DEMYSTIFYING TIPS

FEBRUARY 2021

AUTHOR

ELAINE KAN, CFA
VP, Portfolio Manager

KEVIN KEARNS
VP, Portfolio Manager

ROGER ACKERMAN
VP, Investment Director

WHY CONSIDER THE LOOMIS SAYLES INFLATION PROTECTED SECURITIES FUND?

- Broad flexibility and active management may allow the fund to capitalize on higher inflation and breakeven rates.
- Unlike more traditional TIPS funds, we can express our views on inflation expectations without assuming additional duration risk.
- Active duration management may help mitigate interest rate risk.
- We can enhance our core TIPS portfolio through diversified credit exposure.

MANAGER INSIGHT

FEBRUARY 2021

Pandemic-related stimulus relief, vaccination progress and ongoing Federal Reserve guidance have many investors questioning whether inflation rates may soon turn upward. This sentiment has reignited interest in Treasury inflation-protected securities, or TIPS. These low-risk assets have some built-in inflation protection, but are more complex than this definition implies.

TIPS have a history of cycling in and out of investors' minds as a du jour investment idea. At their core, TIPS can provide a hedge against inflation for a broader fixed income portfolio, but they also have many distinct, often misunderstood, features. Below, we examine TIPS and seek to debunk several misconceptions.

“

First issued by the US government in 1997, TIPS were designed to provide investors with inflation protection. The TIPS market has grown to about **$1.6 trillion,** representing roughly 8% of total Treasury issuance.[i]

What Are TIPS?

First issued by the US government in 1997, TIPS were designed to provide investors with inflation protection. The TIPS market has grown to about $1.6 trillion, representing roughly 8% of total Treasury issuance.[i] Like any asset class, supply and demand can impact valuations. Due to the Federal asset purchase program, the net supply of publicly held TIPS declined by $117 billion in 2020, which pushed TIPS prices higher.[ii]

In practice, the principal value of TIPS increases with inflation and decreases with deflation. Multiplying the adjusted principal by the fixed coupon rate calculates the semiannual coupon payments, so coupons also float relative to the inflation environment. When TIPS mature, the Treasury repays the adjusted or original principal, whichever is greater, creating a deflation floor. Older-issue TIPS are more sensitive to deflation since it erodes accrued inflation. Additionally, coupon payments do not enjoy similar deflation protection because coupon payments may be calculated on an adjusted principal less than par. As a result, there is some deflation risk.

[i] *Monthly Statement of the Public Debt of the United States compiled by the Bureau of the Fiscal Service, as of 12/31/2020.*

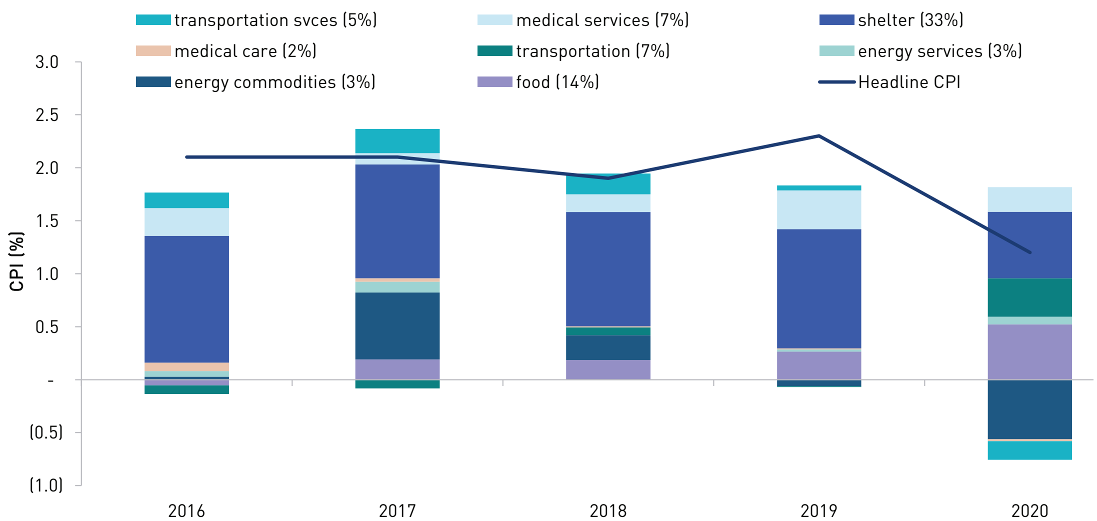
[ii] *"TIPS 2021 Outlook" JP Morgan, 11/24/2020.*

TIPS principal adjustments are calculated monthly with a three-month lag based on changes in the Consumer Price Index for Urban Consumers non-seasonally adjusted (CPI-U). The CPI-U measures changes in the price paid by urban consumers for a basket of consumer goods and services. Shelter, food, transport, energy and medical care prices make up almost 75% of the index.

COMPONENT OF US CPI-U CONTRIBUTION

Source: Bloomberg as of 12/31/2020.

This material is for informational purposes only and should not be construed as investment advice. Information obtained from outside sources is believed to be correct, but Loomis Sayles cannot guarantee its accuracy. This material cannot be copied, reproduced or redistributed without authorization.



What Are Breakeven Inflation Rates?

A breakeven inflation rate is the annualized rate of CPI-U inflation that makes the total return of a TIPS equal the total return of a similar-tenor Treasury. Breakeven rates are calculated as the yield difference between Treasury bonds and TIPS of the same duration.[iii]

Breakeven rates are a proxy for the market's inflation expectations. The smaller the rate, the lower expectations are for inflation. Higher rates indicate increasing inflation expectations. A change in market expectations or uncertainty about inflation can change TIPS prices even if realized inflation remains constant.

[iii] *Bloomberg, as of 12/31/2020.*

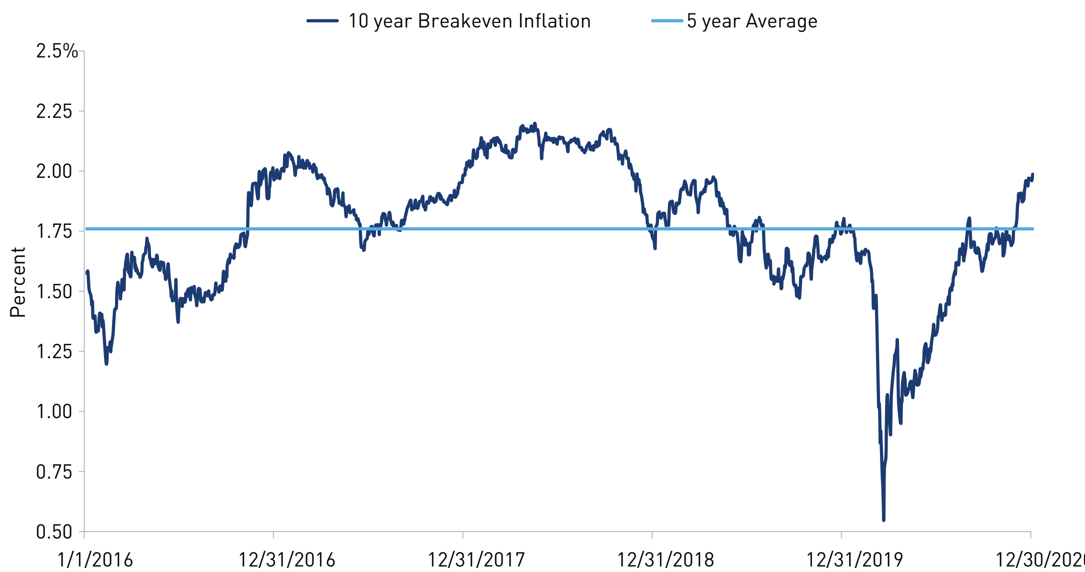
If Inflation Expectations Increase, What Can I Expect?

Ten-year breakeven inflation (expected inflation for the next ten years) is currently hovering just below 2%,[iv] but the five-year average for 10-year breakevens sits just above 1.75%. The market appears to be expecting inflation to rise and TIPS to outperform nominal Treasurys.

10 YEAR BREAKEVEN INFLATION

Source: Bloomberg, as of 12/31/2020.

Duration is price sensitivity to interest rate changes.



If Energy Prices Rise, What Can I Expect?

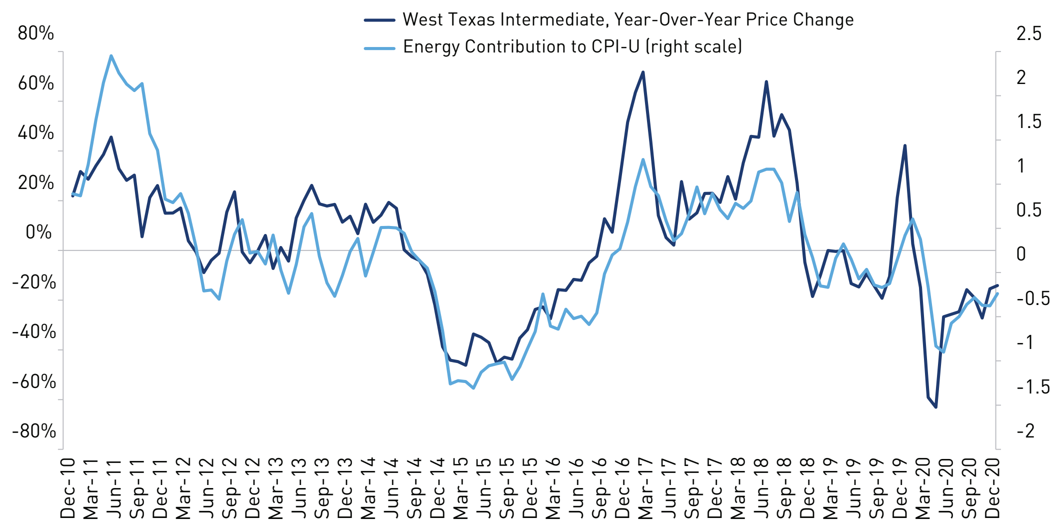
If energy prices continue to increase, CPI-U will likely rise, and in turn, TIPS could benefit from principal accretion and higher coupon payments. If the energy component in CPI-U were to increase 5% year over year, we would expect a 0.3% to 0.6% contribution to CPI-U based on the historical weighting of the energy component. If oil has bottomed, TIPS could stand to benefit.

[iv] *Bloomberg, as of 12/31/2020.*

ENERGY PRICES CONTRIBUTING TO CPI-U

Source: Haver Analytics, as of 12/31/2020.

This material is for informational purposes only and should not be construed as investment advice. Information obtained from outside sources is believed to be correct, but Loomis Sayles cannot guarantee its accuracy. This material cannot be copied, reproduced or redistributed without authorization.



When Do TIPS Outperform Treasurys?

Nominal Treasurys can lose real value when realized inflation exceeds inflation expectations at the time of a bond's purchase. In such an environment, TIPS typically outperform nominal Treasurys. When realized inflation is lower than breakeven inflation, nominal Treasurys usually outperform TIPS.

However, there are some important nuances to the nominal Treasury/TIPS dynamic, mostly depending on whether changes in real or nominal rates are driving inflation expectations. Total returns for TIPS and nominal Treasurys are linked to real economic growth in the long run. In an environment of rising inflation and low growth, we would expect real yields to fall and TIPS to have a positive return, while nominal Treasury bonds may have a flat or even negative return. In an environment of rising inflation and higher growth, TIPS may still outperform nominal Treasurys but could lose value as real interest rates rise along with breakeven inflation.

Why Consider the Loomis Sayles Inflation Protected Securities Fund?

TIPS are more complex and nuanced than investors may initially think. To help capitalize on these dynamics, the Loomis Sayles Inflation Protected Securities Fund has broad flexibility. We actively manage a core TIPS portfolio and seek to enhance performance by leveraging our deep expertise across derivatives and other credit sectors. As a result, the fund may be able to capitalize on higher inflation and breakeven rates with strategies not typically available to long-only TIPS managers.

"

TIPS are more complex and nuanced than investors may initially think. To help capitalize on these dynamics, the Loomis Sayles Inflation Protected Securities Fund has broad flexibility.

EXPRESS OUR VIEWS ON INFLATION EXPECTATIONS WITHOUT ASSUMING DURATION RISK

TIPS can lose value if real interest rates rise despite higher inflation expectations. However, the fund can purchase TIPS and short nominal Treasury exposure, expressing a view on the direction of breakeven rates.[v] This trade pairing generally has positive returns when breakeven rates move higher, whether real rates are moving higher or lower.

ACTIVE DURATION MANAGEMENT

The duration of the Barclays US Treasury Inflation Protected Securities Index is *about eight years*.[vi] The fund can have a duration four years shorter or longer than the index. If real rates begin to rise with higher growth expectations, the fund can hedge interest rate risk and seek to protect capital by shortening duration using derivatives.

ACCESS TO ADDITIONAL ALPHA SOURCES

The fund allows for up to 20% non-TIPS exposure, including nominal Treasurys, asset-backed and mortgage-related securities, and investment grade and high yield corporate bonds. We may also use rate derivatives. We believe this additional flexibility provides potential to enhance returns at the margin based on our broader economic and credit views.

[v] *The fund can use Treasury futures or swaptions (option on interest rate swap) to establish negative nominal Treasury exposure.*

[vi] *Barclays Live, as of 12/31/2020.*

About Risk

Although the US government guarantees the timely payment of principal and interest on most of the fund's underlying securities, the value of fund shares is not guaranteed and will fluctuate. Mutual funds that invest in bonds can lose their value as interest rates rise and an investor can lose principal.

Interest rate increases can cause the price of debt securities to decrease and will affect the value of the fund's underlying investments in income-producing securities. Stock markets, particularly foreign stock markets, are volatile and can decline significantly in response to adverse economic, issuer, political or regulatory changes. Exchange rate risk between the US dollar and foreign currencies may cause the value of the fund's investments to decline. Exposure to commodity markets may subject the fund to greater volatility than investments in traditional securities.

Derivatives, primarily futures and forward contracts, generally have implied leverage (a small amount of money to make an investment of greater value). Because of this, the fund's extensive use of derivatives may magnify any gains or losses on those investments as well as risk to the fund.

AUTHORS

ELAINE KAN, CFA
VP, Portfolio Manager

KEVIN KEARNS
VP, Portfolio Manager

ROGER ACKERMAN
VP, Investment Director

Disclosure

Barclays US Treasury Inflation Protected Securities Index covers the most liquid portion of the global investment grade fixed-rate bond market, including government, credit and collateralized securities. The liquidity constraint for all securities in the index is $300 million. Indexes are unmanaged and do not incur fees. It is not possible to invest directly in an index.

This paper is provided for informational purposes only and should not be construed as investment advice. Investment decisions should consider the individual circumstances of the particular investor. Any opinions or forecasts contained herein reflect the subjective judgments and assumptions of the authors only and do not necessarily reflect the views of Loomis, Sayles & Company, L.P. Investment recommendations may be inconsistent with these opinions. There can be no assurance that developments will transpire as forecasted and actual results will be different. Data and analysis does not represent the actual or expected future performance of any investment product. We believe the information, including that obtained from outside sources, to be correct, but we cannot guarantee its accuracy. The information is subject to change at any time without notice.

Investing involves risks, including risk of loss.

Commodity, interest and derivative trading involves substantial risk of loss.

There is no guarantee that any investment objective will be realized or that the strategy will generate positive or excess return.

Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results.

Before investing, consider the fund's investment objectives, risks, charges, and expenses. Please visit www.loomissayles.com or call 800-633-3330 for a prospectus and a summary prospectus, if available, containing this and other information. Read it carefully.

Natixis Distribution, L.P. (fund distributor, member FINRA|SIPC) and Loomis, Sayles & Company L.P. are affiliated.

***Fixed income securities** may carry one or more of the following risks: credit, interest rate (as interest rates rise bond prices usually fall), inflation and liquidity. Below investment grade fixed income securities may be subject to greater risks (including the risk of default) than other fixed income securities. **Inflation protected securities** move with the rate of inflation and carry the risk that in deflationary conditions (when inflation is negative) the value of the bond may decrease. **Derivatives** involve risk of loss and may entail additional risks. Because derivatives depend on the performance of an underlying asset, they can be highly volatile and are subject to market and credit risks. **Foreign securities** may involve heightened risk due to currency fluctuations. Additionally, they may be subject to greater political, economic, environmental, credit and information risks. Foreign securities may be subject to higher volatility than US securities due to varying degrees of regulation and limited liquidity. **Currency** exchange rates between the US dollar and foreign currencies may cause the value of the fund's investments to decline. **Commodity-related investments,** including derivatives, may be affected by a number of factors including commodity prices, world events, import controls and economic conditions, and therefore may involve substantial risk of loss.*

LSWP189-0221
Exp. 02/28/2022
MALR026810
1496883.2.2