LOOMIS | SAYLES

INVESTMENT OUTLOOK

APRIL 2020

WE BELIEVE THE EXPANSION PHASE OF THE CREDIT CYCLE IS OVER. SEVERAL COUNTRIES ARE NOW HEADING INTO DOWNTURNS, LARGELY BECAUSE OF THE DEMAND SHOCK FROM COVID-19.

However, we have been impressed by the global monetary and fiscal policy response so far. We anticipate a broad rebound later this year on the back of meaningful stimulus recently put in place. Risk assets have already discounted much of the negative news to come and we are finding value across asset classes.

MACRO & MARKET COMMENTARY

APRIL 1, 2020

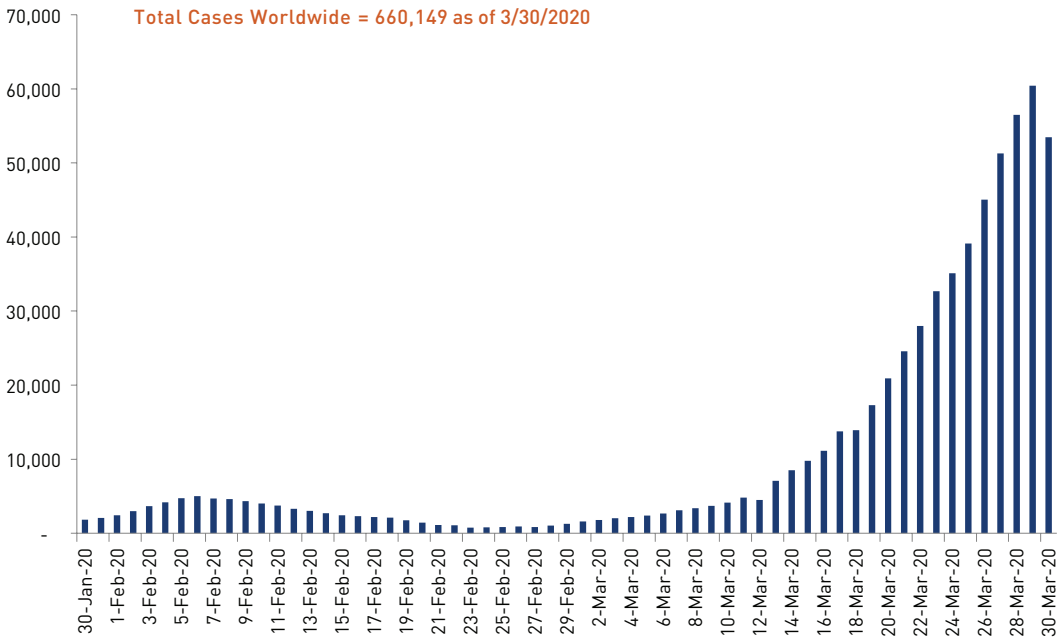
THE COVID-19 FACTOR

COVID-19 is disrupting consumption patterns and business activity across the globe.

- In our opinion, time is the single most important factor determining the severity of the current downturn. It's still too early to establish a pattern, but it seems that new cases can start to slow down about two to three weeks after a lockdown order.
- We believe COVID-19 cases in Europe may peak in mid-April. The United States has had a more muted initial response to the virus, but we expect broader control measures will be implemented in early April. As a result, US cases might not peak until early May.
- We expect it to get worse for most countries, but China's experience fighting the virus has shown us that containment measures are effective and economic activity can eventually resume.
- We have a high degree of confidence that the current downturn will be sharp but brief, as long as lockdowns reach critical mass across the US in early April.

DAILY CASES CONFIRMED WORLDWIDE*

Confirmed COVID-19 case growth is still accelerating.



Source: Center for Systems Science and Engineering at Johns Hopkins University, as of 3/30/2020.

**Data for China is adjusted for reporting differences before and after February 13, 2020.*

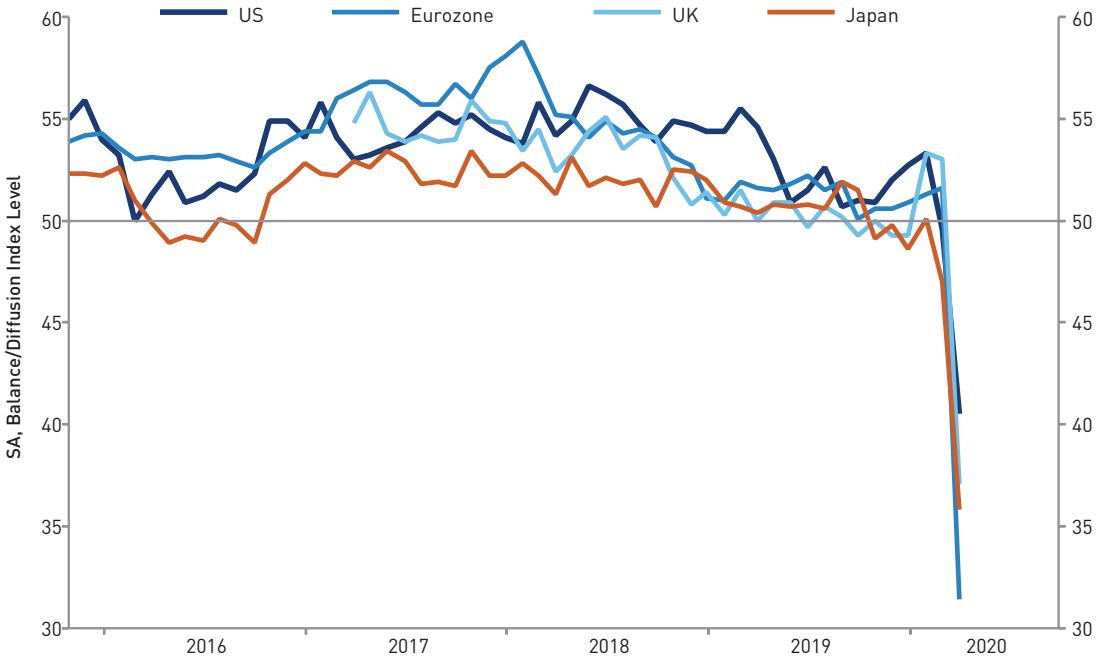
THE ECONOMIC IMPLICATIONS

The global economy is entering the downturn phase of the credit cycle, which is marked by declines in economic activity and corporate profits.

- We believe global containment measures can eventually succeed, allowing an economic rebound to take place in the second half of 2020.
- Global real GDP may inch higher by approximately 0.6% in 2020 led by China and emerging market economies.
- We anticipate a rise in corporate default rates in the quarters ahead, as highly leveraged companies struggle to operate in a macroeconomic environment characterized by manufacturing and service sector shutdowns.
- Risk asset volatility is likely to remain well above average for the next six months as markets digest the evolution of the COVID-19 outbreak and the economic damage it is causing.
- We believe the Federal Reserve and US Treasury Department will continue working diligently to help restore liquidity in US high-grade credit markets. The bipartisan US fiscal policy response came together at record speed and magnitude, especially in a presidential election year. We believe these measures will be effective in supporting economic activity over time.
- Outside the US, fiscal and monetary authorities are actively responding to COVID-19 as well. We believe the series of promptly delivered stimulus measures will limit the severity and length of this downturn.

MARKIT COMPOSITE PMI INDICATORS

Survey indicators suggest incoming hard data, like industrial production and GDP, are going to signal recession in the months ahead.



Source: Refinitiv Datastream, data as of 3/30/2020.

The purchasing managers' index (PMI) is a measure of the prevailing direction of economic trends in manufacturing.

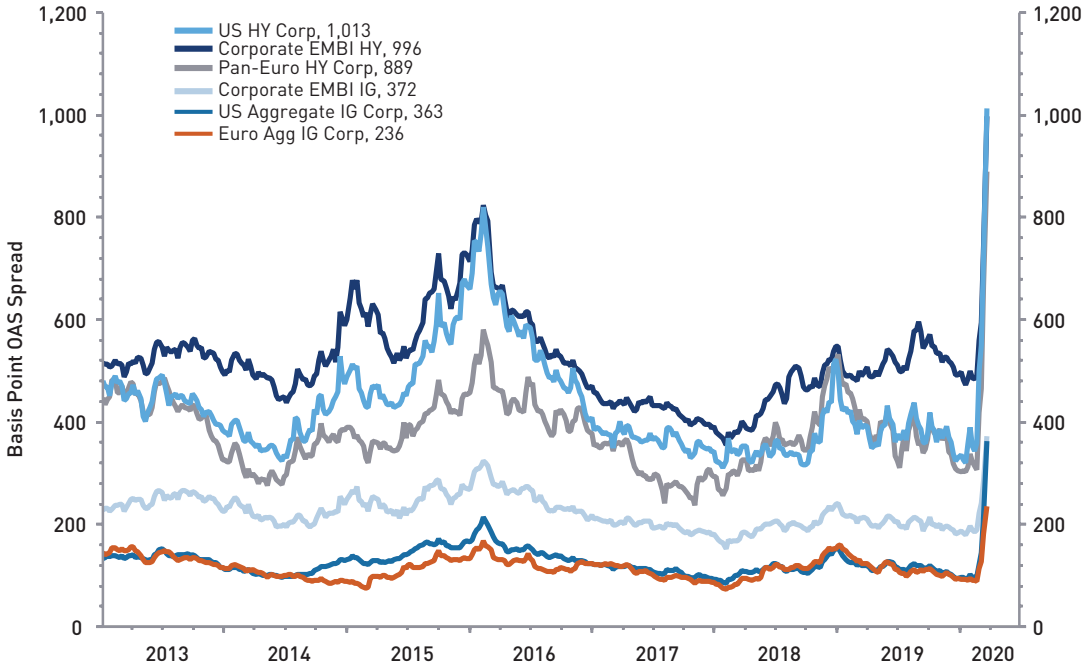
CREDIT

Credit spreads have reached heights not seen since the global financial crisis. However, we are currently finding value in the wreckage.

- Loomis Sayles has proprietary US credit risk premium models that help us measure how far prices typically depart from fundamentals during times of market stress. These models have reached levels that suggest investors may now be adequately compensated for stepping into the markets.
- It will likely take months for the credit cycle to turn toward the more favorable credit repair phase. That said, current valuations could offer some attractive opportunities, especially for active managers.
- Fiscal and monetary policies are providing tremendous support to small and large businesses in the US, but we currently expect defaults to accelerate in the high yield sector. We also anticipate credit rating downgrades in the investment grade sector.
- Long-duration corporate bonds are facing limited interest-rate risk in our view, given that we do not expect Treasury yields to rise much. The Fed has established two new programs to facilitate purchases of investment grade corporate bonds, which are typically longer-duration bonds, in the primary and secondary market. The facilities are already yielding positive results.
- The Fed is also supporting liquidity in the securitized credit market by purchasing agency commercial and residential mortgage-backed securities.

GLOBAL CREDIT SPREADS

We see value in corporate credit because we believe the market has priced in much of the downside risk.



Source: Chart created by Loomis Sayles, data from Bloomberg, as of 3/27/2020.

Past performance is no guarantee of future results.

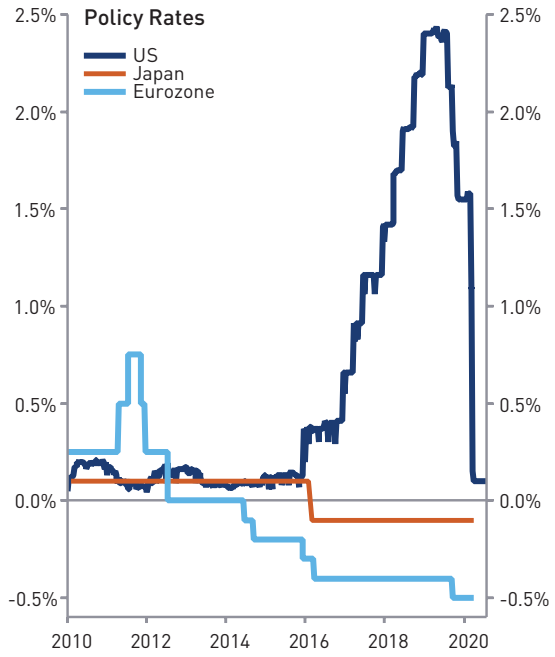
TREASURYS & GOVERNMENT BONDS

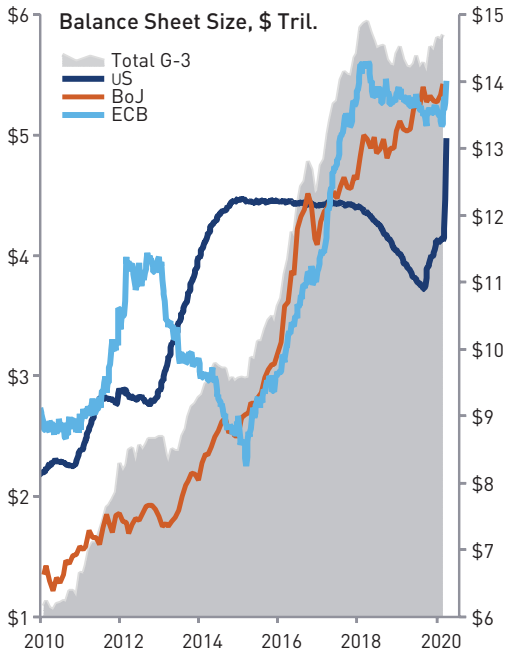
Long-term US Treasury yields continued a multi-decade downtrend during the last economic expansion, the longest in US history.

- We are reluctant to call a bottom now, in the throes of a global downturn.
- Ten-year yields in Japan and several European countries have already spent time below zero. We see a low probability of a severe downturn, but if one occurs, we would not be surprised to see negative US Treasury yields.
- We believe negative policy rates in the US are unlikely because they disrupt the financial sector and have not shown their worth in Europe or Japan.
- Long-term developed-market yields are facing the same set of primary drivers—limited inflation pressure, ultra-low monetary policy rates, demand for relative safe-haven assets and periodic risk aversion. These drivers appear to be preventing a sustainable rise in yields. This condition is generally good for borrowers but not for savers.
- Several central banks are participating in financial markets, purchasing securities and seeking to provide liquidity to soothe fixed income volatility. We expect the Fed's balance sheet to rise substantially.

G-3 CENTRAL BANK MONETARY POLICY

The Fed is back at the zero lower bound and purchasing securities at a rapid clip to restore liquidity in the Treasury and investment grade credit markets.





Source: Refinitiv Datastream, data as of 3/30/2020.

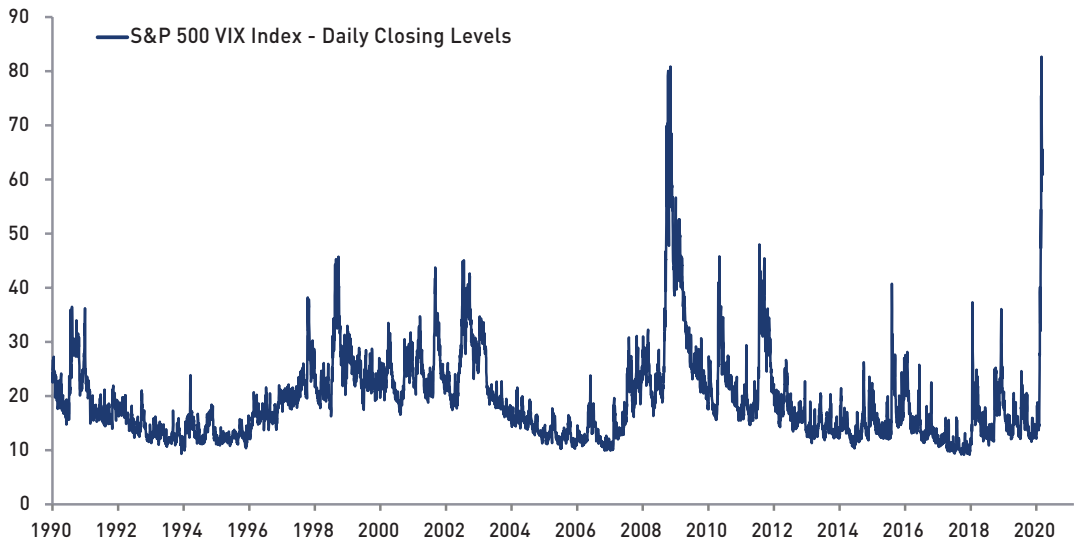
GLOBAL EQUITIES

Corporate profits at the equity index level are widely expected to decline across the globe in 2020.

- Guidance from company management signals weakness ahead, but with few specifics.
- We expect significantly above-average market volatility to persist while the depth of the economic and corporate profit downturns remain highly uncertain.
- We expect weak S&P 500 first-quarter 2020 earnings, and second-quarter earnings are likely to be even weaker. We are anticipating some sequential improvement in the third quarter, and we see potential for modest year-over-year growth in the fourth quarter.
- We believe S&P 500 profits may contract 25% to 30% in calendar year 2020.
- Equity markets have already discounted a mild downturn in the global economy. We believe investors with a time horizon of one year or longer should consider allocating to equities during this volatile time.

S&P 500 VIX DAILY CLOSING LEVELS

US equity market volatility in mid-March reached heights not seen since the global financial crisis.



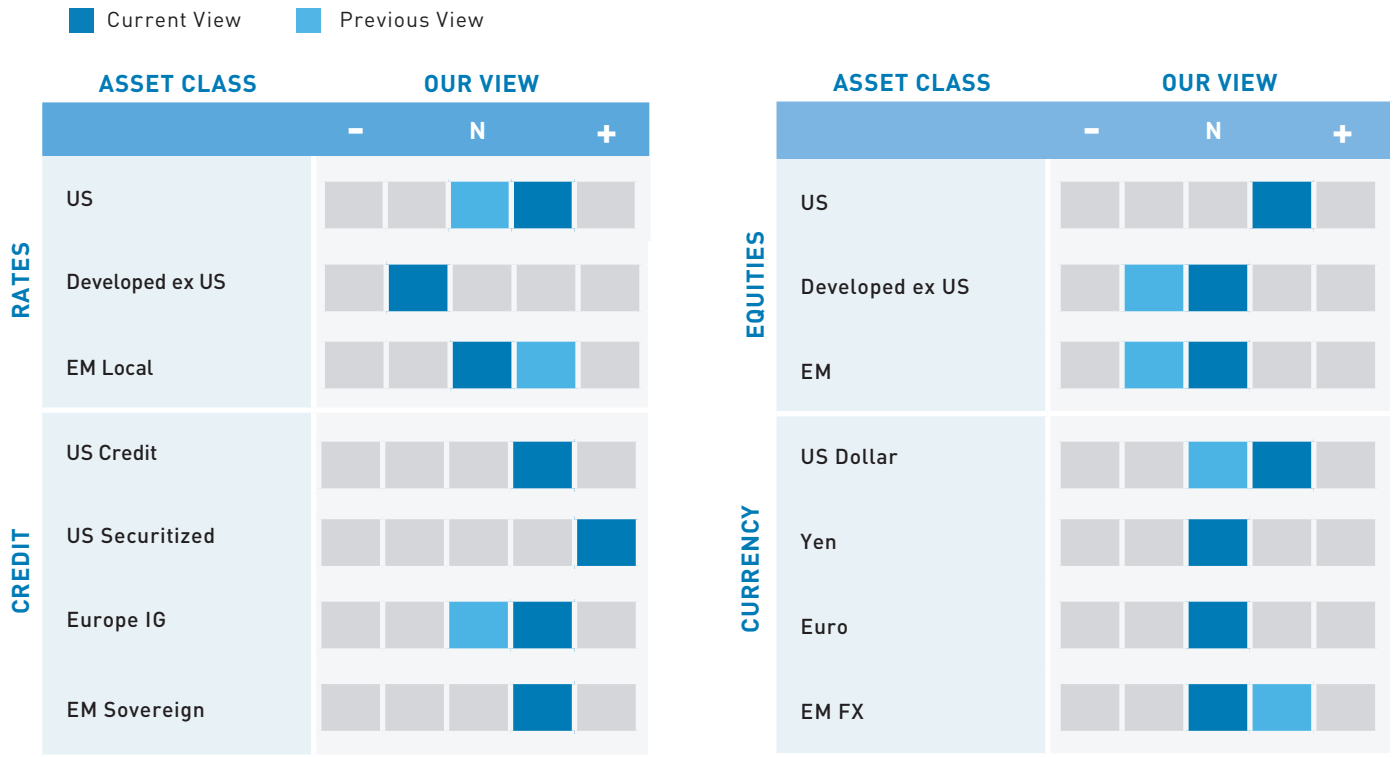
Source: Chart created by Loomis Sayles, data from CBOE and Bloomberg, as of 3/30/2020.

POTENTIAL RISKS

One of the largest risks we currently face is a severe and prolonged downturn.

- If broader containment measures are not taken soon, a wider spread of the virus could lead to a more severe downturn.
- The longer it takes to reach a peak in new COVID-19 cases, the longer it will likely take to lift quarantines and resume normal economic activity. We believe governments need to act swiftly to minimize the economic damage.
- Risk markets have already discounted a mild downturn scenario, but if the shock becomes more severe, the eventual recovery in risk assets will take longer than we currently expect.
- A key silver lining is the fiscal and monetary policy response to the outbreak, which has been rapid and of significant magnitude.

ASSET CLASS OUTLOOK



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