All the Credit® Episode 33

Transcript

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Female Voice: You're listening to All the Credit, a monthly podcast series brought to you by PGIM Fixed Income an active global fixed income investment manager. And now your host senior portfolio manager, Mike Collins.

Mike Collins, CFA, Host and Senior Portfolio Manager, Multi-sector Strategies: Hello. Welcome to Episode 33 of All the Credit, PGIM Fixed Income's monthly podcast. I'm Mike Collins, just one of the many investment professionals at PGIM Fixed Income and your host of All the Credit. Throughout my entire three-plus-decade long career and probably for the entire lives of many of the loyal listeners of All the Credit, long-term interest rates in the US and throughout much of the developed world have been falling. The yield on 10-year treasuries peaked near 16% just over 40 years ago and hit a recent low of just one-half of 1% just 2 years ago in the summer of 2020. Accordingly, the federal funds target rate went from 15% to zero during that period. In fact, the funds rates spent most of the last 14 years pegged at zero or some call it the "zero lower bound." Of course, in some jurisdictions like the Eurozone, that zero lower bound did not apply, as central bank policy rates were trapped in negative territory for most of the past decade. Now, fortunately for many of the clients at PGIM Fixed Income, we've mostly been on the right side of this trade, oftentimes adding duration following spikes in interest rates throughout this long-lasting bull market in bonds. But now for the first time in decades, long-term interest rates have broken out of their steady downtrend to the upside. The 10-year treasury yield and its European counterpart are at their highest levels in over a decade. The federal funds rate may soon flirt with 5% for the first time since 2008. So, the big questions hanging over the bond market are, is today's interest rate environment a new paradigm or are we just simply going back to the good old days when interest rates and inflation spent most of the time well above zero? Was that nearly 15-year period of super low interest rates the aberration? Will that period of zero and even negative policy rates end up being viewed by bond market historians as a failed experiment never to be relived? Or is this recent surge in interest rates just a cyclical, inflationary blip? And will we find ourselves right back in a prolonged era of ultralow interest rates and incessant quantitative easing? And this episode of All the Credit, we'll review the events that put us down the path of ever low, lower interest rates. We'll discuss the conditions that powered the decades of disinflation, delve into that era of ultralow interest rates and try our best to seek answers to all those questions above. And we are really fortunate to have the perfect guest for this deep dive on interest rates. Robert Tipp has really been one of the visionary architects of the low for long interest rate view at PGIM Fixed Income and is undoubtedly our firm's de facto bond market historian. Robert has a knack for thinking outside the box, as they say, and seeing new paradigms that others do not. Personally, I have been blessed to have worked side by side with Robert for practically my entire career in Fixed Income. So, as a proper introduction, Robert Tipp is the Chief Investment Strategist and Head of Global Bonds at PGIM Fixed Income, responsible for co-managing our global multi-sector strategies and overseeing the global rates positioning across many portfolios. Mr. Tipp has worked with the firm for just over 30 years and previously held stents at First Boston, the Allstate Research and Planning Center and Wells Fargo Advisors. Robert received his Bachelor of Science and MBA degrees from Cal Berkeley and also holds the CFA designation. And Robert and I are here to give you All the Credit. Robert, welcome to your second appearance on All the Credit. And thank you for your decades of leadership and investment insights that we've all benefited from.

Robert Tipp, CFA, Chief Investment Strategist, Head of Global Bonds: Hey, Mike, thanks a lot for that illustrious introduction. I'll see if I can rise to it and add some value here.

Mike: Yes, rise to it like interest rates have been rising lately. So, why don't we just set the stage, you know? Like I said, we've kind of lived our careers in this 30-plus year bull market. And again, generally our clients and our portfolios have benefited from that. Why don't you just go through the kind of history of that and how our views on interest rates have progressed through those last couple of decades?

Robert: Sure. Thanks, Mike. I'll go through this in three bites of the declining and the low for long, and low for longer, and lower and lower for longer and longer kind of stories. And when you and I, in the '90s, were looking at this and yields were coming down from the eights, you could look back over the centuries and see that interest rates on high quality bonds and developed economies had typically been in the 4 to 5% area, unless something unusual is going on. Like a Napoleonic War where your credit quality was in serious jeopardy, the yields might be a little higher. Or, if it was World War II and the U.S. Treasury was capping– Federal Reserve and Treasury were capping treasury yields at a lower level. If that wasn't the case, 4 or 5% would kind of be the level. And in the '90s, there are a lot of reasons if interest rates could come down, we've looked at demographics and other factors. But these were anomalously high rates. There was a lot of carry in the curve. They were positive. It was a diversifier. It can be long duration in a portfolio relative to the credit risk in the portfolio. It was all signals go. And rate should clearly be on their way down, certainly to 6% or lower. So, that's bite number one. Now, in that bite number one, I noticed a couple other things historically as we're going through this one. Inflation was not particularly natural. As fiscal stimulus came into the fore and ongoing social safety nets came into being in the 20th century, you went from negative inflation rates, steady negative inflation rates to mildly positive. So, that's something to keep in mind as we move into higher and higher ongoing levels of budget deficits, that you're going to get a little bit higher inflation over time. But now as well looking back at those historical periods, something else we'll come back to, is that if you look at the roaring '20s or you look at the strong growth in the 1960s, those just happened to be periods right after pandemics – Spanish Flu, 1957 Global Flu. You know, people tend to be pretty aggressive in their consumption, economic behavior post-pandemics, little bit more inclined to enjoy life and less likely to want to go and work. And that was actually consistent in previous periods. But anyway, easy call, bite number one, down to 6%. Now in 2003, we're coming out of a recession and we put out that piece economic recovery creates opportunity in bonds. You're backup at the 6% level. And looking back over the previous decade, it was pretty clear that a 6% level in rates had been strongly disinflationary. And that could be owing to the end of communism and China coming on to the World Trade Organization (WTO) stage, you know, all these different things. But anyway, it was disinflationary and a more likely destination for rates was probably in the 3.5% area for the 10-year treasury to get inflation to stop coming down. So, that's bite number two. Bite number three, 2013, rates had been lower and they sold off in the taper tantrum. And we took a look at this and said, "You know, actually, we have an inflation target now in the United States." And inflation is still coming down. If they want to keep inflation up at 2%, you're probably looking at in this post global financial crisis environment (GFC), all things considered, you probably need rates under 3% for the foreseeable future. And those were kind of the three bites. And we were in that realm, post-financial crisis through the European sovereign crisis where they locked their rates into negative territory with a quantitative easing (QE) infinity as of 2019. And the Fed was looking at personal consumption expenditures (PCE) of 1.6, 1.7, and they were locked at the effective lower bound convinced they needed to get that 2%. We went into a mania environment. And that is how the low and lower came into being. That last period though, 2011 to 2022, about 2% average tenure yield was very uncomfortable because honestly, the inflation and growth fundamentals were different than the prior 10-year period but yields were much lower. So, it was very clear at that point, it wasn't the demographics, it wasn't the debt levels necessarily; it was the central bankers driving this motif of this incredibly low equilibrium. And that was going to persist until something broke that cycle.

Mike: So, dive a little bit more into that low equilibrium, right? A lot of our listeners have kind of lived through that and have anchored their expectations for rates kind of at that zero lower bound and long-term rates at much lower. What kind of problems does that type of zero rate equilibrium end up making for markets and for behavior?

Robert: Right. Yeah. Well, I saw that period really as a monomania. You know, these central bankers in my opinion kind of lost their heads. I mean, if you think about it, first of all, can you run lower interest rates and get inflation up to a level just because you want it to go there? And I think Japan had pretty soundly refuted that hypothesis by taking rates to zero during QE when they started with the "Rinban" operations in the 90s and people said, "Oh, you know, if a central banker wants inflation, they can get it." Let me tell you, they were not getting it. I think common sense wise, it stood to reason that if you tell the average Japanese corporation or person that the money supply has doubled, that doesn't make them want to go and pay 2x for a coffee or borrow money to go invest. Because what they see on the ground is that the fundamentals of the economy do not drive a positive inflation level there. So, developed market (DM) governments, they have credibility. Increasing the money supply, it doesn't do it. And so, it didn't make sense from that vantage point. The other thing though was this perception that if low rates, you know, if you drop interest rates from 6% to 3%, you're in a recession, people go out, they take mortgages, the interest rate sensitive sectors of the economy rebound, you can get growth back. I think all economists would agree, that is a short-term solution. And you can run countercyclical monetary policy like that, but that's not really what we were seeing. We were seeing a secular policy of this. And that struck me as ludicrous because you're basically saying in the case of Europe, we know you're an ageing population or in the case of the United States, an aging population that's dramatically under-saved on average. And what we would like you to do is instead of saving, we would like to motivate you to borrow more money to boost the economy now so we could get a higher rate of inflation. And I think the average person would look at that logically and say, "Well, actually, if I want to retire ever, I need to save more money. And if I'm a retiree and I was spending based on my income of a 4% or 6% annuity, I'm not going to get anything off of my savings now. And so, I need to spend less." And so, I think they were missing the notion that when you go from countercyclical to a chronic low interest rate environment, you are discouraging people from saving which reducing the savings stock is not going to be good for productivity which is the real way to increase human welfare. And they were running a policy that was, to my way of thinking, an unnaturally low of interest rates that took them away from what the economies needed which was higher savings. And for people to think about their futures and save for that as opposed to trying to get a higher inflation level which I think anybody would have told you they did not want. So, I think that was a maniacal period. And the question of what could get us out of that but I thought that is a very dark period that hopefully we're not going to go back into.

Mike: Well, good. Well, thank you for that history lesson. I promised you guys, you'll get a little bit of a history lesson from Mr. Tipp. And maybe we can check the box on that that was hopefully a period that would be viewed as being a failed experiment and let's hope we don't go back to that because that's a brutal world for almost everybody. So, let's fast forward, Robert, to today, right? We have this really volatile macroeconomic backdrop, a tremendous amount of uncertainty in terms of growth and inflation, interest rates, credit trends. There's this big debate even in our shop between the hard landing and the soft landing. What is your view and how would you expect the global and the U.S. economy to play out over the next few years from a macro perspective?

Robert: Sure. Well, I agree with you, it is wide open and that's why we're debating it. And I think on the interest rate front, the thing that would get us out of that environment and then the question about what kind of environment we might get, what it would do to the rates, you needed to get a huge increase in growth. And it had to be one where the central banks would not keep the interest rates down. So, like in a world war, you have a lot of fiscal spending, a lot of growth but the central banks will depress the interest rates to keep things humming. The boost from COVID-19 fiscal and the psychological positive of people coming out, spending money and traveling has taken us into a boom with high inflation. And that has gotten the Fed behind this. And that has sparked the hard-landing fears. So, where do these hard-landing fears come from? And there is a consensus among the economic community and a preponderance even in our shop for folks who are looking for this. And this is because there's not a lot of data with cyclitic experience successfully bringing high inflation down. And when it's been done successfully and definitively, that's typically required a recession. And so based on that, it would make sense. I think the question in my mind is: that a fair comparison? Because when you look at a period like the early '90s or you look at a period like the early '80s, you had a very different backdrop, you had underlying problems in the economy that brought you that distinct recession. So in the '90s whether it was emerging market assets or commercial real estate assets on bank balance sheets, in the early 2000s after the tech bubble burst, you had had overinvestment in technology, in fiber optic cables at the bottom of the ocean, you know, all these things that brought really deep recessions. And then you had widespread financial fraud after the '02, '03 recession. Those were the things that I think after the Fed had brought on these recessions, made them so severe. So, looking at the economy now, we're post-financial crisis, financial institutions are very well-capitalized. Lending against real estate has been pretty conservative. And, you know, we've had a lot of volatility lately which, yes, the higher rates are definitely stopping the real estate market kind of in its tracks, it looks like, on a global basis. But aside from that, the rest of the economy seems to be kind of making up for it. And the appreciation in real estate prices was that fueling growth, was the appreciation of the stock market fueling growth, was the fiscal stimulus fueling growth. Well, we're starting to get incoming data that says the economy is growing moderately and that none of those things have stopped growth. And frankly, the high inflation which has been higher than wage growth, that has not stopped growth either. So, this might be a pretty robust economy. And even if we do get a slowdown here, we get a pause from the central bank hikes while they tried to get inflation down, you know, it may be one where corporations have not been able to over hire and maybe they're not aggressive in releasing staff, in firing. So, if you get the landing, the recession, maybe it would not be that deep, would be one thing I would throw out there. The other one is that the reason you get a hard landing is because the inflation doesn't cooperate. And right now, there are a lot of forward-looking indicators that say inflation is going to cooperate. A huge part of inflation is rent and home prices are not going up. And in some places, people not being able to buy is pushing up rents. But I think the Fed, you know, is going to look pretty hard at this data before assuming that falling home prices is inflationary. So, I think you can maybe check the box of that huge chunk of PCE and consumer price index (CPI) is going to be waning as a threat. The core goods element that was really being pushed up by supply chain disruptions, both the demand side and supply side, they are our principal component analysis, and also, these cruder messages–these other indicators, just your supplier delivery times, all those things seemed to be improving dramatically suggesting that core goods inflation should be coming down when in fact in this most recent CPI core inflation, shelter, food and energy, that was a -0.1. So, I don't think we're dropping into deflation. But it wouldn't surprise me if those things leveled off and frankly even commodity prices. There was an incredible rise in grains, in energy prices. And maybe some of that was a result of the Europeans gunning up the price of energy to get their storage levels up. And with a little bit of luck on the weather side and so on, maybe we're not going to pass those prior peaks which essentially means energy prices and commodity prices are now in deflation. So, if the inflation backdrop is easing up, then all of a sudden, your central banks are going to move right to the sidelines and say, “We don't have a reason to slow this down.” So, the hard landing is definitely out there. If these inflation numbers reaccelerate, they're going to bring on the hard landing if they need to, to get the inflation down. But it strikes me that the economy shows a lot of resilience, number one. And number two, in the back of my mind, there's that historical reminder that you're coming out of a pandemic. This is not a normal period and people may be pretty resilient in their economic behavior. Maybe a little bit more than you'd expect.

Mike: Yeah. I mean, I'm looking, Robert, at long-term inflation expectations embedded in markets like the TIPS market and they are falling, man, they are going toward, 2%. And obviously, the Fed pays a lot of attention to that. And in terms of the hard landing versus soft landing, it does seem like there's this kind of dissonance between the macroeconomists who see all these traditional indicators using past experience that, “Hey, maybe this will be a hard landing.” But when you talk to our 130-plus analysts and look from the bottom up, and I kind of put myself more in the fundamental analysts camp, looking at companies and industries and even some of the big cyclical sectors that have caused problems in the past, they're actually in pretty good shape, right? They're not over levered. They're not overinvested. They're not over inventory. They're not over their skis. I mean, you know, it's actually hard to find big industries that are going to have big problems to cause, you know, like an existential credit crisis and a lot of defaults. So, that's where the soft landing I think has a lot of merit. So, thank you for that. On the future path of the funds rate, right, and what that means for interest rates. Let's just say inflation does roll over from 5% to 4% to 3% and who knows, maybe lower and growth hangs around 1%, or 2%, or 2.5%, or whatever kind of a normal growth range is. And what does that mean for the future path of the funds rate? Is our old range of 0% to 3%, you know, a bygone of another era? And what is the new range on that funds rate for the future? And what does that imply for the likely path of longer-term rates?

Robert: So, until we got to COVID-19, we were locked in a just below target inflation level all around the world. And these central banks were locked at the effective lower bound and that brought you to that kind of 2% neutral 10-year treasury level. All that stuff is gone. And now, I think what we have to realize is that every Fed funds rate hike cycle of the last 50 years, except for the 2018 cycle, ended above 5%. You know, economies can be very resilient with a 4% tenure. And so, I think that's what we're seeing. I think that across a wide range of scenarios that 4% tenure, maybe 4.5%, maybe 3.75%, but that area is going to be very sticky. I think you could envision that. Let's say things turn out to be hotter than expected. The Fed, they get to 4.4%, they're there for a while, inflation is not coming down but real estate is really slowing down. And they inch their way up towards 5%. I don't think the tenure is going to be that much higher than 4%, you know? If they get to 6%, 6.5% then yeah, maybe you're pushing upwards 5%. But I think there's going to be a real gravity there where people are going to recognize that that's temporary and cash rates that get up above 4.5% are going to pull money out of the economy, right? And so, that's going to keep that expectation down there. So, in terms of the bond market, I don't find that to be an incredibly threatening environment. I think that, you know, you're going into this, if you're going into the average corporate bond with 6% yield or whatever, you're in the mid-single digits or you have a reasonable amount of cushion there that over 2 to 5 years across a wide range of rates scenarios, you're going to have a pretty significant positive return. Now, are you supposed to go into cash and try to hoover up a 4.5% Fed funds rate when the tenure is only at 4%? I think the thing that we've always seen with that historically, is that 5 or 10 years from now, you're going to look back and see that this was a peak growth level coming out of COVID-19. This was a peak inflation level with a war and all these unique elements. 5 or 10 years from now, growth and inflation are going to be lower and rates are going to be at these levels or lower. And strategically, fixed income is probably back. So, I think in those kind of overheating scenarios, you're going to be sticky at 4%. But I think the same thing is true in the softer scenarios. So, if you fast forward six to twelve months, like you said, and if growth is zero or inflation has dropped down to one of those soft scenarios, and the Fed has cut interest rates to 2%. I mean, you would have 150 basis point positive curve in the 10 years at 3.5%. I think what we've seen historically is that slower growth, not a recession, but slower growth can actually be very kind to credit spreads. 2017, 2019, those were years when the economy began to really take a break and get policymakers paused. But, you know, spreads did well as fixed income got a bit in the search for yield, got a bit and like you said, from the bottom up, can you find good credits, can you find opportunities in there that look pretty recession resilient? I think you can. So, I think that backend of the curve is going to have a lot of stickiness in the 4% area. Stronger economy, you invert more. Weaker economy, lower inflation, you get a positive curve. But that long range return potential I think is there, you know, based on where the yields and the spreads are.

Mike: Yeah, that's a great point about the flat and inverted curve, Robert, right? And this is a point we make a lot, and a lot of our clients, especially retail clients, their knee-jerk reaction when you have a flat or inverted curve is to go into cash. And the message we've been telling them is when you do that, you're actually taking a lot of interest rate risk because, yeah, you might earn a four-handle yield today but that could go away really quickly. And this is actually an environment when you have a flat curve to extend the ration more often than not and take advantage and lock in, like you said, these higher interest rates. So, that's a really important point I think and really helpful message for our clients. So, I know this is kind of maybe a red herring but a lot of people talk about it, you know, the Fed loves to talk about it, we love to talk about R-star, or the real neutral funds rate, right? And some people think it should be zero, right? I mean, why should you get a positive return over inflation to sit in treasury bills (T-bills) for example? I know the Fed thinks over the long term, their neutral nominal funds rate is 2.5% and the inflation expectation is like 2%, so kind of a zero-ish, maybe slightly positive, real funds rate. But do you think that matters or where would you peg that like on average for the next 10 years, that real neutral funds rate?

Robert: Yeah. So, I would think in the zero to one, you know, is probably the zone dependent on a lot of factors. But, you know, if you think about it, one of the things you and I have discussed over the years is especially going back into the '90s and the early 2000s, we'd say, “Well, we had that view that rates are still too high, they got to go down.” The notion was this idea that was out there with the Taylor Rule and so on, that you should get a 2% or higher real yield on cash. That was ridiculous that you should–for having all the liquidity in the world and absolutely no term structure risk, you probably should get zero real return. And maybe even you're shocked to pay for that. And, if the central banks are trying to create inflation. So, I think there is a notion there that you're not supposed to make a killing being in cash. So, I think, you know, being in that 0-1% is probably the likely area. But like I said at the beginning, you can have a pretty wide range of equilibriums established depending on the druthers of the central bank because in the end, the economic actors are going to try to make sensible decisions even if the central bank doesn’t.

Mike: Yeah, that seems reasonable. So now, the nominal level of funds rate is contingent upon where inflation is, right? And, you know, we've kind of just gone through this really disinflationary world, you know, driven by all kinds of maybe one-time factors that you mentioned including offloading all of our manufacturing to China, taking advantage of really cheap labor and it feels like that trade is over. And there may be more structural reasons to think that, heck, maybe inflation in the next 10 years isn't going to be 1% or 2%, maybe it's going to be 2% or 3%. I mean, was that some of the concept that you would buy into?

Robert: You know, I would. I mean, I think that we've seen over time that running higher budget deficits, you know, when you are on a gold standard 1950s and earlier, you had no inflation. I mean, kind of on average or 1920s and before, but there was no ongoing expansion via the government and now, that will be a contributor. Another contributor, I think there's an element of monopsony and monopoly pricing power. So, in the labor markets, you're getting fewer and fewer employers that are pricing labor. But on the product side, that your distribution power of these global brands, people tray down across these different organizations over time as real incomes don't keep up and so on. But at some point, there's a certain level of generic brands that we all reach where you don't go below. And then once you're at that point, the retailers, they seemed to have this ability to kind of raise the prices and for that to stick. And so, I think there's an element of that, too. If you look at the number of antitrust cases that are brought over time, it's not there. And this is not a value judgment or a political statement. It may be that these companies need to be the sizes to compete globally. I really don't know. But I think it's a fact of the matter that when you go to the store on the orange juice, I mean, they have some pricing power there. That's what we're seeing over time. So between that, I think also labor has been at the short end of the stick and wages as a percent of GDP have been going down over time and corporate profit is going up. And at some point, the worker realizes they have to ask for the pay increases to match the inflation. So, I'm not saying the employers are going to pay it but it's going to be a little bit more so than it has been in the past. And you're beginning to see some efforts on the collective bargaining and so on. I think that's an element that it will eat into margins to some extent but it's going to contribute to motivating the businesses to keep a little bit higher level of inflation going on here. So, I think those factors as well as the secular ones that I mentioned earlier and you mentioned here that all these workers from the communist side of the world had come into free more market-oriented, that's come to pass and China's come way up the curve. You know, what were the benefits there? And what are the costs of now going into an environment of where the working age population in China and Europe is shrinking? And does that tip the balance on the wage side and forces employers to pay more and for them to try to pass it through? So, I think there are a lot of things that could contribute on the margin to a little bit higher inflation so whereas these central banks struggled mightily to levels like in Europe from 1% to 2%, which they couldn't do, or from 1.6% or 1.7% to 2% in the United States, which they couldn't do. And these things were going on in Australia and other places as well that now inflation may drop down to 2.5% for all we know and not want to go to 2%. And my highest and greatest hope in that case would be that the central banks suck it up. And they say, "You know, these 2% levels are actually quite arbitrary. And we need to take a little bit of a broader look at how we're managing policy here." And God forbid, inject a little bit more common sense into this. And I think the sense before was that they couldn't be trusted with it. But I think after what we saw with the negative rates and so on, I would hope that they would feel that they could.

Mike: Yeah. So, I definitely buy into your argument that a lot of the leading indicators of inflation are pointing down, right? That's the big supply demand and balance we had following COVID-19 is reversing in a big way. I mean, just listening to the earnings coming into the holiday season and listening to our analysts every morning as you do, Robert. I mean, they're worried about significant discounting. Consumers are already trading down. So, kind of inflation at some point does fall on its own weight. And the question is, you know, does it go back to 1.5% or does it stay at 2.5%? And I would add things like climate change and kind of probably more prolonged, heightened geopolitical risk. The fact that supply chains are probably going to be reengineered at some point. I mean, you know, getting all your chips from China and all your wheat from the Ukraine didn't really work out that well, right? Maybe you're supposed to diversify your suppliers more. So, all those things could arguably result in maybe a little bit stickier inflation than we've seen in the past.

Robert: Yeah. So, let me just say one thing on that inflation point. I think it's a secular versus cyclical. So, you're asking on a secular basis, we think inflation will be a little higher? Yes. But on a cyclical basis, shorter term, all the momentum appears to be coming down. And my suggestion would be think longer term. And if you go up to 40,000 feet or 100,000 feet, whatever you need to and you look down, you say, "How does this look?" I mean, in the past, you know, 3 years ago, 6 years ago, if we were doing this then, when the rates were going lower and lower, I would have said this is going to support higher and higher price earnings multiples on equities and earnings growth looked really good after the Sarbanes-Oxley cleanup, you know, earlier the century and the real yields in equities look really competitive relative to fixed income. And, you know, now that's not the case. I would say fixed income looks incredibly competitive by standards of what we've seen the last 15 years. And are bonds going to continue to underperform? I don't know. I think they're back to a level that to me looks incredibly solid. And maybe that notion I was talking about of where the wage slice of the economic pie, that you're getting a little bit of pushback there. I mean, that may cost you on the profit growth side. I think that the playing field has really been leveled out. And whereas it looked much more positive for equities relative to fixed income, now that looks balanced. And I would say fixed income strategically should be at a normal level whereas somebody could have made the case before, it didn't look competitive, you know, versus equities. In terms of credit and the credit cycle, again, I think the easier compare is credit relative to equities. And, you know, we're not priced for recessions necessarily. I mean, in Europe, it's closer to that in the credit markets. But over the last 10 years, if you look at where spreads have been, they are wider than average. And 150 over kind of spreads in the U.S. and 200 in Europe, that's a lot of value for investment grade credits where the odds of default in the next however many years, they look really low. So, I think that tactically it's a really tough call whether you're going to have that hard landing or not. There's a huge consensus on the hard land and which makes me a little bit skeptical. It does not completely seem to be aligning with the data. But as we've seen, inflation can be very stubborn and can make a comeback to bring that on. So, I think it could be a tough six months. But even in that hard-landing scenario, 12 to 24-month outlook for credit. Well, by the time you get to the far side of that, your structured product, your investment-grade corporate bonds, all those things are going to be benefiting from a Fed going towards an easing posture and a steeper curve. And the excess return cumulative over that to 24 months is highly likely to be positive. And the fixed income return spectrum is decidedly positive. So I think short term would be a difficult crux point. 12 to 24 months, the outlook looks good. And then like I said earlier, if you go out five to 10 years and look back, if you're getting cautious here, shortening duration, reduce the exposure to 5% or 9%, you know, high yield, looking back 5 to 10 years from now, it may look like, you know, pretty clear that you're at a strategic buy zone. And it was not the right time to be going, you know, in cash or T-bills and locking something in for a short period of time.

Mike: You know, people ask me, "Mike, is the 60/40 portfolio dead?" And I say, "Yes, it should be 50/50," right? I mean, maybe own more bonds. And we've seen decades in the past where fixed income has outperformed equities. And who knows? I don't know if we're in store for one of those but it's certainly much more competitive as you laid out. So, thank you, Robert, for all of those great insights. This is a super discussion. Are there any last words you want to add before we close?

Robert: No, I think you've exhausted me. You know, it looks like any good ideas I have. It looks like a pretty good strategic point to me for fixed income. And it's tougher being saddled with the short-term tactical decision on the duration on the credit but from a longer term, intermediate to longer term perspective, it looks pretty favorable to me.

Mike: Yeah, I think that's right. I mean, looking at our strategies we manage, they're yielding between kind of 6% and 8% for some pretty high-quality bonds, right? Those are big numbers and numbers we haven't seen a long time. So, I think you're right. In retrospect, people look out and say, "Wow, I wish I should have owned more of that stuff." So, thank you again, Robert, thanks for everything you do for us and our clients. And thank you for the loyal listeners out there. Remember, check out our website PGIMFixedIncome.com for all of our weekly views from the desk, our thought leadership. We have a bond blog called The Bond Blog. It's easy to find. We just put out a piece the other day called "Where Volatility Meets Opportunity for Municipal Bonds." And unlike many other high-quality bonds, municipal bonds have also taken it on the chin and they're actually offering some pretty attractive, you know, tax-exempt yields. So, keep an eye for that and thank you for listening.

[Music]

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