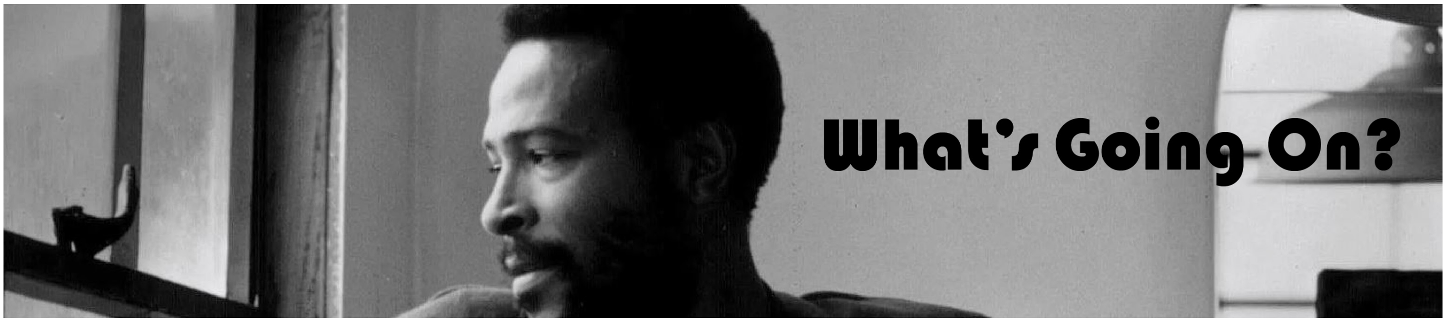
DoubleLine Just Markets Webcast Recap

Originally aired on January 10, 2023



About this Webcast Recap

On January 10, 2023, Chief Executive Officer Jeffrey Gundlach held a webcast titled "What's Going On?" discussing the economy, the markets, and his outlook for what he believes may be the stronger investment strategies and sector allocations for 2023.

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 DoubleLine.com by clicking on Insights, Market Insights, Webcasts or browse additional insights by Thought Leader.

2022 Recap

- 2022 was the third worst year for the S&P 500 Index since 1976 (2002, 2008).
- The Bloomberg US Aggregate Bond Index, the data for which goes back to 1976, experienced its worst calendar-year return in 2022 .
- Commodities and the U.S. dollar were the sole bright spots of 2022, albeit most of the positive return for each was experienced in the first half of the year.
- Bank loans, which Jeffrey Gundlach lauded as one of his favorite sectors of fixed income in his 2022 Just Markets webcast, broadly was the best-performing sector in fixed income in 2022.
  - Following the rise in interest rates in 2022 and the possibility for higher default rates moving forward, DoubleLine believes bank loans are far less favorable now than one year ago.
- The Federal Reserve's monetary policy tightening in response to "nontransitory" inflation led to drastic changes in the yield curve.
- DoubleLine believes the bond market is suggesting that the Fed will not reach 5% on the effective federal funds rate.
- Mr. Gundlach believes the Fed would be wise to resist the temptation to do quantitative easing (QE) again. However, he would not be surprised to see further QE if the environment is sufficiently dire.
- The interest burden on U.S. government debt has accelerated higher due to higher interest rates.
- The Fed's balance sheet has had a high correlation to the performance of the S&P 500 post-Global Financial Crisis (GFC). Mr. Gundlach thinks this relationship is worth watching as the Fed embarks on quantitative tightening. Global central bank balance sheets and FANG+ Index[1] have an even higher correlation.

[1] FANG+ Index constituents: Meta, Apple, Amazon, Netflix, Microsoft, Google, Tesla, Nvidia, Snowflake, Advance Micro Devices (AMD)

Economic Data

- Supplier delivery delays caused by pandemic-related supply chain constraints have relaxed greatly. While this is interpreted as good news, there could potentially be a lack-of-demand component aiding the relaxation.
- Housing affordability has collapsed. The combination of price increases and higher mortgage rates are to blame for the lowest housing affordability level going back to the late 1980s.
    - Housing prices have come down since their peak in March 2022 but are still elevated relative to pre-pandemic levels.
    - DoubleLine does not believe there will be a significant rise in defaults by mortgage borrowers due to tighter underwriting standards post-GFC and record home equity.
- The U.S. personal savings rate as a percentage of income is at the lowest level in over 14 years after skyrocketing to record highs amid the pandemic due to government stimulus.
    - Lower savings rates have forced households to draw down excess savings in 2022.
    - Mr. Gundlach believes higher credit card spending is not a sign of consumer strength but rather a sign of consumer stress among elevated inflation and lower savings rates.
- Consumer sentiment is depressed and slightly above its lowest level in the past 40 years.
- U.S. employment remains one of the last nonrecessionary indicator holdouts.
    - DoubleLine believes if the U-3 unemployment rate breaks above its 12-month moving average, it would be a strong indication that the U.S. is entering the front edge of a recession.
- The Conference Board Leading Economic Indicator Index (LEI) was negative 4.5% year-over-year (YoY) as of November 2022, strongly indicating recession. Historically speaking, a recession has never been avoided once the LEI has reached its current level.
- The U.S. Treasury yield curve is inverted, also signaling recession.
    - The 10-year Treasury yield minus three-month Treasury yield first inverted in October 2022, and the 10-year Treasury yield minus two-year Treasury yield first inverted in July 2022. Both measures have inverted further. The 10-year yield minus three-month yield has not been this inverted since the 1980s.
- Mr. Gundlach now believes bonds are cheaper than stocks on a relative basis, a reversal from his view in his January 2022 Just Markets webcast.

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Inflation

- The U.S. headline Consumer Price Index (CPI), which was roughly range-bound between zero to 3% YoY for the last 10 years pre-pandemic, peaked at 9.1% in June 2022 and has been declining since at roughly the same pace.
  - Mr. Gundlach doubts the plausibility of economist forecasts for inflation to recede to 2% YoY in the near term then subsequently stay at that level. Should restrictive monetary policy by the Fed accomplish this goal in 2023 or early 2024, it's likely that inflation would then continue dropping below zero.
- Money supply growth, as measured by M2, tends to lead the inflation rate over the long term. As of November 2022, M2 YoY reached 0.0%, its lowest level since the Fed began tracking the data in 1960.
  - The last time M2 YoY dropped neared this level (in 1993), inflation continued to fall for several years.
- Commodity prices peaked in June 2022, as measured by the Bloomberg Commodity (BCOM) Index.
  - Mr. Gundlach would like to see the BCOM above its 200-moving day average before broadly buying commodities. This might happen if the dollar continues its decline.
- Mr. Gundlach believes it is a reasonably good time to buy and hold gold. DoubleLine turned bullish on gold when it went below $1,800 per ounce.

Risk Assets

- U.S. real yields, based on Treasury Inflation-Protected Securities (TIPS), have stopped going up, which is generally good for risk assets. DoubleLine does not believe real yields will go up in the first part of 2023, which should be a tailwind for risk assets.
  - DoubleLine believes risk assets will start the year reasonably well as a result, combined with anticipated inflows back into financial assets following aggressive outflows in 2022.
- Broad-based trends in equity markets, which have worked in investors' favor in recent years, have reversed.
  - The equal-weighted S&P 500 began outperforming the market-cap weighted index in the fall of 2020.
  - Mr. Gundlach believes the momentum behind an equal-weighted S&P 500 outperforming the market-cap weighted S&P 500 might be losing steam, with a lot of the repricing behind us.
  - Nasdaq 100 Index outperformance versus the S&P 500 has also reversed course. Mr. Gundlach believes this trend has some room to continue.
- The U.S. stock market has been a world beater for years. However, this trend line was broken in the fourth quarter of 2022.
  - Mr. Gundlach prefers non-U.S. stocks to U.S. stocks, particularly emerging markets (EM) equities. DoubleLine also believes the recent trend of European stocks outperforming U.S. stocks could continue.

Currencies

- DoubleLine believes the dollar is heading lower and may not return to the 115 level seen in late September 2022, as measured by the U.S. Dollar Index, even if there are flight-to-quality bounces higher.
  - One reason for a negative long-term view of the dollar is we believe as inflation recedes, the Fed could ease monetary policy more than the market expects, which would be incrementally negative for the dollar.
- The EM currency index is now above its 200-day moving average. If the dollar weakens and the EM currency index holds above the 200-day moving average, it would be a tailwind for EM bonds and stocks to outperform developed markets.
- EM sovereign bond spreads (dollar denominated) are highly correlated to moves in the dollar. When the dollar weakens, spreads tighten and vice versa.

Interest Rates & Fixed Income

- DoubleLine believes the Fed was behind the curve by waiting to tighten monetary policy to combat inflation, but it has subsequently caught up.
- The copper-gold ratio was strongly indicating the 10-year Treasury yield was going higher from mid-2020 to the beginning of 2021, which eventually occurred. Now it is strongly indicating that the 10-year Treasury yield should go lower.
- Due to the rise in interest rates in 2022, Treasuries at the long end of the curve have the potential for price appreciation while also being a successful hedge to credit risk
- Despite the repricing higher of the Treasury yield curve, corporate credit spreads have been relatively contained.
  - Investment grade (IG) corporate spreads never reached 200 basis points over Treasuries following the 2020 recession.
  - IG is broadly more attractive than it was 18 months ago, as yields are higher, and spreads are slightly wider.
  - High yield (HY) corporate spreads are elevated but nowhere near levels typically reached in recessions. HY spreads and the strong labor market are two of the better arguments against a recession, as the HY market is not showing a recessionary spread at this time.
    - In contrast to broader HY corporate spreads, the CCC-BB HY spread differential is elevated.
- The ratings quality differential for leveraged loans versus HY has moved in favor of HY bonds.
  - One should expect higher default rates in a recessionary environment given the lower-quality makeup of the loan market.
- The convexity profile of Agency mortgage-backed securities (MBS) has improved dramatically over the last 12 months.
  - The Agency MBS market briefly exhibited positive convexity in 2022, a historical aberration.
  - DoubleLine remains bullish on Agency MBS due to their neutral convexity profile and excess yield versus Treasuries.
- DoubleLine believes securitized credit spreads are generally cheap relative to similarly rated corporate bonds. Commercial MBS (CMBS) rated AAA are arguably the cheapest relative to IG corporate bonds than they have been in over 10 years.
- Wider spreads and upside in Treasuries make Mr. Gundlach the most excited he has been about the fixed income market in over 10 years.

Definitions

Bloomberg Commodity (BCOM) Index – This index (formerly the Dow Jones-UBS Commodity Index) is calculated on an excess return basis and reflects the price movements of commodity futures. It rebalances annually, weighted two-thirds by trading volume and one-third by world production, and weight caps are applied at the commodity, sector and group levels for diversification. The roll period typically occurs from the sixth to 10th business day based on the roll schedule.

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

Conference Board Leading Economic Index (LEI) – This index tracks a group of composite indexes (manufacturers' orders, initial unemployment insurance claims, et al.) as a means of gauging the strength of a particular industry or the economy.

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

Federal Funds Rate – Target interest rate, set by the Federal Reserve at its Federal Open Market Committee (FOMC) meetings, at which commercial banks borrow and lend their excess reserves to each other overnight. The Fed sets a target federal funds rate eight times a year, based on prevailing economic conditions.

High Yield (HY) – Bonds that pay higher interest rates because they have lower credit ratings than investment grade (IG) bonds. HY bonds are more likely to default, so they must pay a higher yield than IG bonds to compensate investors.

Investment Grade (IG) – Rating that signifies a municipal or corporate bond presents a relatively low risk of default. Bonds below this designation are considered to have a high risk of default and are commonly referred to as high yield (HY) or "junk bonds." The higher the bond rating the more likely the bond will return 100 cents on the U.S. dollar.

M2 Money Supply – Calculation of the money supply that includes all elements of M1 as well as "near money." M1 includes cash and checking deposits, while near money refers to savings deposits, money market securities, mutual funds and other time deposits. These assets are less liquid than M1 and not as suitable as exchange mediums, but they can be quickly converted into cash or checking deposits.

Nasdaq 100 Index – This index comprises the 100 largest U.S. and non-U.S. nonfinancial securities based on market capitalization listed on the Nasdaq stock exchange. The index reflects companies across major industry groups including computer hardware and software, telecommunications, biotechnology and retail/wholesale trade.

Quantitative Easing (QE) – An unconventional monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective. A central bank implements quantitative easing by buying specified amounts of financial assets from commercial banks and other private institutions, thus raising the prices of those financial assets and lowering their yield, while simultaneously increasing the monetary base.

Quantitative Tightening (QT) – Reverse of quantitative easing (QE); a central bank that acquired financial assets under QE undertakes steps to reduce its balance sheet.

S&P 500 Index – This unmanaged capitalization-weighted index of the stocks of the 500 largest publicly traded U.S. companies is designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks, which represent all major industries.

Treasury Inflation-Protected Securities (TIPS) – Type of Treasury security issued by the U.S. government that is indexed to inflation in order to protect investors from a decline in the purchasing power of their money. As inflation rises, TIPS adjust in price to maintain their real value.

U-3 Unemployment Rate – Officially recognized rate of unemployment, compiled and released monthly by the U.S. Bureau of Labor Statistics, measuring the number of unemployed people as a percentage of the labor force.

U.S. Dollar Index (DXY) – A weighted geometric mean of the U.S. dollar's value relative to a basket of six major foreign currencies: the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc.

You cannot invest directly in an index.

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