MACKAY SHIELDS
A NEW YORK LIFE INVESTMENTS COMPANY

INSIGHTS & PERSPECTIVES
from MacKay Shields Global Fixed Income Team

JANUARY 2022

# MacKay's Global Fixed Income Insights for 2022

2021 proved to be a year of transition in fixed income, starting with the early stages of an economic expansion and easy monetary policy before moving to potential accelerated tapering and the slow withdrawal of unprecedented stimulus to the economy.

Inflation pressures grew, bringing supply chain woes and wage growth fears. Yet, the anticipated break-out in long-term rates hadn't materialized as the end of 2021 neared. Even in the changing fixed income climate, we continue to see compelling value in select areas where we seek attractive opportunities for total return and income without assuming excessive risk.

### Expect More Volatility on the Short End

As the Federal Reserve adjusts to a tighter monetary policy, expect rates on shorter maturity bonds to move higher from current levels. Both the timing and magnitude of the move may prompt increased volatility in shorter-maturing bonds relative to longer-maturing bonds. Should FOMC rate hikes happen sooner than anticipated or more aggressively than projected, the yield curve is likely to flatten as investors weigh the risks of a more proactive Fed inducing a slowdown. Moderating inflation may shrink the yield differential between longer and shorter maturities. We are decreasing allocations to short-term debt to reduce the risk that a flattening yield curve poses.

### Corporate Credit: Catch A "Rising" Star

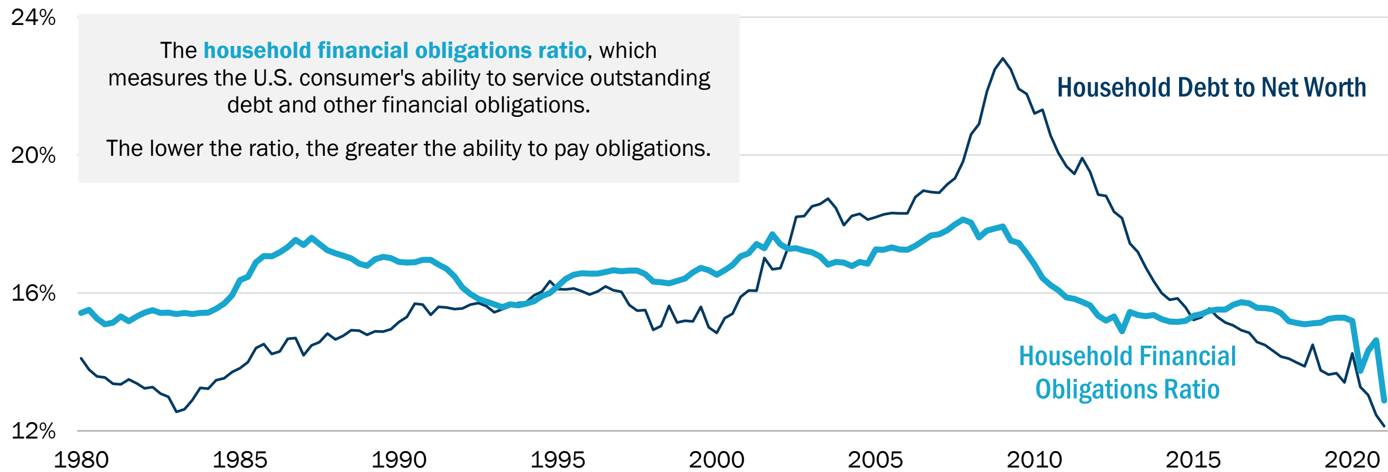
We see 2022 as a year of positive ratings trajectories that will result in a higher volume of "rising stars" or companies upgraded to an investment grade rating (BBB-/Baa3 or higher). During the pandemic-induced volatility in 2020 the credit markets experienced approximately $200 billion in "fallen angels" or companies whose credit rating was reduced from investment grade to junk status (BB+/Baa1 or lower). In 2021, the downgrade trend reversed as "rising stars" outpaced fallen angels by 2-to-1, according to data from JPMorgan. We expect this trend to continue into 2022 and beyond as more companies continue to de-lever, increase free cash flow and improve their balance sheets as the economic expansion enters its second full year.

Most Wall Street estimates call for over $100 billion in rising star candidates in 2022 (and more in 2023). We remain encouraged by the number of companies we follow that are proactively taking steps to improve their credit profiles. Although the credit ratings of some of these companies may still not reflect this improving trend, we ultimately believe the companies will be rewarded, which would further support an environment of potential price appreciation that would benefit active management.

### Don't Count Consumers Out

U.S. consumers continue to be a bright spot in the economic recovery and remain poised to power future economic activity. Thanks to generous fiscal stimulus and a tight labor market, consumers are flush with savings and confidence remains high. We expect consumer spending to remain strong in the coming year. Two key metrics—the household obligation ratio and household debt to net worth—have fallen to their lowest levels in 40 years, suggesting consumers also have room to pay down debt (see display below). Investors in securitized credit card debt and auto loans are likely to see rapid repayments.

FIGURE 1: A HEALTHY CONSUMER SECTOR CAN PAY DOWN DEBT
KEY DIFFERENCE IN THE SECURITIZED MARKET: PRE-GLOBAL FINANCIAL CRISIS VS. TODAY




Source: U Federal Reserve Board, Haver Analytics

## A New Inflation Regime

Rising wages and housing costs suggest higher inflation in the years ahead; capital spending on renewable energy and carbon-neutral initiatives will likely be inflationary longer-term. Thus, we think it is unlikely that inflation returns to pre-COVID levels, despite productivity improvements gained by businesses and reductions in supply-chain bottlenecks.

While the Federal Reserve has broadcast a likely shift in monetary policy, it is likely to remain highly accommodative, with real (inflation-adjusted) interest rates below zero. We don’t expect the economy to slow below trend. Debt-financed government spending on infrastructure and social programs is also likely to support demand in an economy already well supported by previous monetary infusions and high savings rates.

## Housing Market Rolls On

We expect the supply/demand imbalance in housing to support price increases in 2022. Housing prices have exceeded expectations as limited supply and competition met multi-generational demand. COVID and the advent of hybrid work has meaningfully altered housing preferences.

Low inventories, particularly in the fastest growing cities, are likely to persist with little identifiable new sources coming to the market in the near term. Since the Global Financial Crisis, underwriting standards have improved as evidenced by average FICO scores increasing and Loan to value ratios declining. Importantly, lenders also no longer offer affordability loans such as pay option adjustable-rate mortgages. Rising prices for underlying assets coupled with strong underwriting standards should generally support mortgage-related debt instruments.

## NOTE TO EUROPEAN INVESTORS

This document is intended for the use of professional and qualifying investors (as defined in the Alternative Investment Fund Manager's Directive) only. Where applicable, this document has been issued by MacKay Shields Europe Investment Management Limited, Hamilton House, 28 Fitzwilliam Place, Dublin 2 Ireland, which is authorized and regulated by the Central Bank of Ireland.

## IMPORTANT DISCLOSURE

Availability of this document and products and services provided by MacKay Shields LLC may be limited by applicable laws and regulations in certain jurisdictions and this document is provided only for persons to whom this document and the products and services of MacKay Shields LLC may otherwise lawfully be issued or made available. None of the products and services provided by MacKay Shields LLC are offered to any person in any jurisdiction where such offering would be contrary to local law or regulation. This document is provided for information purposes only. It does not constitute investment or tax advice and should not be construed as an offer to buy securities. The contents of this document have not been reviewed by any regulatory authority in any jurisdiction.

This material contains the opinions of the Global Fixed Income team but not necessarily those of MacKay Shields LLC. The opinions expressed herein are subject to change without notice. This material is distributed for informational purposes only. Forecasts, estimates, and opinions contained herein should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. Any forward-looking statements speak only as of the date they are made and MacKay Shields assumes no duty and does not undertake to update forward-looking statements. No part of this document may be reproduced in any form, or referred to in any other publication, without express written permission of MacKay Shields LLC. ©2021, MacKay Shields LLC. All Rights Reserved.

**Information included herein should not be considered predicative of future transactions or commitments made by MacKay Shields LLC nor as an indication of current or future profitability. There is no assurance investment objectives will be met.**

**Past performance is not indicative of future results.**