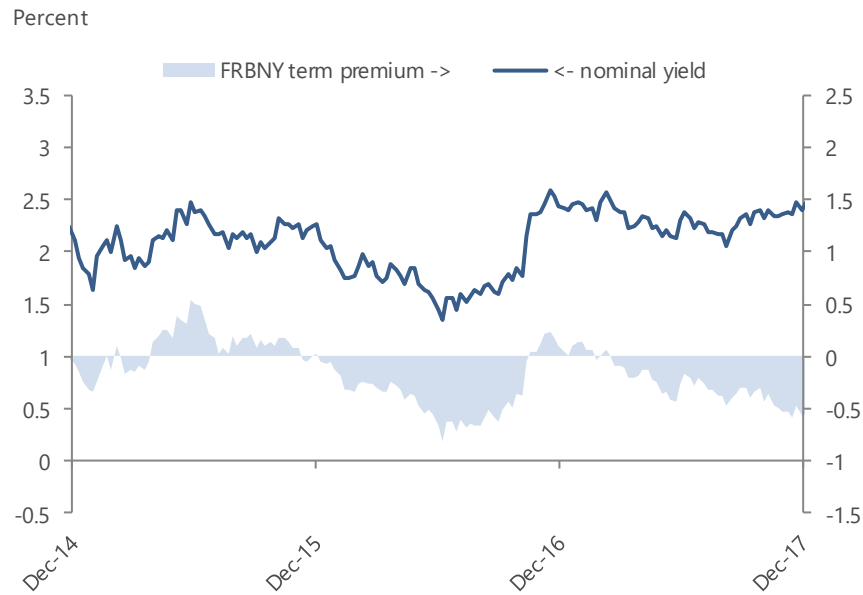
- ▶ The Federal Reserve rate will tighten more than currently built into markets.
- ▶ Other central banks in developed markets are also moving, albeit slowly, to renormalize monetary policy;
- ▶ But they remain willing to lean against market instability.
- ▶ Volatility will remain stubbornly and historically low.

S&P 500 Implied Price Volatility

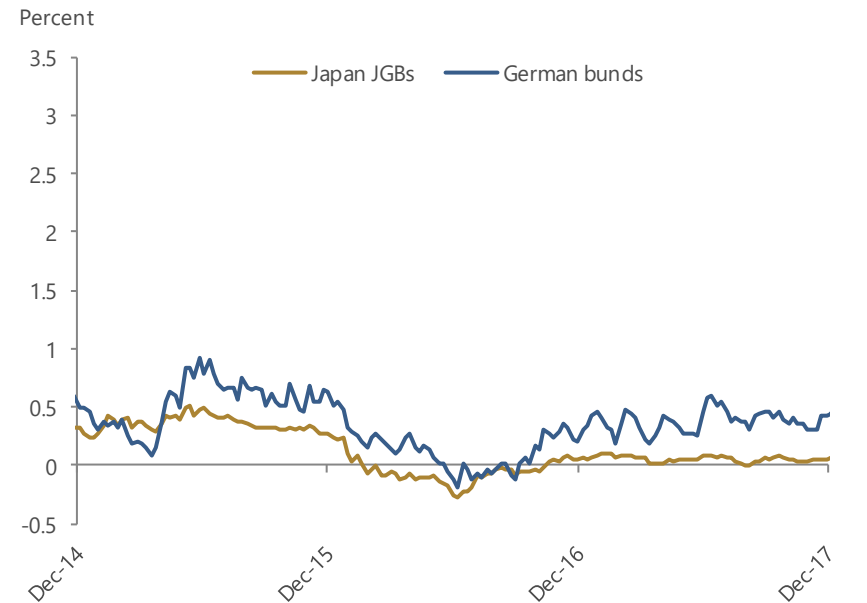


# Synchronized Economic Expansion Makes Developed Market Sovereign Yields Expensive

### Ten-Year U.S. Treasury Yield



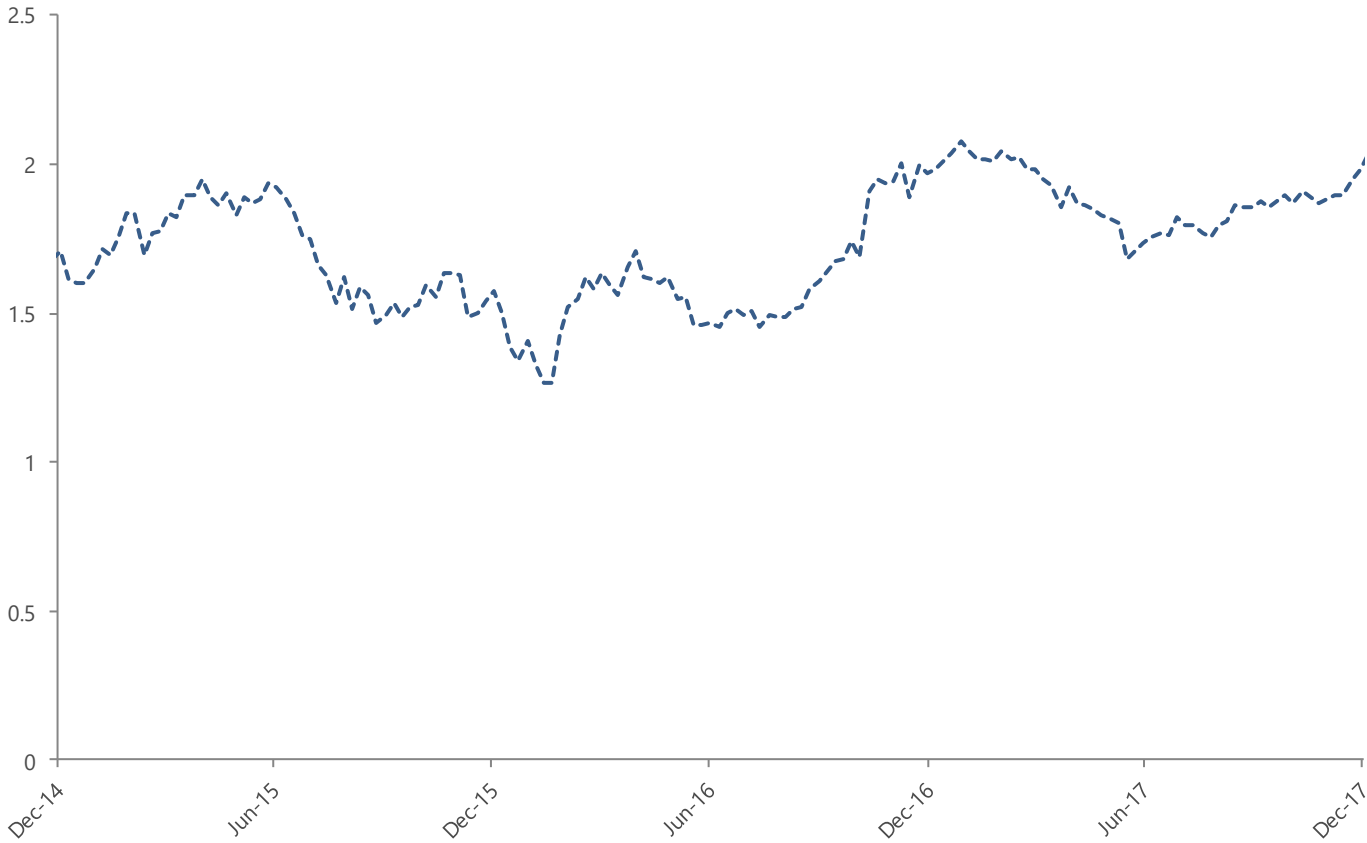
### Ten-Year Sovereign Yields



# Break-Evens Offer Value and Provide Inexpensive Protection to Upside Surprises to Inflation

Ten-Year U.S. Treasury Breakeven Inflation

Percent



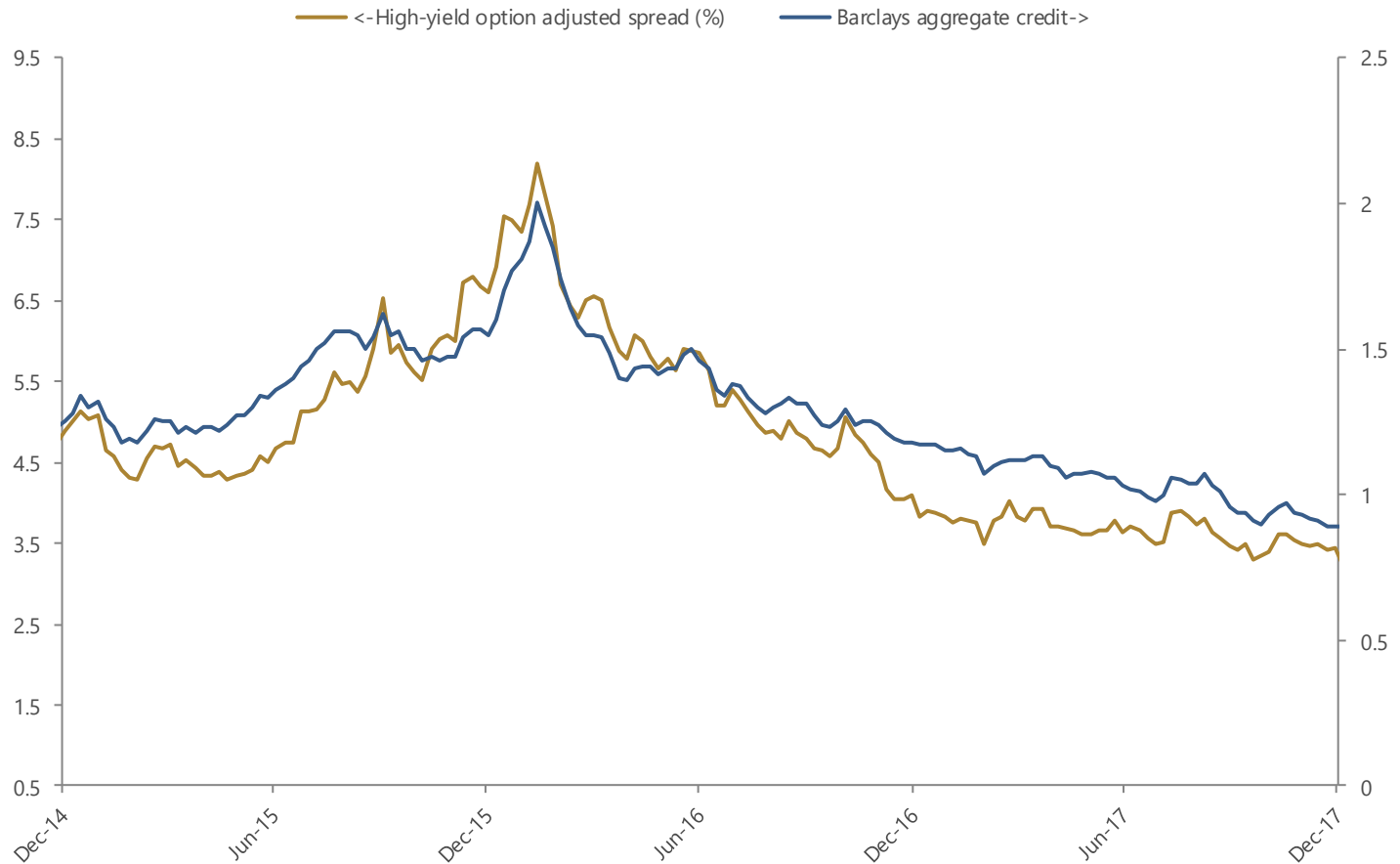
Source: Bloomberg, accessed January 16, 2018



# With Fundamentals Improving, Developed Market Corporate Spreads Have Limited Room to Tighten

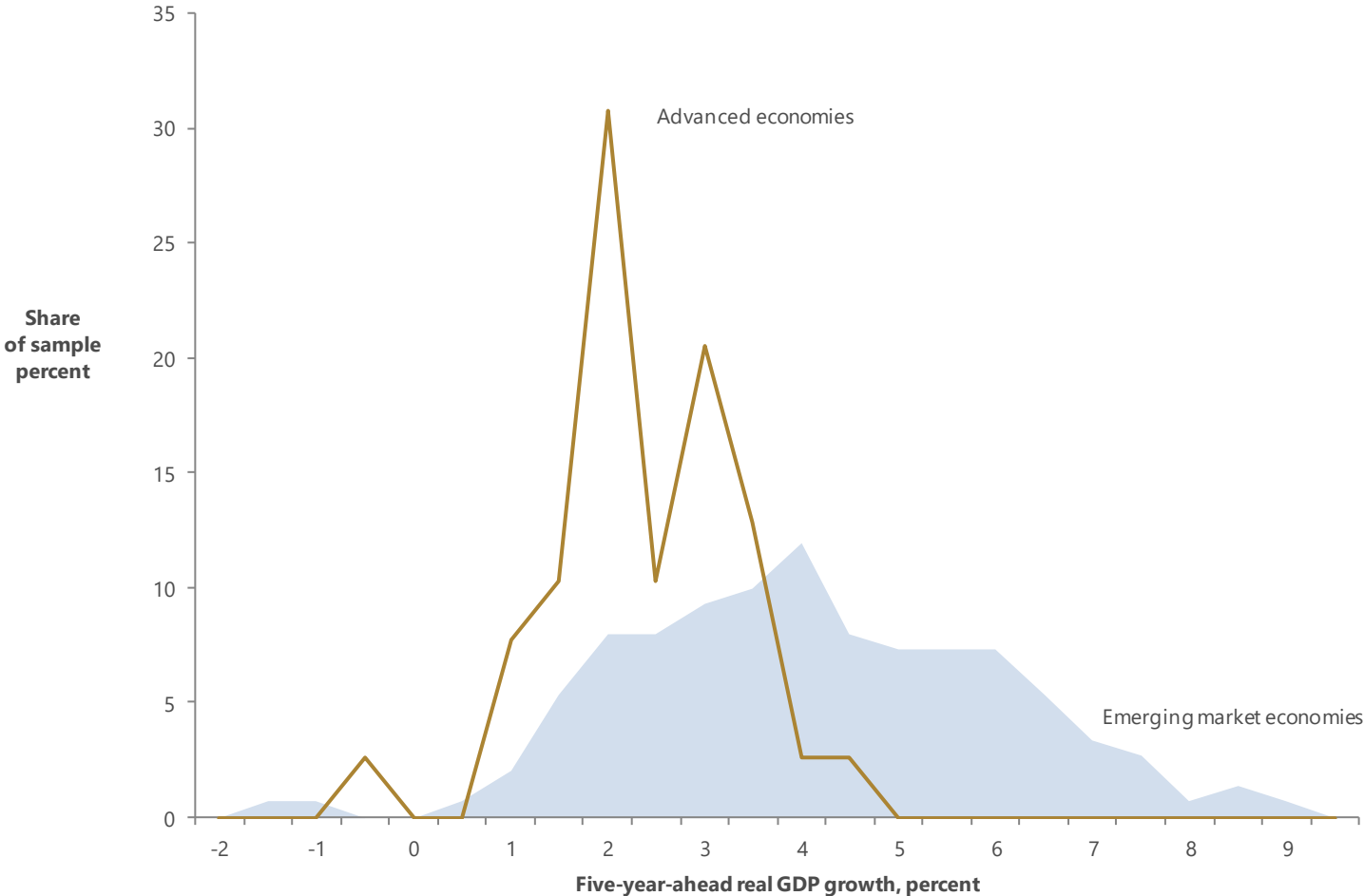
## Selected Yield Spreads

Percentage Points



# Many Emerging Market Economies Have Higher Trend Economic Growth Than in Advanced Economies

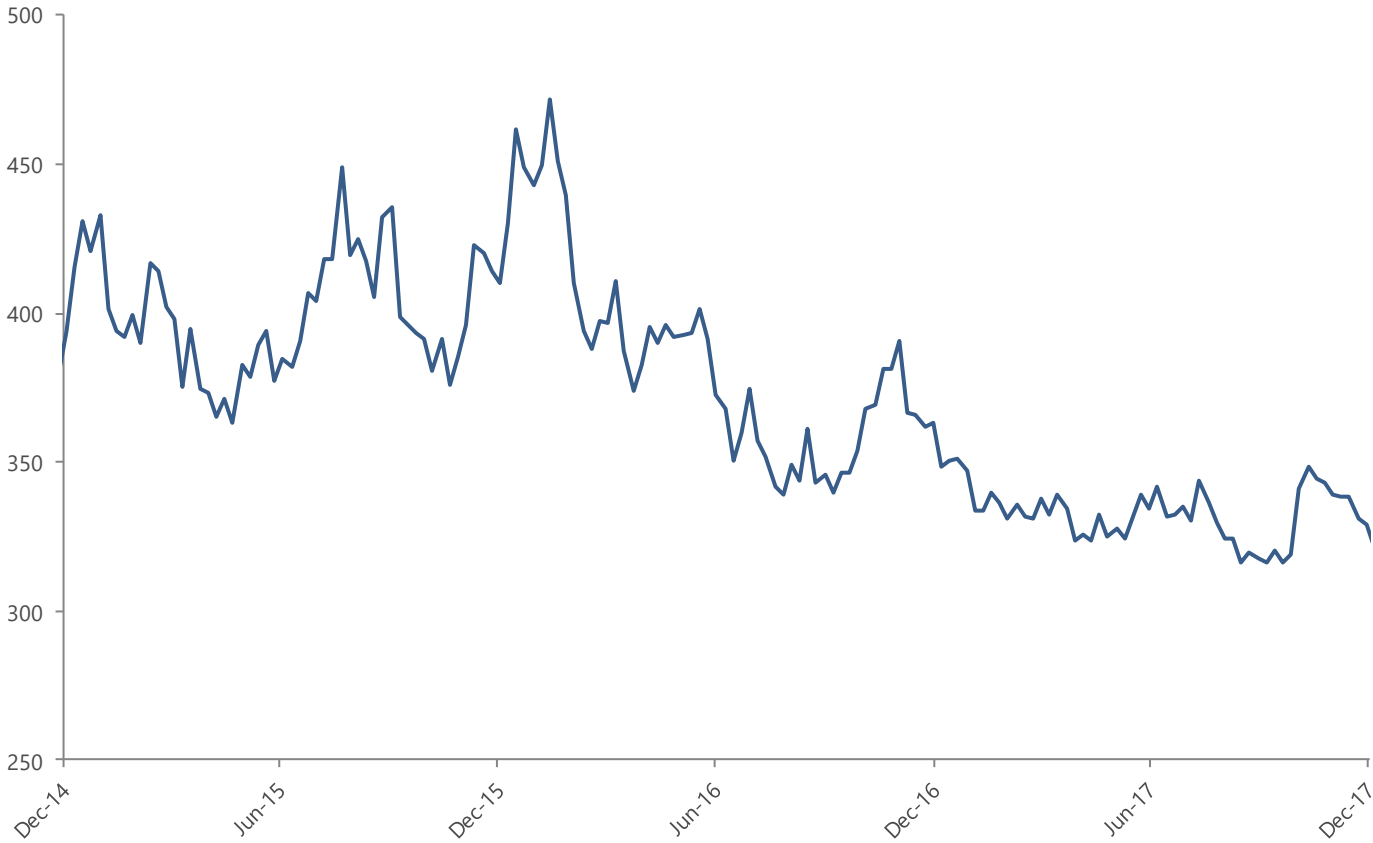
Five-Year Ahead Forecasted Real GDP Growth Across 190 Economies



# Higher Quality Emerging Markets Dollar Debt Looks Fairly Valued

## EMBI+ Sovereign Yield Spread

Basis Points



# The Entire Investment Map...

## Economic Landscape

Despite the net decline in US equity prices and rise in volatility, financial conditions remain accommodative. Additional fiscal impetus further supports economic growth, likely exacerbating excess demand.

Other advanced economies are expanding synchronously and robust growth in China supports emerging market economies and commodity prices.

As of now, cost pressures are muted, but inflation is likely to tick higher.

The Federal Reserve rate will tighten more than currently built into markets.

With the Fed in the lead, central banks in developed markets are moving, albeit slowly, to renormalize monetary policy;

They thus far remain willing to lean against market instability.

## Fixed-Income Valuation

Synchronized economic expansion makes developed market sovereign yields expensive.

Break-evens offer value and provide inexpensive protection to upside surprises to inflation.

The dollar appears expensive against other developed and emerging market currencies.

For institutional investors, municipal assets are somewhat rich.

Corporate spreads are modestly expensive but strong fundamentals and supportive technicals are likely to limit spread widening.

Uncertainty around political events open opportunities in emerging markets local currency.

High quality emerging markets dollar debt looks fairly valued, but some frontier markets look attractive.

While interest rate volatility has risen, it is still at historically low levels.

Valuations of securitized products generally appear fair to rich.

## Investment Themes

Maintain short duration bias in core developed market sovereign securities but look for opportunities to trim positions as yields move closer to fair value.

Be biased toward increasing short dollar exposure.

Maintain modest exposure to break-evens.

Selectively remain overweight EM risk.

Maintain modest credit exposure and be prepared to add on bouts of volatility.

Be underweight tax-exempt municipal securities.

Maintain modest underweight on MBS and emphasize ABS versus CMBS.

Continue option strategies with minimal cost to keep portfolios sufficiently convex.

With the overall risk budget lean, emphasizing quality, and protected against outsized events, look for opportunities to add to risk

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To the extent the strategy invests in foreign securities, its performance will be influenced by political, social and economic factors affecting investments in foreign companies. Special risks associated with investments in foreign companies include exposure to currency fluctuations and controls, less liquidity, less developed or less efficient trading markets, less governmental supervision and regulation, lack of comprehensive company information, political instability, greater market volatility, and differing auditing and legal standards.

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These risks are magnified in emerging markets and countries since they generally have less diverse and less mature economic structures and less stable political systems than those of developed countries.

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The information regarding the index is included merely to show the general trends in the periods indicated and is not intended to imply that the portfolio was similar to the index in composition or risk.

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BNYM AMNA sector models use regression analysis such as multi-linear data inputs, panel data, and probit function. Variables that the models take into account are: PMI, US Core CPI, Fed Fund rate, 3-month Libor, 3-month T-bill rate, foreign purchases of US Government bonds, Commodity Indices, Capacity Utilization, Deficit as a percent of GDP, S&P 500 return, Chicago Fed Index, IGOV, US output gap, Europe Core CPI, US unemployment rate, EU unemployment rate, and slope of the yield curve. Assumptions made are that samples are representative of the population for the inference prediction; regression residuals are approximately normally distributed, uncorrelated, and have constant volatility; no high degrees of multi-collinearity in the independent variables; variable sensitivity remains constant in the short term; and no structural shift in the short term.

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