TRANSCRIPT

Bonds are Back: A Historic Opportunity in Actively Managed Bonds

Presenters: David Braun, Ken Chambers, and Danielle Fox

Ken Chambers: All right. Welcome to Bonds are Back, the active advantage with Fidelity and PIMCO. I'm Ken Chambers, a fixed income strategist at PIMCO, focused on multi-sector strategies, like our income fund, our total return fund, as well as ETFs, like the BOND and PYLD ETFs.

We just heard from Heather Knight of Fidelity and Jerome Schneider and John Nersesian from PIMCO about how to take action for investing cash and moving off the sidelines. In this next session, we'll focus on the role of fixed income in a portfolio and an overall asset allocation. We'll explain why we think bonds are attractive right now, where we see the most value across the fixed-income landscape and, importantly, how investors might take advantage of these opportunities.

To help me with this, I have a few colleagues here to assist with all the heavy lifting. First, I'm joined by Danielle Fox, a fixed income regional consultant at Fidelity, and second, David Braun, a managing director and the lead portfolio manager for PIMCO's BOND ETF. Danielle, Dave, thanks for joining us today.

David Braun: Thank you for having us.

Ken Chambers: All right. We got a lot of opportunities. Let's jump right into this.. Dave, let's start with you. Look, you've spent your entire career in markets, first as a risk manager. The last two decades, you've been a portfolio manager. Can you share some of the key characteristics, really the features, benefits, of both bonds and stocks? And how do those features potentially impact an investor's allocation over time?

David Braun: Great. Thank you. Thank you to all the investors and advisors on this call. We at PIMCO really cherish the relationship we have together. So look, we all know stocks and bonds are different. If we go to the next page, stocks offer, at least historically, quite a bit higher total returns over time than bonds over the long run. But that comes with a cost of higher volatility and larger drawdowns in bad years. And you can see this here on the charts here.

And the whereas bonds provide more stability, lower volatility, more muted drawdowns in bad years. And that comes at the trade off with the cost of a lower total return over time. Now, one thing that's interesting is it doesn't have to be an all or nothing.

And these sets of pie charts and tables here show that as you go from 100% stocks on the left-hand side to 100% bonds with two stops in the middle going to a 70/30 stock portfolio and then a 30/70 bond portfolio, it all kind of holds together. You see the average return goes down. All stocks being the highest. All bonds being the

lowest. And again, I'm not telling you nothing you don't know. But I want to just state the facts here.

And then also, the worst year goes down, where the worst year for stocks is much larger. As you go to 70 and 30, it cuts down. Then you go all the way to bond, and it's lowest. And the number of years with a negative result-- and again, this goes back about 50 years since the mid '70s-- goes down as well.

Now, one interesting thing-- I want to point this out because I want to talk a lot about this. And those of you who listen to Dr. Bernanke's session two hours ago, look at the best year. That's a little quirky. That's the only one that doesn't follow the pattern I talked about, where you have the best year, clearly 100% stocks. And then the two in the middle are actually lower than the best year for bonds. Why? That was 1982.

I'm sure a lot of you on this phone call aren't old enough to remember that, but some of us are. And that was when Federal funds went from 15% down to 9%. And you had that tremendous bond market return. Now, no one is calling for that to happen, but it is worth noting that bonds usually have their best years when the Fed is embarking on a cutting cycle. And you heard Dr. Bernanke talk about we're starting our cutting cycle. And Fed funds is no longer going to be at 5.5%, not even there anymore. It's 5%.

And on the next slide-- so that was historical looking last 50 years. We don't profess to being perfect at predicting the future, but we believe that you have to have a view

and you have to try to project future outcomes. And that's what the right side of this is. This is using PIMCO's capital market assumptions. And it incorporates things like historical returns, circle volatilities, but also most importantly, today's starting valuations.

And we know equity valuations are quite robust. It seems every day you open the newspaper, turn on the news, stock market's hitting a new high. PE multipliers are elevated on a historical context. And we also know bond yields are attractive right now. They're higher than they've been in 15, 20 years.

So what we do is we start with that as the initial conditions and project where things can go. And here you see, it's not as stark of a difference as you just saw in history, that given the starting valuations of stocks and bonds, we think that gap between 100% bond, 100% stock portfolio has closed a lot on the all-in yield.

Just look quickly. 100% in the Barclays Agg, a 5.5% yield with a 5% volatility. Go to all stocks. Yes, a higher yield or a higher return, 6.8%, but three times the volatility. And then when you do the blends, you're closing that gap on the return potential, and you're cutting your volatility from the all stock.

Interestingly, Sharpe ratio is something investors should be looking at, which is the excess return over, like, a T-bill portfolio of an investment divided by its volatility. And not surprising, given how rich stocks are right now and how equity volatility is going

forward, the Sharpe ratio is most attractive, at least in our modeling, of bonds and the bond-heavy 70/30 portfolio.

Ken Chambers: Now, Dave, I think that's a great point. And you actually can see it on this slide, this idea of the efficient frontier starting to form basically as you have that trade off between bonds and stocks and the complementary nature. We'll talk a little bit about being active within fixed income and how you can potentially improve upon these index types of returns.

Danielle, we just heard from Dave talk a little bit about features and benefits, equities versus fixed income. Look, you talk to clients all the time. How do you advise clients on making those asset-allocation decisions between equities and fixed income? What role do those investments play over time?

Danielle Fox: It's a great question, and I appreciate the chance to join you guys today to talk about this and some of the other topics. And as we think about an asset allocation, working with an advisor to determine what an optimal mix is definitely a key step of the process. But I'd like to think about each of the asset classes, stocks, bonds, and cash, and what role they serve.

And I think a lot of savers sometimes, as they get closer to retirement, may sometimes have to rethink what fixed income serves as a component of the portfolio. And what I mean by that is when I've been a long-term saver and I've been investing

in stocks and equities, I'm expecting my assets to grow. I'm expecting my wealth to grow. And I'm also expecting probably a outpace inflation.

But when I start to introduce fixed income or more of it into the portfolio, it's really about keeping what I have and creating a solid foundation for that volatility that might be taking place in the equity market and creating income for potential use. And I think that's an important tenant to always come back to and start with the why. And this is an important piece when you may have had a lot of investment history with the equity market where you had a different measure of what success looked like.

So when you think about asset allocation, you want to start with, what does the optimal mix look like? And that could include taking into account your own tolerance for a roller coaster ride in the equity market, which you might be less interested in as you get older and want to start enjoying life in a different way. So there's some kind of qualitative aspects that should be included in any asset-allocation decision.

Ken Chambers: No, absolutely. That income component I think is really, really important. The capital preservation nature also really key. And exactly what you talked about that. Equity diversification, lower volatility profile, those are all, again, those features benefits of fixed income that, I think, as investors age and as they retire and they count upon that, things that are there with fixed income.

OK. Danielle, given that we heard earlier from Dr. Ben Bernanke and PIMCO's group chief investment officer Dan Ivascyn on PIMCO's economic outlook, how are you thinking about the current macroeconomic environment in terms of the investment opportunity set today?

Danielle Fox: A lot of the clients that I'm speaking with, I try to get them to think about how they want to evaluate and mitigate, to the extent that they can, interest rate risk and credit risk, which are two of the key risks that any fixed-income investor should be cognizant of when building and maintaining a portfolio. So obviously, interest rate risk has been top of mind for a lot of investors for the last couple of years and maybe the majority of the focus.

But if we think about where we are in the rate cycle, we're at the end of higher for longer. The Fed last week cut rates for the first time. They've largely told us the answers to the test for the remaining half of the year here in terms of another half and expected rate cuts. So when the roller coaster is heading down in terms of interest rates, from a portfolio theme perspective and an opportunity set, it's about extension, meaning picking up maturity or slowing down how quickly your money is coming back to you within reason. Everyone's got a different tolerance for time horizon, so it's making sure that you have a good awareness around that and then extending within that.

But then also, if we're moving towards this soft-landing scenario where parts of the economy might be softening, you don't want to ignore credit risk. And so you don't want to be complacent and kind of sleep on that. And in an environment where parts of the economy may be softening, unemployment rate may be rising and all of those aspects. Quality is king, right?

And so you really want to be cognizant not just of interest rate risk, but also how you're thinking about credit risk because that risk may materialize as you're in a recession or coming out of it. So it can kind of sneak up on you if you're not paying attention to it. So in terms of macroeconomic and then thinking about where we are from a portfolio-construction perspective, it's taking the fact that we're in the late cycle and saying, all right, well, what do I want to do from an interest rate risk mitigation perspective? And then what do I want to do around credit risk mitigation?

Ken Chambers: Yeah, exactly right. If you think about where we're at in that cycle and as we're basically in the process of a cycle turning over with the Fed heading in a different direction, locking in levels of yield. And what we'll talk about with Dave is also this idea of investing for multiple scenarios, this idea that there is a base case, markets are pricing certain things in, but there is event risk. There's credit risk. And so you want to think about how portfolios potentially behave. And so being sure that you're on sides in terms of those asset allocations, it's really, really important.

All right, Dave. Look, you talk to clients all the time. You talk to investors regularly, given your role as the lead on BOND ETF. Why is fixed income attractive today?

David Braun: So let's go back. I mean, fixed income has had a rough go here the past four or five years with super low rates in COVID. We shut down the economy, and rates went to, literally, all time lows. And then a big inflation fight where we had to get on a horse and start hiking rates at the central bank level. And then now we're coming off that.

So when you go back to what we all learned when we grew up in this business, why own a bond? Three reasons. The income or the yield you get. And we think yields are very attractive right now. I got a nice slide on this in a second. But you literally have to go back 16, 17, 18 years to before the great financial crisis to see yields like this on high-quality bonds. So this COVID, then inflation fight we've had has created a generational repricing of yields upwards, which is very advantageous to the investor.

The second reason we own bonds, in the middle there, defensive posture, meaning capital preservation. And I get thrown back in my face a lot, well, capital preservation didn't work well for me in 2020 in bond funds. But if you look at history, bond funds have a long history of really light, small drawdowns in their worst years.

Now, 2022 was an anomaly. And just think about what happened there. You could argue it was the perfect storm. We entered 2022 coming off the lowest ever rates in the United States. The US 10-year Treasury went down to 50 basis points. Something

I and a lot of you probably thought you'd never see in your career. And that was actually good.

Japan, Germany, a lot of other countries, their rates were negative rates. Think about that, negative rates. I give some money as a loan, and I pay them to have the privilege of giving them a loan. It's kind of perverse, but that's the world we're in with COVID. And then all of a sudden, we get inflation, COVID supply chains, the reopening of economies, pent-up demand by the consumer. And then all the stimulus we throw at it on a monetary with the Fed and the fiscal side led to this perfect storm of inflation. And then we had to hike rates rapidly.

If you just do some simple bond math, we entered 2022 with Fed funds at 25 basis points. And the Fed hiked 425 basis points up to 450. So that's going to carry you out on a stretcher in a bond fund when you have that short of a period with that aggressive of a hiking cycle and you started the year with no forward momentum, meaning that your yield on a bond fund was low. It was, like, 1.5%. So it was all the pain of the rate hike and no yield.

Totally different today. We've got nice fat yield as our tailwind, and no one is calling for the Fed to hike rates. Everyone's saying the Fed has to cut rates. So this fear and this trying to fight the last battle we lost and assuming that bonds do not offer capital preservation, we think is kind of a recency bias and just looking at what happened two years ago.

And then the third thing-- and you heard Dr. Bernanke talk about this-- as growth slows and unemployment rises and the risk of recession increases and we actually hit a recession, usually bonds act in a negative way or opposite direction as stocks. So they serve as a nice insurance policy against the end investors riskier assets. We believe that relationship is coming back.

You saw earlier this month when some of the equities got in trouble there with not meeting their earnings, quickly back to new highs. And you saw a couple of months ago when the yen carry trade blew up and stocks were in free fall and bonds did their job.

And then the next page just shows what I mean by these starting yields, puts it in context. It looks back to beginning of 2022. And you can see I focus on the core, which is the third from the left. You can see, we're at 440. So the Barclays Aggregate is yielding about 4 and 1/2, 440 right now. And it was yielding under 2 heading into 2022. That 4 and 1/2 is attractive on history. Like I said, you got to go back 16, 17 years to get a yield commensurate with today's starting yield.

It's attractive when you take out inflation, so not just a nominal 4 and 1/2 percent. But peel off 2 and 1/2, 2 and a 1/4 of inflation, you're still getting a real yield on your bond fund outpacing inflation by over 2%. And we just saw various other high-quality sectors of the public bond universe here.

Ken Chambers: Yeah, that's right, Dave. So, look, as an active manager, we're going to develop our forward-looking views. They're prevalent in equities and fixed income. What are the trade offs between active and passive strategies?

David Braun: So look, when we think about the fixed-income world-- and that's our area of expertise-- we firmly believe that active management is the way to go. We've got a long history ourselves of delivering value by using active management. And then this just looks at the broader universe, not even just PIMCO funds, all mutual funds and ETFs in these spaces.

And you can see on the left, the active management, the green bar-- and then the blue bar is passive, so someone just trying to replicate an index-- they haven't had a long history net of fees of beating the passive peer group. On the right is bonds. And you can see the passive peer group, because of replication costs and transaction costs, they actually don't deliver the index. They deliver slightly less than the index.

And then you can see an active bond manager on average-- this is the average-- has delivered 24 basis points of annual excess return net of fee versus the index. And then if you look at the next page, it shows probabilities or what percentile of managers beat it, because if you're getting 25% average, some are beating it, some aren't beating it. But this shows quite visibly how-- the right four bar charts are equities.

And you can see they're all below 50%. Not a lot of active managers have beat on a five year-- it's the blue bars in 10 year-- the green bars. So the active managers, less than 50% of them have consistently beaten their passive peers. Look on the five the right, those bar charts, the blues and the greens. The blues are, again, five year. And the greens are 10 year. Almost all of them, they all are over 50%. Some of them are north of 70%.

So the history shows-- and again, history is no guarantee for the future. But in a historical basis, active bond managers have had success beating the index and beating their passive peers who try to replicate that index, even net of fees.

And the last thing I'd say is-- and Dan Ivascyn hit this earlier this morning on this call-- we're in a high-volatility environment right now. And he and Bernanke talked about all the uncertainty on the outlook with political elections, with the path of the Fed and other central banks, with rising unemployment and slowing growth. That's a lot of uncertainty. Uncertainty breeds volatility in the markets.

And we're going to talk later about dispersion in the markets as well. And those three things, volatility, uncertainty and dispersion, is a nice fertile backdrop for an active manager to try to generate excess returns over a passive manager.

Ken Chambers: And the starting point even-- go ahead, Danielle.

Danielle Fox: Just going to add one quick thing that I find with investors. They're surprised to learn how many bonds are actually outside of the index. And that's quite a stark comparison from what you see on the equity side. So I think there's oftentimes this translation from, well, if I do it on the equity side, I can do it on the fixed-income side and I'm going to get a similar type of representation. When in fact, particularly in the investment-grade taxable market, there's so much that kind of lurks outside the index that David has a chance to potentially buy or peers of his.

Ken Chambers: Danielle, you're hitting on a perfect point. If we think about bond indices, there's structural inefficiencies all over the place, not within just those indexes, but different market participants that are interacting with things. And so we often think about the aggregate index. It's comprised of US treasuries, US agency mortgages and investment-grade credit only, just those three asset classes.

And so an ability to bring in other types of securities that have maybe even a better risk and return profile, it breeds diversification. Dave, actually, one natural segue. Let's talk a little bit about these numbers. What drives some of this? And exactly to Danielle's point, maybe, what are some of these structural inefficiencies that allow an active fixed-income manager to potentially outperform benchmarks?

David Braun: Danielle, thanks for bringing that up. And Ken, thanks for giving me a chance to elaborate on that. So, look, just think about it. The S&P 500, I mean, it's in the name, 500 securities, 500 stocks. And guess what? They're all exchange traded.

Guess what? They all have to file public filings compliant with the SEC. So there's a tremendous amount of transparency and efficiency in how they trade. And then last, there's only a little bit of turnover, maybe like 3% to 4% of them fall out of the S&P 500 every year and 3% to 4% more come in.

Let's talk about the Bloomberg Barclays Aggregate Index, it’s got over 13,000 securities in it. Think about that, 13,000. And guess what? Those 13,000 securities trade over the counter, not on an exchange trade. So they're less liquid, more friction in trading them, higher bid ask and transaction costs. And also, it's a more opaque market. It might be harder to get some information on some of these bonds that are out there available to you to invest in.

Many bond issuers might have a dozen or more bonds out there that you can go buy as an investor. This is just a simple schematic. Obviously, things are simple, like different maturities. We've got 5 year, 10, year, 20 year. We can figure out, OK, for this given company, where's the most attractive part of the curve for us to buy on them?

They might have different ratings. People always say, what do you mean different ratings? Think about a big bank. They may have a subordinated bond that might get a BBB. They may have the regular bond that might be A-rated. Then they might securitize something. Think of credit card receivables or mortgages that they may originate. Those might get AAA.

So you've got a tremendous amount-- and to Danielle's point, only a small subset of those bonds make their way into an index. So if you're either a passive manager, who has to paint by numbers and replicate the index, or you're a lower active share active manager, who likes to be close to the index and stay close to home, you're losing a tremendous opportunity set of bonds to buy, just because someone said they're not index eligible.

And as Ken mentioned at PIMCO, we don't really care if it's index eligible or if other people like the bond. We're trying to invest for you in the most attractive risk-versus-reward securities we can find with an agnostic view to whether or not they're included in someone's index.

Ken Chambers: Yeah, Dave, that's exactly right. When we think about the complexity of markets only getting more and more complex, having the resources to do a lot of the research on those individual companies, understand what the valuations are on the individual securities. And then as we put things together in an overall portfolio context, what is the risk? What's the return potential? Is it worth it? And ultimately have some level of balance between that inclusion of additional asset classes that are very high quality in nature.

All right, Danielle. Let's talk a little bit about maybe selecting managers within the fixed-income universe. What do you tend to focus on? And maybe could you speak to some of the characteristics that you look for in a manager.

Danielle Fox: Sure. And when I think about hiring a manager, whether it's David or a peer of his, I always want to think about going into it from a time-horizon perspective. And I'll use David as an example. He and I have a similar time horizon in terms of holding period. I want to set myself up for success. I also want to invest alongside someone like David, who has a certain view on where he wants to be along the yield curve.

And this is not an all inclusive list of variables that I would consider when selecting an active manager, but time horizon is a big one. If I am planning for retirement, and retirement is 20 years from now, 10 years from now, maybe I have a little more flexibility than if I'm living in retirement and actively drawing down on some of the assets that are in the discussion. So time horizon, huge piece and a huge component.

I also pay attention to looking at the mandate of a fund or an investment manager. What are they allowed to invest in? What are they not investing in? And does it align with the values that I have in terms of the role that fixed income plays in the portfolio? So does that strategy align with how I view that or how I interpret it?

And then, I would say, a little bit to that is evaluating credit risk from a composition perspective. If it's a core-plus strategy or something like that, what's my tolerance for non-investment grade merging markets and maybe some of the more spicy parts of the market that can provide equity-like correlations when I'm counting on it as part of my fixed-income allocation?

So mandate and time horizon are a big one, especially when you're looking at a perpetual security, like an ETF or a mutual fund, where at some point, I'm going to have to go in and either rebalance or sell shares. And so I want to make sure that time horizon, fund manager and I are on the same page at the end of the day. So that would be a big one for me when selecting a manager.

Ken Chambers: That makes a ton of sense, really, that sequencing component. Does my time horizon align with what the manager is ultimately managing towards? Because when you think about the sequencing and if you have a volatile year and you weren't expecting that, you could be left holding the bag. And that bag might be a little bit less than you ultimately thought it was going to be. And so very, very important, depending upon where you're at in your investment, time horizon overall.

I think also that idea of credit risk and what's allowed within the portfolio. We tend to focus a lot in terms of bottom-up resources, capabilities to ensure that things are default remote. But at the same time, that doesn't mean that there's no volatility. Often talk about this idea of low volatility does not mean no volatility. And so thinking about what that profile looks like over time, it gets to exactly, is the asset or is the investment ultimately delivering upon what you want?

Dave, look, we spend a lot of time thinking about building products, what kind of style and what we're trying to achieve. How do you think that an end investor should think about the risk profile and the style of the different managers?

David Braun: So for those of you who listened to the prior session with my colleague Jerome and John, they had a cute phrase in there, which was, all cash is not created equal. And I wrote that down. I thought it was interesting. Well, as a core bond manager, I would argue all core bonds are not created equal. And core bond managers do not build portfolios equally or the same.

And what I mean by that is-- and Danielle hit on this-- what is their style? What levers are they pulling? And that's very, very important. I mean, just because something is benchmarked to the Bloomberg Barclays US Aggregate doesn't mean the managers are building a portfolio the same way. And what I mean by that is like, go look at some of them right now. There's some very credit-heavy ones out there that have done very well because I'm going to show you in a second that credit spreads are very, very low right now. So if you had a lot of credit, you did really, really well.

I'm talking managers who structurally put 10%, 15% high yield in a high-quality fund trying to beat the Agg where there's no high yield in the Agg. And that strategy works pretty well until it doesn't. And it's worked really, really well recently. But at these spread levels, we would question whether it's going to work well. Now, if it's a beta movement rotation call, good for those managers. Get the 15% when they're attractive and then unwind it.

But if you look, a lot of people out there have 10% to 15% high yield in every year that they run the portfolio. And it works over a 10-, 20-year horizon. But to Danielle's

point, what is someone's horizon? The problem with that strategy of relying solely on credit risk to beat the Agg-- and that's not what we do. I'm going to get to that in a second.

But relying solely on credit risk is oftentimes when stocks are in trouble, your bond fund is not behaving like an insurance policy. You've put so much credit risk in the bond fund, that it starts behaving more like an equity fund than a bond fund. And you're 60/40 or 70/30, there's no hedging power. They're both going down.

So what we try to do at PIMCO is build you a more diversified portfolio that we think has a really good chance of beating the Agg, but is not beholden to just one lever, meaning high yield or weak investment-grade credit. So we're trying to go where the opportunities are. We have 14 specialty desks that trade just one part of the public fixed-income market.

And portfolio managers, like myself, at PIMCO, our job is to partner with them and build you a portfolio that's diversified, spreading your risk across the markets, going where the opportunities are, not just where we set and forget it, and then being active in trading it. That's the second thing we do. So diversification, active trading. So the way our portfolio looks today is not the way it probably looked a year or two ago. I know it's not. And it probably won't be the same way it looks a year from now. So we're trying to actively trade and adapt with the markets and opportunities out there.

And then the final thing I'd say is to Danielle's point before, over 80% of the bonds out there that we can trade aren't really in major indices. So if you go out there and go shopping in the bond supermarket for broader bonds, not just index-eligible bonds, there's a wonderful opportunity set. So expand that tool kit. Dan Ivascyn and Dr. Bernanke talked about the global differences, some central banks hiking rates, like Japan, some central banks already in the cutting process or just starting the cutting process. There's major differences across the globe. And that creates global opportunities. So expand your tool kit rather than just throw a bunch of credit in a portfolio to try to beat it.

Ken Chambers: I think the hallmark of our strategy is this idea of multiple and diverse sources of return and really focusing on the active component, not just managing interest rate risk, thinking about that, but also the different types of credit risk to ultimately build a portfolio that has a high-quality, forward-looking profile. OK. Let's talk a little bit about some of those investment themes that we're seeing today. Danielle, what strategies are clients emphasizing? And maybe where should they tread a bit more carefully right now?

Danielle Fox: Sure. I would say-- and this probably won't come as a huge surprise since we just did a session on cash-- cash management proxies, cash alternatives have obviously resonated a lot with clients from an investment-theme perspective, I

would say, over the last, let's say, 2, 2 and 1/2 years. As one client told me, it was T-bill and chill, I believe, was the term that he used.

But now with the Fed cutting rates, this concept of extension is really something that from a theme perspective we're really trying to explore with our clients. And so then it kind of gets into the asset-allocation conversation. Are these non-retirement account taxable dollars? Are you in a high-tax state where tax mitigation techniques might be helpful and extension might take place in? Say, the municipal market, which is a much higher credit quality market on average than the corporate market, has ratings, resiliency in a way that is potentially quite different from the corporate market.

And then for retirement account tax shelter dollars, potentially looking at extension through the intermediate part of the taxable bond market. And again, being late in the business cycle, trying to overindex-- pun intended-- on credit quality a little bit to have that defensive positioning that David was talking about earlier. So I would say theme-wise, there's been a little bit of the barbell scenario going on, where if you think about going to the gym, if you visually think about a barbell, you've got the short and the longer term and not as much in the middle.

And we're now starting to see some of that short term start to drift out into the intermediate, long-intermediate space. And depending on what your tax situation is and where the assets are located, it might dictate that taxable versus tax-exempt

space. And that's part of having a conversation with an advisor from a financial planning perspective can be awfully helpful. And again, keeping the quality on the higher end just so that you have the ability to weather whatever volatility might shake out due to soft landing, late cycle, all of those fun terms that we like to toss around.

Ken Chambers: It makes complete sense from our perspective too, and having a plan, working with a professional, thinking about, what are my goals? And then sticking to those goals and recognizing that adjustments need to be made. You can't be complacent because markets absolutely move. And you see your portfolio move around and making sure that you're topped up in the right spot, makes a ton of sense. Go ahead, Danielle.

Danielle Fox: I'm going to add because I neglected to mention this earlier. As clients are thinking about that shift, it's not just thinking about, are rates going higher or lower? The direction. But it's also, how quickly do you think rates are going to change and how much? So the magnitude of change and then the pace at which it occurs could influence the shift from that shorter-term cash management alternative into more intermediate.

And so I would encourage and invite clients to think about, what am I going to do going forward to protect or preserve yield? And that's the question that everyone should be asking themselves.

Ken Chambers: Yeah, how can I lock in levels of yield that are here today that are going to be around if I lock it in for a bit longer than simply just sitting in T-bills?

Danielle Fox: Yes.

Ken Chambers: All right, Dave. Maybe same question to you, probably more on the investment side. Obviously, you run our BOND ETF here at PIMCO. You're a member of our total return portfolio management team and thinking about how we're allocating across an array of different strategies. What asset classes are we finding attractive today? What regions are we starting to emphasize? And what areas of the market are maybe a little less attractive?

David Braun: So Danielle put it perfectly. Like, how can investors preserve and protect yield? Those people who have moved out of bonds and camped out in the front end, Jerome's space, money market funds and the very front end, that served them wonderfully over the past couple of years because you avoided the drawdown in bond funds, and you had higher yields than bond funds were giving you at the time. So that's been a wonderful trade.

I think we all think that trade is starting to get long in the tooth and, perhaps, has seen its better days. And moving out the curve to a core bond fund that's trying to beat the Agg somewhere in the 5, 6 duration part of the yield curve seems a prudent thing. And what we show here, if you draw a line below the first four rows, those are yields. And below, that's spread. So let me tackle yields first.

And the way this page works is if you're on the right-hand side, this is a historical distribution for the last 10 years. And if I showed you for 20 years, it'd be about the same. Remember, I said, we haven't seen yields like this for 17 or 18 years, so the 20-year numbers would be about the same or percentile rankings. And you could see, if you're to the right, yields are attractive or spreads are attractive, if you're to the left, they're not.

So let's just take the first one, US Core, 83rd percentile, meaning that over the last 10 years-- and again, 20 years, a similar story-- only 17% of the time were yields more attractive. And guess where those 17% were? They're about a year ago when the 10-year Treasury hit 5%. Remember, October 2023, we had a cup of coffee at 5% on the 10 year. And it's pretty tremendous. I mean, two years earlier or three years earlier, we were at 50 basis points. And remember when we were at 5%, what the world looked like.

The debate wasn't, how much is the Fed going to cut? The debate was, doesn't the Fed have to hike more? The inflation fight back then did not look like it was over. And the debate was, Powell has got to get going and hike more. Now the debate is, he's got to cut more. So it'd be hard to retest those highs. So even though its 83rd percentile, not a 100 percentile, fine, we missed the highs. But it's still historically very attractive, firmly in the cheapest quartile in its history.

And it's similar story for the Global Agg or munis. You see the munis there. And even emerging markets in dollar space are pretty attractive. Now, myself and my PIMCO portfolio manager colleagues, we don't just look at yield. We're not just like, oh, yields are great. Let's go buy more of the bonds that are in the index. I already trashed that strategy, didn't I?

So what we try to do is say, where's the yield coming from? How much of it from the Treasury component? And how much is it for the spread that you're getting compensated for taking credit risk? And that's the bottom four rows. And this is what I mentioned before about some dispersion in the market. Remember, I said, uncertainty, volatility and dispersion are the fertile backdrop for an active manager to generate some alpha. We've got dispersion.

Check these four rows out. You've got the high yield. Let's start with the bottom, high yield credit, the riskiest parts of the public, corporate world. BB-, BBB-, CCC-rated bonds are trading eighth percentile. That means 92% of the time over this time horizon, the spreads were more attractive. You're getting paid more in spread to take that risk.

And then investment grade corporates not much better, 19th percentile. So they're both firmly in their richest first and second decile in history. Now, we've got a big opportunity kit. I already said, if I want to beat the Agg, I could go buy a bunch of

high yield, buy a bunch of BBB corporates. But that strategy doesn't look too attractive right now to us, given where they're trading at these starting valuations.

Go a row above, the third one from the bottom, AAA Securitized. My colleague Dan Ivascyn talked about this, how much we like lending to the US consumer with their house as collateral, given how strong the consumer looks, how good their balance sheet looks. Loan to values on their mortgages are pretty low. They've been saving a lot. They've got good job prospects. So lent to them with their house as collateral. That's trailing second and third quartile. Do we wish it was cheaper? Of course. But it's way better than being in that richest decile.

And if you go one row above that to agency mortgages, these are the Fannie, Freddie, Ginnie-guaranteed mortgages, government guaranteed, they're firmly in the cheapest quartile. So someone like me, who's building a diversified portfolio, can figure out what's attractive? What's paying us for the risk we're taking? What's not paying us? And build you a portfolio. So it's no surprise, we're up in quality. The AAA Securitized, those agency MBS or AAA. I guess, I can't really say AAA there because the government has two AA pluses. So AA plus because they get their rating from the US Treasury.

But you get the point. So it's no surprise that a PIMCO portfolio is really overweight the high quality. And by the way, those high-quality parts are the most liquid. Should something bad happen in the economy, something bad happened in stock market,

something bad happened to high yield, and those high-yield bonds and those corporate bonds reprice to something more attractive, we've got a lot of flexibility and liquidity in our portfolios.

Ken Chambers: An opportunity to certainly go on the offense. Having that high-liquidity profile is really, really important. All right. Let's be quick here and talk how to access the market. Danielle, we've talked about attractive prospects [INAUDIBLE].

David Braun: One thing I didn't mention is some of the parts of the market we're not too keen on. Take one second to jump on that?

Ken Chambers: Please. Please.

David Braun: So, look, we went through a really interesting path here. When you think about the all-time lows and rates in 2020 and 2021, it forced a lot of investors to get out of their comfort zone. Rather than buy a bond fund yielding 50 basis points or 100 basis points, go do something else with your bond proxy money. And a lot of that money went into floating rate-type products that had a lot more credit element to it, so like levered loans, a lot of direct lending, a lot of these floating-rate vehicles that kind of soaked up what normally would have been in a high-quality bond fund.

And it actually worked out wonderfully for people. In 2020, 2021, you had a lot of spread in there, a lot of credit risk in there. It worked well. And then you sidestepped

because you floated your rates up. And you have duration when rates rose in 2022 and 2023. So you had a four-year winning streak on those strategies.

Now, the negative of that is, again, it's floating rate. So we know rates are coming down and they're tied to policy rates. So that yield on those strategies is coming down one for one. They're also less liquid. They're also lower credit quality. And we all growth is slowing and unemployment is rising. So we look at that and say, it was a good trade for the time. Those of you who did it, congratulations.

But you might want to consider, as those yields are coming down, as they're closer to taking capital losses, should we not have the soft landing, should we have a hard landing, these structures are relatively untested and perhaps have seen their better days. So again, we're moving up in quality, out of subordinated position into more senior positions, out of less liquid and complex positions into more higher quality and liquid position where we can be nimble and cultivate the opportunities of active management that we would expect to continue.

Ken Chambers: Dave, a really important point, aligns exactly with what Danielle highlighted, too, that idea of there is credit risk out there. Complacency is not OK. It has the potential to be tested. And so thinking before it gets tested is really, really important, especially if it was a winning strategy. It's a time to potentially be active and think through what maybe the next four or five years are going to look like. Probably not the last four or five years, just given where we're at in the cycle.

I do want to touch a little bit on how to access the market. Danielle, we talked about the attractive prospects of fixed income. Let's talk about vehicles that investors can actually access this opportunity set. Maybe you can detail mutual funds. Can you talk about maybe features and benefits of mutual funds that are fixed income?

Danielle Fox: Sure. And there's really three main vehicles that one could consider in the fixed-income space. Owning an individual bond directly or outright, a mutual fund, which is a pooled investment, more often than not, perpetual in nature. So at some point, you'll go in and sell shares. And an ETF, or exchange traded fund, more often than not, a perpetual investment, pooled investment for which you'll go in and sell shares and rebalance at some point.

So I would encourage and invite clients again to think about-- it's not, I do this or I do that. It might be a combination of all three.

While I have capital markets experience, I was never an analyst. And I see the value in that. And I don't want to diminish the role of someone much smarter than me determining whether or not that A-rating on a corporate bond is actually legitimate or not. No disrespect to Moody's and S&P, but you want to have a second set of eyes and an internal rating.

So if I think about a mutual fund, it's probably in those maybe less liquid parts of the market where I'm not as comfortable doing the research. And when you think about how to own fixed income, you're also accepting an unknown rate of return. And this

goes back to something that David mentioned earlier about that defensive positioning. If you give a fund or an ETF enough time to do its job, it will. But the hardest part is giving it enough time to do its job. Showing patience, that may be the hardest time, which many of us may have experienced over the last couple of years in a rising-rate environment.

When I start to think about whether or not I prioritize a fund versus an exchange-traded fund, it's, do I place a high value on intraday liquidity? Being able to sell it at 1:00 instead of waiting until 4:00? And/or being able to place a protective order on a position to protect a gain or potentially limit a loss. And I might do that in parts of the market where there might be more volatility to it. So there's always different ways to access the market.

And again, it's, where do you trust yourself? And where should you delegate and hand the keys over to the car to someone else? And really taking personal inventory on what your strengths and weaknesses are. Because with an individual bond, if I buy that, I know exactly what I'm getting and what I'm getting it, assuming the issuer remains solvent, which in some parts of the market is not insignificant, as an asterisk. But you do want to think about that credit-risk mitigation and who should be involved in that. Is it just you? Or you and someone else?

Ken Chambers: Right. You always kind of have that self-doubt at times. And so also having that steady pair of hands, some experience and, I think, the bottom-up credit

research. And Dave touched on this, the optimization of different securities and asset classes, bringing it all together in a portfolio, it certainly is important.

I think about ETFs. Dave, I want to get your perspective. We've been running active ETFs at PIMCO since 2007. You lead our BOND ETF $5 billion strategy, meant to be essentially the ballast of an overall balanced portfolio, diversify, equity, risk. What are some of the features, benefits of ETFs for investors to gain access to the market?

David Braun: So, look, at PIMCO, we feel we have a very good investment engine in the public bond space. And that leads us to be relatively vehicle agnostic. So when ETFs started to make their way into bonds 15, 20 years ago, we said, hey, if there's a growing cohort of investors and advisors who like ETFs, for whatever reason they've concluded-- they like ETFs more than 40 Act mutual funds or SMAs-- and we have a good mousetrap over here on investing bonds, let's get involved.

And so BOND that I run, we launched in 2012, so 12, 13 years ago. And MINT is even older than that, the front end one that Jerome was talking about. So the moral of the story is at the end of the day, the vehicle, the ETF versus the SMA or versus the mutual fund is just a wrapper or a vehicle. And we're trying to do the same active management trades and styles that we can do in there. Obviously, with an SMA or a ladder portfolio, a little harder to be active, but you get the point.

Now I understand. And I go on the front lines with a lot of you and hope to go on the front lines with more of you and meet both advisors and investors to understand your

likes and dislikes. But what I hear a lot of people liking about the ETF and-- I put my money where my mouth -- is the daily transparency. You can see what's going on in the fund. The ability, if you need some money during the day or you want to do an asset-allocation rotation, you get done, as Danielle said, at 1:00 PM rather than wait for the close and then invest the money tomorrow. So those things are nice. The people like that.

I think there's also opportunities, it says right there, to make the ETF trading style and the way it's managed a little more tax efficient than perhaps in a mutual fund. And just lots of good characteristics there. But again, at the end of the day, what we're trying to deliver people is better bond outcomes via our active management and work with folks like Danielle and others who are on the front lines to come up with the expressions of that via the vehicles it's in that's best for their end investors.

Ken Chambers: All right. We're rounding third. We're coming home. Last two questions, then we're going to open things up a little bit. Danielle, we've discussed characteristic of bonds, how to access the bond market, what to look for in an active manager, as well as different ways to access different fixed-income offerings. Let's lastly turn the conversation to now focus on what responsible bond ownership. Looks like once you've created that portfolio or made that investment, how should an investor think about that allocation on a go-forward basis?

Danielle Fox: So looking around and saying, OK, now what? Because you put all this time and energy in and you think, all right, I'm done. And the answer is, no, you're not. So one of my core business beliefs is around having an exit strategy. And if you don't have one, hire someone who does. And that is in particular with risk assets, things that can default on you, whether it's emerging markets, corporate bonds, investment grade or non-investment grade municipals, all of that fun stuff.

You don't want to stick your head in the sand and assume that your AA-rated municipal bond or your investment-grade corporate bond is going to stay that way for the longevity of its life. So monitoring whether-- for example, if you make the choice to go into individual bonds, I, on my Fidelity account, get alerts when potential credit quality changes are going to happen. It's a way for me to stay on top of things without having to look at each bond position every single day. And I have an exit strategy related to credit. Even though I wasn't a credit analyst, I got to protect myself from myself.

But then when I start to get into the more interesting or spicy parts of the bond market, I'll pick an active manager. And then you're getting into, where are we in the business cycle? And do I still want to have that type of exposure? And so whether it's quarterly, semiannually, annually, having some type of rebalancing responsibility to say, all right, my high yield had a great run over the last year or so. Do I need to pare

some of this back and put it elsewhere? Because I'm worried about where we are in the business cycle.

Those are things around responsible bond ownership, particularly when you get into more segmented funds or very specific parts of the market that are sub asset class specific as opposed to broader in nature. Like, if I'm in David's fund, I'm going to let him make the decision on when to be overweight or underweight mortgage-backed securities and take on duration and all of that fun stuff. So again, it kind of comes back to, where do you see your responsibilities? Like, what can you sustainably be responsible for? And then where should I consider delegating or kind of giving the keys to someone else, so to speak, for that?

Ken Chambers: I love that idea of don't just put your head in the sand. It's important to look around and understand what's going on. It's important to have a plan and then work that plan, check in with things. Don't be complacent. All right, Dave, last question to you. You're constantly adjusting and really optimizing portfolios for value in the market as it interchanges. How should investors consider positioning themselves for today's market? And what should they look for in the future?

David Braun: So look, bonds have had an interesting past couple of years. And clearly, the higher rates are behind us. Fed funds are likely not going back to 550. The 10 year is likely not going back to 5%. So we could all sit here and remiss that we miss

the highs. But bond yields, as I tried to illuminate earlier and my colleagues on the earlier session tried to illuminate, are pretty darn attractive at these levels.

And as I tried to illuminate earlier, often high-quality bonds, at least historically, have come with a third of the volatility of stocks and a much more muted drawdown, with 2022 being the one exception. So the moral of the story is we think bonds are very attractive here. The cash trade and some of these floating rate, more levered, lower quality private vehicles have had a nice day in the sun, but we think that's behind them as the Fed normalizes policy rates. We went from 5 and 1/2 to 550. Those floating rate securities are going to come down one for one with that.

And then make sure you underwrite the manager and what the strategy is. Again, our strategy right now is to be up in quality because growth is slowing. And the up and quality stuff is offering a little more meat on the bone in the terms of spread than the lower quality stuff, at least on a historical context, and have a lot of liquidity in the portfolio because we think the next couple of years are probably going to be as bumpy and uncertain as the last couple of years were.

And then we also would encourage people to really focus on an active manager in the core bond space because this type of environment, again, with major dispersion across the globe, dispersion across one's opportunity set, a lot of uncertainty on the horizon. Economic outlook, geopolitical, political outlook is uncertain. That breeds volatility. And that creates the backdrop that we active managers hope for because

that gives us a chance of making good alpha and beating passive managers and beating benchmarks. So that's my story.

Ken Chambers: That's great, Dave. Let's leave it there. Dave, Danielle, thank you both for joining us today. Your insights have been fantastic. Look, we covered a lot of ground today. A consistent theme from the discussion here and the previous sessions really centers on the value proposition of bonds or fixed income really as an asset class because of the attractive yield profile and, importantly, because of the defensive qualities in a balanced portfolio.

To help bring this together, the themes, actionable solutions, we have available for you to download the PIMCO Investment Solutions Guide. Danielle is going to walk us through additional resources available through fidelity.com. But as we close, speaking for Dave and myself, thank you for taking the time to watch this session as well as the previous ones. We hope that you have a great day. Danielle, maybe I'll turn it over to you to walk us through fidelity.com.

Danielle Fox: Sure. I'll do, in the interest of time, kind of one quick round Robin here. So if today's conversation has inspired you to want to dive in further-- you'll notice I'm sitting on Fidelity's website, fidelity.com. This is something I'd be signed in for. But where I am is News and Research and then Fixed Income Bonds and CDs. And the reason I wanted to come here, if I scroll down, this is really a wonderful

springboard into the last few topics that we talked about. Like, how do I want to own the market? Individual securities, mutual funds or ETFs?

So what you're looking at here is a chart organized by both time and perceived credit risk in terms of the investment-grade landscape, both taxable and tax exempt. But let's say that feels a little more than what I want. And I want to explore the mutual fund and/or the ETF space. So you'll notice that there are tabs running from left to right across the top of this yield chart, which allow me to access those alternative investment vehicles as opposed to direct ownership.

So given that we've got David here, let's go down the ETF space here and say, all right, now I'm looking at different categories that Morningstar has. If I wanted to, let's say, isolate ETFs that are intermediate in nature, and then let's add that active overlay to it, you'll notice with a handful of mouse clicks, I'll actually be able to distill this list of available ETFs down to something far easier.

So I clicked on intermediate core. One thing that we didn't touch on a ton today in the ETF space is this is organized by net assets. So liquidity is oftentimes influenced by the size of a fund and how actively it trades. So you don't want to sneeze on that when you're making a consideration. But if I wanted to look at, for example, an actively-managed ETF, if I get my notes out of the way here, and I use the Search functionality here on the left-hand side to isolate Actively-managed Bond ETFs, I've now taken the universe of intermediate ETFs.

I'm isolating those that have a person or persons managing them as opposed to index based. And I've now got a list of securities that I can now start to add additional screening criteria to. You can do something similar on the mutual fund side. So if that's indirect ownership, via management, whether it be a fund or an ETF is your speed, this is a great way to go about doing it.

Ken Chambers: That's awesome. It's great to see all the different options and ways to work through that. Appreciate you walking us through that. Thanks so much, Danielle.

Danielle Fox: No problem. My pleasure.

Ken Chambers: All right. I think with that, we'll wrap up this session. Again, thank you to all that are tuned in for not just this session but the other sessions prior to this. We appreciate the partnership with you all. And we hope you all have a great day. Thank you.

Danielle Fox: Thank you, guys.

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