

# DoubleLine's Just Markets Webcast Recap

Originally aired on January 12, 2021



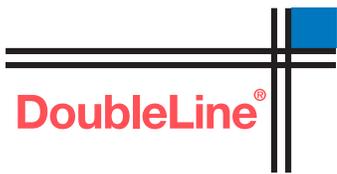
## About this Webcast Recap

On January 12, 2021, Chief Executive Officer Jeffrey Gundlach held a webcast titled “Aqualung,” discussing the economy, the markets, and his outlook for what he believes may be the best investment strategies and sector allocations for 2021. This recap is not intended to represent a complete transcript of the webcast. It is not intended as a solicitation to buy or sell securities. If you are interested in hearing more of Mr. Gundlach’s views, please listen to the full version of this webcast on [www.doubleline.com](http://www.doubleline.com) and click on the “Webcasts” menu item under the “Webcasts & Podcasts” section of the homepage.

*Slide numbers shown refer to the Just Markets “Aqualung” presentation pages. The presentation is available for download under the “Event Content” tab of the webcast player.*

## Macro Viewpoints

- The U.S. stock market returned 18.4% in 2020, as measured by the S&P 500 Index. The total return gap between the best- and worst-performing sectors was 77.6%, with information technology returning 43.9% and energy falling 33.7%.
- U.S. fixed-income returns showed a similar pattern to the equity market as there was a 22.1% difference between the best- and worst-performing sectors. BB-rated high yield (HY) bonds returned 10.2% while BBB-rated commercial mortgage-backed securities declined 11.9%, as measured by the Bloomberg Barclays CMBS ERISA Eligible BAA Total Return Index. *(slide 7)*
- Due to the COVID-19-induced lockdowns, the number of travelers passing through Transportation Security Administration checkpoints at commercial airports was down approximately 750,000 travelers from 2.25 million year-over-year (YoY). *(slide 10)*
- Kastle’s Back-to-Work Barometer, which tracks commercial office use in the top 10 metro areas across the U.S., was unchanged from the September reading as of Jan. 6, 2021. *(slide 11)*
- U.S. work-from-home preferences shifted YoY. In June 2019, 27% of respondents said they’d like to work from home five days per week. A year later, June 2020, in the midst of the COVID-19 pandemic, 61% of respondents said they’d like to work from home five days per week. *(slide 12)*
  - Employees’ favorable view of working from home could cause business leaders to draw conclusions as to whether they will need to restructure how and where they conduct their business.
- Technology stocks flourished in 2020 due in part to the COVID-19-induced lockdowns. Mr. Gundlach pointed out that by the end of 2020, the technology sector made up 38% of the S&P 500 market capitalization yet only 2% of U.S. employment and 6% of GDP. Mr. Gundlach believes that this large disparity is driving wealth inequality. *(slide 15)*



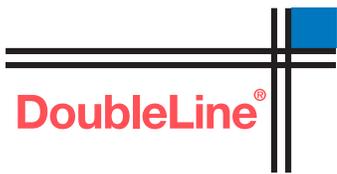
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- The Federal Reserve's balance sheet increased in response to the COVID-19 pandemic as the Fed enacted a number of policy measures to stabilize markets and increase liquidity. Prior to the pandemic, the Fed's balance sheet stood at \$3.8 trillion in August 2019. In response to the pandemic, the Fed's balance sheet increased to \$7.4 trillion by December 2020. *(slide 19)*
- One of Mr. Gundlach's highest-conviction ideas for 2021 is that the U.S. dollar will weaken.
  - There is a high correlation between the twin deficits (fiscal debt and trade balance) and the value of the dollar. When the twin deficits go up, the dollar historically faces downward pressure. Currently, the U.S. trade balance is deteriorating while the budget deficit is exploding. *(slide 22)*

## Equities

- Using the forward price-to-earnings ratio of the S&P 500 to compare current equity valuations to the peaks of past cycles, the equity market is at its second highest valuation of all time at 22.3x, as of Dec. 31. This is in comparison to the forward price-to-earnings ratio of 27.2x achieved during the dot-com boom in March 2000. *(slide 27)*
- DoubleLine has recently observed a few significant regime changes for equity markets:
  - The price of the Nasdaq 100 Index relative to the S&P 500 recently matched its peak from the dot-com bubble. Before the dot-com bubble peaked in 2000, the Nasdaq 100 was nearly 3.5x the value of the S&P 500. Twenty years later, the Nasdaq 100 is once again nearly 3.5x the value of the S&P 500. However, Mr. Gundlach notes that this trend seems to be reversing. *(slide 29)*
  - Another trend that seems to be reversing is Goldman Sach's Strong Versus Weak Balance Sheet Equity Basket Index, which has moved decisively lower since its high on Oct. 16. Mr. Gundlach highlighted the fact that companies with strong balance sheets have outperformed essentially from the election of President Donald Trump through the 2020 election. *(slide 33)*
- Due in part to the Fed's low interest rate policy, the percentage of U.S. small-cap companies with debt interest greater than their profits for at least three years has increased from 8% in 2010 to 15% in 2020.
  - Mr. Gundlach notes that this could be a deflationary force because these companies generally produce goods without generating profits, keeping prices lower than the market would accommodate. *(slide 37)*
- U.S. equity prices versus the rest of the world seem to have peaked, as measured by the MSCI USA Price Return Index versus the MSCI World ex-U.S. Index. Since the Global Financial Crisis (GFC), the U.S. has outperformed the rest of the world by a factor of three.
  - Recently, there has been a large setback in this measure. *(slide 39)*
- The cyclically adjusted price-to-earnings (CAPE) ratio of the MSCI U.S. Index versus the CAPE ratio of the MSCI ACWI Index shows that U.S. equities are twice as expensive as their global counterparts. Contrary to popular belief, U.S. equities do not always trade higher than their global counterparts based on this measure.
  - In the late 1980s, global equities' CAPE ratio was significantly higher than U.S. equities' CAPE ratio. *(slide 41)*



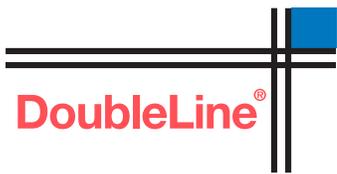
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- The impact of negative interest rates in Europe and Japan is exemplified by the performance of each countries' bank stocks:
  - The Bank of Japan (BOJ) employed a sub-1% interest rate policy beginning in 1995, which eventually led to the BOJ adopting negative interest rates in 2016. Since 1995, Japanese bank stocks are down nearly 84% as measured by the Tokyo Stock Exchange TOPIX Banks Index.
  - From 1995 to the GFC, European and U.S. banks significantly outperformed Japanese banks.
    - In an attempt to stimulate the eurozone economy post-GFC, the European Central Bank introduced negative interest rates in 2014.
    - Since the GFC, the Euro Stoxx Banks Price EUR Index has significantly underperformed U.S. banks as measured by the KBW Bank Index.
  - Fed Chairman Jerome H. Powell has stated that he does not want to implement negative interest rates. If the U.S. were to implement negative interest rates, DoubleLine believes it could be fatal to the global financial system. *(slide 43)*
- One of Mr. Gundlach's top investment ideas for 2021 is to favor emerging market (EM) equities, particularly Asian EM. Looking at the performance of the iShares MSCI Emerging Markets ETF versus the SPDR S&P 500 ETF, Mr. Gundlach notes that EM equities have reversed their trend of underperformance and have significantly outperformed U.S. equities since June 2020. This coincides with a weakening U.S. dollar, which is generally a tailwind for EM. *(slide 46)*

## Inflation

- The U.S. core Consumer Price Index (CPI) YoY has not been above 3% for over 25 years. Relative to history, this has been an incredibly stable inflation regime. *(slide 53)*
  - The big question is, will this stable inflation regime continue? Mr. Gundlach is confident that the answer is no. Mr. Gundlach believes the risks of both deflation due to the massive amount of U.S. national debt and inflation due to the increase in the U.S. money supply need to be respected.
    - Because of this, Mr. Gundlach believes investors should have a barbell asset allocation, with part of a portfolio allocated to deflation protection and another part to hedge for inflation.
    - Mr. Gundlach suggests allocating to cash and long-term U.S. Treasury bonds to protect against deflation.
    - If there is inflation, an allocation to equities and real assets would benefit. Mr. Gundlach recommends favoring Asian EM equities with an additional allocation to gold, real estate or other real assets.



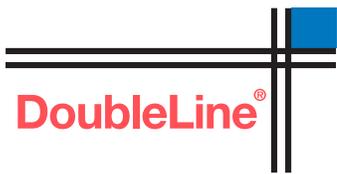
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- Measures of expected inflation have been going up. Five-year breakevens, the difference in yield between five-year Treasury Inflation-Protected Securities and nominal five-year Treasuries, have been rising. *(slide 54)*
  - As of Jan. 12, 2021, the five-year breakeven was 2.08%, up from 0.18% in March 2020.
    - DoubleLine believes the Fed wants interest rates to be negative on a real basis. It wants inflation to be higher than interest rates and, so far, it has succeeded. Even though interest rates have risen across the Treasury curve in 2021, CPI is likely to go higher on a headline basis this year.
    - At DoubleLine we believe headline CPI is going above 2.5% by June. This means that the Fed could remain happy even if the 10-year Treasury goes to 2%.

## FX/Commodities

- Industrial metals fell dramatically at the onset of the COVID-19 pandemic but have since retraced their drawdown and moved higher. Industrial metals historically have been positively correlated to EM equities' outperformance relative to the rest of the world. *(slide 52)*
- Mr. Gundlach turned neutral on gold a few months ago, largely driven by technicals. *(slide 55)*
- Bitcoin previously peaked in December 2017 at around \$19,000. Recently, the price of bitcoin has risen to approximately \$40,000.
  - Relative to gold, the price of one bitcoin also recently surpassed its 2017 peak.
- Mr. Gundlach turned neutral on bitcoin at \$23,000 and remains neutral because bitcoin looks like a dangerous market with high volatility. *(slide 57)*
- A falling dollar is historically bullish for commodities. Should the dollar continue to weaken, DoubleLine believes commodities could continue to rally. This is one reason why an allocation to real assets, like commodities, could potentially benefit investors. *(slide 58)*
- From 1994 to 2008, the returns of the Bloomberg Commodity Index and S&P 500 were almost the same. In response to the GFC, the Fed grew its balance sheet, which favored the S&P 500, while commodities significantly underperformed. *(slide 59)*
- One reason to believe that commodities will continue to rally is that the Bloomberg Economics China Credit Impulse tends to lead price movements in industrial metals by roughly 12 months to 18 months. The China Credit Impulse continues to move up, which suggests further increases in the prices of industrial metals. *(slide 62)*

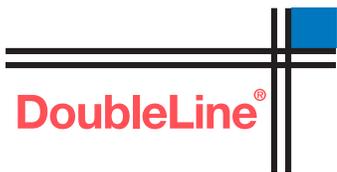


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## Fixed Income

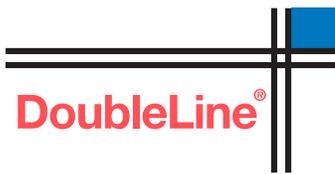
- Although U.S. equities are in the top percentile of valuation using many metrics, they don't appear to be expensive relative to bonds. Comparing stock valuations, using Shiller earnings yield, with 10-year average bond yields, equities appear cheap relative to bonds. *(slide 66)*
- U.S. real yields also indicate that bonds seem to be overvalued. The real yield on the two-year note is negative 220 basis points (bps) while the 30-year bond is negative 22 bps. Negative real yields penalize fixed-income investors. *(slide 67)*
- Fixed-income issuance in the government sector is projected to be robust going forward. In 2020, there was approximately \$1.7 trillion in issuance in Treasuries, and the Fed expanded its balance sheet by more than double that amount. *(slide 69)*
  - J.P. Morgan's estimate for 2021 total fixed-income issuance is \$4 trillion, of which \$2.8 trillion is expected to be Treasury issuance. The Fed is committed to at least \$1.44 trillion of quantitative easing in 2021, which includes purchasing \$80 billion of Treasuries and \$40 billion of Agency mortgage-backed securities (MBS) per month. With the Fed purchasing only \$960 billion of Treasuries and Agency MBS in 2021, there could be a large gap between Treasury issuance and Fed purchases.
  - Foreign holdings of Treasury bonds have been falling for seven years, and the decline accelerated meaningfully in the last two years. Without increasing domestic ownership of Treasury bonds, increasing supply could outstrip demand. *(slide 72)*
- The yield curve, as measured by the difference in yield of the three-month bill and the 10-year note, seems to be correlated to the movement of the Fed's balance sheet. Treasury yields fell and then ultimately inverted as the Fed allowed its balance sheet to shrink from 2018 into 2019. As the Fed's balance sheet increased in the second half of 2019, the yield curve began steepening. *(slide 70)*
  - DoubleLine expects the yield curve to steepen unless the Fed implements yield curve control.
- U.S. corporate HY option-adjusted spreads (OAS) have reversed back to pre-COVID-19 levels. *(slide 73)*
- Due to Fed intervention, the yield of investment grade (IG) corporate bonds – to no defaults – is lower than the inflation rate. This is a benefit to corporate bond issuers since if inflation is running higher than the cost of issuing bonds, it reduces the debt servicing burden. *(slide 74)*
- The yield to worst for BBB-rated corporate bonds is roughly 2.15%. Given DoubleLine's outlook for CPI in the months ahead, that nominal yield could turn into a negative real yield. *(slide 75)*
- The duration of the IG corporate debt market lengthened to record highs in the past 18 months. Therefore, interest rate risk in the corporate bond market is substantially higher than it was 10 years ago. *(slide 76)*
- IG OAS is near its lowest level since pre-GFC. *(slide 77)*
  - Mr. Gundlach said in his "Just Markets" webcast in 2020 that investors would be better off owning BBB-rated debt than BB-rated debt as the spread differential between the two was very narrow in early 2020. That was a correct call as the spread differential widened significantly during the sell-off in March and has only reversed roughly halfway. *(slide 78)*



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- Bank loans look attractive. Retail fund flows into bank loans tend to increase as the U.S. 10-year Treasury yield increases. *(slide 79)*
  - Bank loans were slightly negative last year on a price basis, although they had a positive total return with their coupon. Given that interest rates are not likely to go negative, based upon Powell's statements, the coupon on floating-rate bank debt can only benefit from a flat-to-rising rate environment.
- EM corporate bond spreads widened from inside of 300 bps pre-COVID-19 to over 700 bps after the pandemic gripped financial markets. As of Jan. 5, 2021, the EMBI Global Diversified sovereign spread was 351 bps, below the long-term average of roughly 400 bps. *(slide 80)*
  - Weakness of the U.S. dollar is central to DoubleLine's longer-term forecast, which would be supportive of the relative outperformance of EM bonds.
- The Atlanta Fed Wage Growth Tracker is showing wage growth should be moving up at about 3.5% to 3.7% per annum. This measure has been fairly stable for the past four years. Meanwhile, 30-year mortgage rates have been coming down, helped by lower Treasury rates and spread compression in the mortgage market. *(slide 81)*
  - Today, the 30-year mortgage rate is lower than the Atlanta Fed Wage Growth Tracker, which suggests that taking on mortgage debt is historically cheap.
- The pandemic reversed two important housing-related trends. Rents of primary residences fell during the pandemic, but home prices rose.
  - The Core Logic Case Shiller Home Price Index is up 4% YoY, and there are some metropolitan areas where it rose over 10%. *(slide 82)*
  - The quality of mortgage underwriting is very strong. Since the onset of COVID-19, a majority of mortgage originations have been loans made to borrowers with a credit score over 760. *(slide 83)*
- Credit card delinquencies show the effect of government transfer payments. Usually during economic downturns there is significant distress in credit cards. However, there was actually a decline in delinquency rates for credit cards in 2020. *(slide 84)*
  - Mr. Gundlach believes this is one of the most-unusual recessions ever because of the extraordinary fiscal and monetary responses, and he hopes that the responses don't have the dark underbelly of Jeff Koons' "Aqualung."



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## Definitions

**Below Investment Grade/Non-Investment Grade** – Term indicating a security is rated below investment grade (IG). These securities are seen as having higher default risk or being prone to other adverse credit events. They typically pay higher yields than higher-quality bonds in order to make them attractive. They are less likely than IG bonds to pay back 100 cents on the dollar.

**Bloomberg Economic China Credit Impulse 12-Month Change Index** – This index tracks the 12-month change in the China credit impulse, which tracks the change in the growth rate of aggregate credit as a percentage of China's gross domestic product.

**Bloomberg Barclays US Aggregate Bond Index** – This index represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

**BPS** – A common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1% and is used to denote the percentage change in a financial instrument.

**Consumer Price Index (CPI)** – This index examines the weighted average of the prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by averaging price changes for each item in the basket. Changes in the CPI are used to assess price changes associated with the cost of living. The CPI is one of the most frequently used statistics for identifying periods of inflation or deflation.

**Copper-Gold Ratio (CGR)** – Calculated by dividing the market price of a pound of copper by the market price of an ounce of gold.

**Correlation** – A statistical measurement of the relationship between two variables. Possible correlations range from +1 to -1. A zero correlation indicates that there is no relationship between the variables. A correlation of -1 indicates a perfect negative correlation and +1 indicates a perfect positive correlation.

**Credit Quality** – Determined from the highest available credit rating from any Nationally Recognized Statistical Rating Agency (NRSRO, generally S&P, Moody's or Fitch). DoubleLine chooses to display credit ratings using S&P's rating convention, although the rating itself might be sourced from another NRSRO. The firm evaluates a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from "AAA", which is the highest grade, to "D", which is the lowest grade. In limited situations when the rating agency has not issued a formal rating, the rating agency will classify the security as nonrated.

**Cyclically Adjusted Price-to-Earnings (CAPE) Ratio** – This ratio measures valuation by using real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle. It is also known as the "Shiller P/E ratio" for Yale University professor Robert Shiller, who popularized its use.

**Drawdown** – Peak-to-trough decline during a specific period for an investment, trading account or fund. A drawdown is usually quoted as the percentage between the peak and the subsequent trough.

**Duration** – Duration is a commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration.

**Investment Grade** – A level of credit rating for stocks regarded as carrying a minimal risk to investors. Ratings are based on corporate bond model. The higher the rating the more likely the bond will pay back par/100 cents on the dollar.

**Morgan Stanley Capital International All Country World Index (MSCI ACWI)** – This market capitalization-weighted index is designed to provide a broad measure of stock performance throughout the world. It comprises stocks from 23 developed countries and 24 emerging markets.

**Morgan Stanley Capital International Emerging Markets Index (MSCI EMI)** – This index captures large- and mid-cap representation across 26 emerging markets countries. With 1,385 constituents, the index covers approximately 85% of the free-float-adjusted market capitalization in each country.

**Price-to-Earnings (P/E) Ratio** – This ratio for valuing a company measures current share price relative to earnings per share (EPS). The P/E ratio is also sometimes known as the "price multiple" or the "earnings multiple." A high P/E ratio could mean that a company's stock is overvalued, or investors are expecting high growth rates in the future.

**Russell 2000 Index** – This market capitalization-weighted index comprises 2,000 small-cap U.S. companies and is considered a bellwether index for small-cap investing.

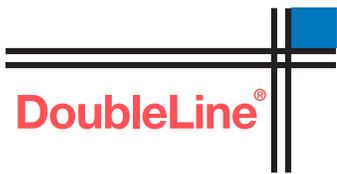
**Spread** – Difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings or risk.

**S&P 500** – Is the stock market index that tracks the stocks of 500 large-cap U.S. companies. Financials include the S&P 500 financial companies.

**S&P 500 Market Cap-to-GDP Ratio** – This ratio gauges the market capitalization of the members of the S&P 500 Index to the U.S. gross domestic product.

**Weekly Economic Index (WEI)** – This index, compiled and published by the Federal Reserve Bank of New York, tracks 10 indicators of real economic activity and is scaled to align with the four-quarter GDP growth rate. It represents the common component of series covering consumer behavior, the labor market and production.

**Yield Curve** – A curve on a graph in which the yield of fixed-interest securities is plotted against the length of time they have to run to maturity.



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