Morgan Stanley
INVESTMENT MANAGEMENT

Forward Thinking

Navigating the Curve

INVESTMENT INSIGHT | FIXED INCOME TEAM | DECEMBER 2024

Today's bond market offers investors a rare set of opportunities to suit a wide range of portfolio objectives. The market expects some divergence in the pace of rate cuts, with slower declines in the U.S. and faster falls in many other markets. Our investment managers outline strategies for seeking higher current income or capital appreciation during this period of yield curve normalization, with more attractive choices than we have seen in many years.

VISHAL KHANDUJA
Co-Head of Broad Markets Fixed Income
Portfolio Manager

BROAD MARKETS | GREEN BOND | HIGH YIELD | EMERGING MARKETS DEBT

1 **High quality fixed income is delivering strong yields not seen in over a decade**

2 **High quality spreads are attractive as fundamentals remain strong**

3 **As the Fed pivots toward cutting rates, stock and bond returns should once again move in opposite directions**

High quality fixed income remains compelling, as global central banks continue measured path of rate cuts

"Against a base case of a global economic soft-landing, we continue to find value across global fixed income markets. Global interest rate markets remain volatile, we are broadly neutral duration risk, favouring to generate outperformance through attractively valued credit spread sectors. Fundamentals across consumers and corporates continue to remain robust, with government balance sheets more challenged as expansionary fiscal policy likely sets to continue through most major economies. Valuations although tight across many spread sectors, are fair given these resilient fundamentals and continued demand."

Note: The returns referred to in this document are those of representative indexes and are not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

LEON GRENYER

Head of European Multi-Sector Fixed Income Portfolio Manager

BROAD MARKETS | **GREEN BOND** | HIGH YIELD | EMERGING MARKETS DEBT

1 **Backdrop remains constructive for the Green Bonds market**

2 **Growing bond universe provides diversification with dissipating greeniums**

3 **Market's buy-and-hold nature often results in lower price volatility**

Stable demand drivers and robust fundamentals supportive of Green Bonds

"Amid steady demand for bonds carrying sustainability-related labels, investors can tap into a universe that has reached critical mass and a similar opportunity set as for traditional bonds. Our base case for a soft landing remains constructive for global green bonds, where we are neutral on duration and remain modestly overweight credit with a modest bias to high quality issuers. We believe the most attractive opportunities remain in securitized credit, particularly in U.S. mortgage-backed securities. U.S. households with prime credit ratings have strong balance sheets, which should continue to support consumer credit and ancillary structures, especially as house prices remain firm."

JEFFREY D. MUELLER

Co-Head Fixed Income
Co-Head of High Yield
Portfolio Manager

BROAD MARKETS | GREEN BOND | **HIGH YIELD** | EMERGING MARKETS DEBT

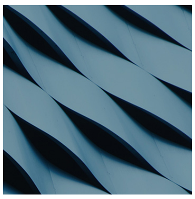
1 **We believe leveraged credit yields offer attractive compensation relative to anticipated credit risk**

2 **Credit conditions continue to loosen, enabling high yield issuers globally to aggressively address liquidity needs**

3 **Credit fundamentals have proven broadly resilient, despite a modest increase in distressed bonds**

Active, discerning selection critical in 2025

"Our outlook for the high yield market has improved, but it appears that many others share this view, with average spreads currently at post-global financial crisis lows. Despite this, we expect capital inflows from global institutional investors to continue due to the ongoing combination of the market's historically attractive yield, generally supportive fundamentals and relatively high-quality profile. In this environment, investors need to allocate capital with prudence and be particularly leery of insufficient compensation in fundamentally challenged market segments. Valuations in lower-rated credit are compressed and more susceptible to volatility. Attractive, idiosyncratic opportunities remain, but need to be harvested through an active, discerning approach."



EMERGING MARKETS DEBT TEAM

BROAD MARKETS | GREEN BOND | HIGH YIELD | **EMERGING MARKETS DEBT**

1 **Narratives surrounding Trump 2.0's impact on EM assets tend to ignore actual developments from his first term**

2 **Current EM asset prices appear attractive relative to most areas of developed markets**

3 **Over 50 years, what's mattered most in EM investing is economic reform at the country level**

Emerging Markets: Empirics vs. Narratives

"Historical evidence upends the narrative that Donald Trump's re-election will be bad for emerging markets. For starters, portfolio flows into EM assets hit record levels and the USD remained relatively flat during Trump 1.0. Unlike then, the Fed appears to be easing policy today, and EM assets appear attractively priced relative to developed markets (DM). More importantly, the past 50 years show what really matters for EM investors: Economic reform. Because many EM countries often have policies and institutions that are less sound than their DM peers, the market prices in a larger "policy discount rate" via higher bond yields and lower equity multiples. Reform, no matter the starting point, typically sees that discount rate decline and assets there can become more valuable. This is independent of global growth and inflation, Fed policy and even U.S. elections and is key for unlocking EM's potential benefits: Higher income, improved returns and meaningful diversification."

Source of Data: Morgan Stanley Investment Management, as of December 11, 2024, unless otherwise specified.

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Dubai: MSIM Ltd (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158).

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