2023 NATIXIS AND LOOMIS SAYLES FIXED INCOME PULSE SURVEY

Yield is back: The long and short of it.

Advisors navigate inflation, rates, and duration to reset bond strategy in 2023

NATIXIS INVESTMENT MANAGERS | LOOMIS SAYLES®

After ten rate hikes in 12 months and the fed funds target rate at a 15-year high, nine out of ten financial advisors (87%) declare that yield is back.

According to results of the Natixis IM/Loomis Sayles Fixed Income Pulse Survey, seven in ten advisors (69%) also say this is the best return opportunity for bonds in 15 years.

Not only have 475 basis points in hikes enhanced the yield opportunity, but many also see that rising rates have also ushered in a return to fixed income's traditional risk management role and three-quarters of advisors believe bonds are once again ballast in portfolios.

While rising rates may be driving more positive sentiment, inflation continues to be the focal point of the bond discussion. After seeing inflation as high as 9% in 2022, advisors recognize that today's declines are significant and seven out of ten (69%) believe lower inflation makes bonds more attractive. But inflation is a double-edged sword for advisors.

Declining to 5% as of March 2023, inflation may be half what it was one year ago, but it still ranks as the top portfolio risk for advisors in 2023 and almost two-thirds worry that high inflation could linger longer than expected.

The 2023 Fixed Income Pulse Survey has been produced in cooperation with Natixis Center for Investor Insight and Loomis, Sayles and Company. An affiliate of Natixis Investment Managers, Loomis Sayles lends nine decades of investment experience and industry-leading fixed income capabilities to the goal of better understanding financial advisor sentiment and strategy in today's bond market.

Overall, the survey, which included 350 financial advisors in the United States who manage a cumulative $1.7 trillion in client assets, offers insights into what advisors think about bonds, their risk concerns and market perceptions, and most importantly their portfolio strategies for the rising rate environment. Key takeaways include:

Yield is back

Advisors may have strong convictions about the resurgence in bonds, but the consensus is split as to whether short duration (58%) or long duration (42%) bonds will outperform in 2023.

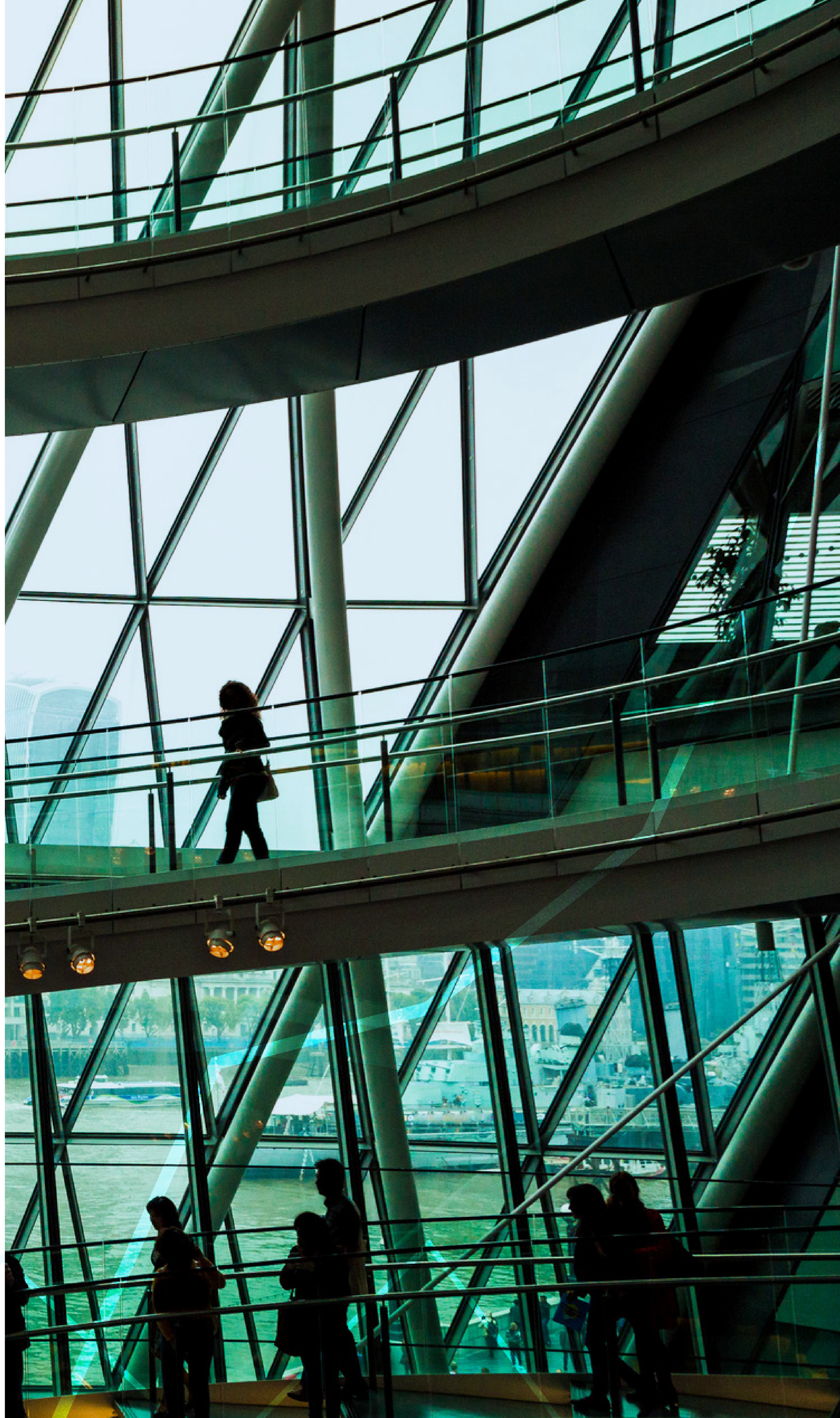
Inflation remains the key risk

But 56% of advisors also see central bank uncertainty as a critical concern, with more hikes likely as the Fed manages toward a 2% inflation target. These concerns are not limited to bonds and show up loud and clear in their overall market outlook for the rest of 2023.

Active management essential in bond strategies

Seven in ten advisors (71%) say active investing makes more sense for fixed income than passive. And as they look to adapt investment strategy, half (49%) say they would like to know more about building income portfolios.

Interest rates, which had been at or near all-time lows since the 2008 Global Financial Crisis, held bonds to historically low yields, forcing many investors to go further afield to generate income and enhance diversification. But now with the fed funds target rate quoted at 4.75%–5.0% as of March 22, advisors are finding their way back to bonds.



Yield is back.

Since the start of 2023, the yield on 10-year Treasuries has ranged from 3.3% to 4.0%, leading to what nine out of ten (86%) advisors say is the best yield opportunity they've seen in years. In fact, it's been more than 15 years since bonds have offered anything better on an absolute basis.

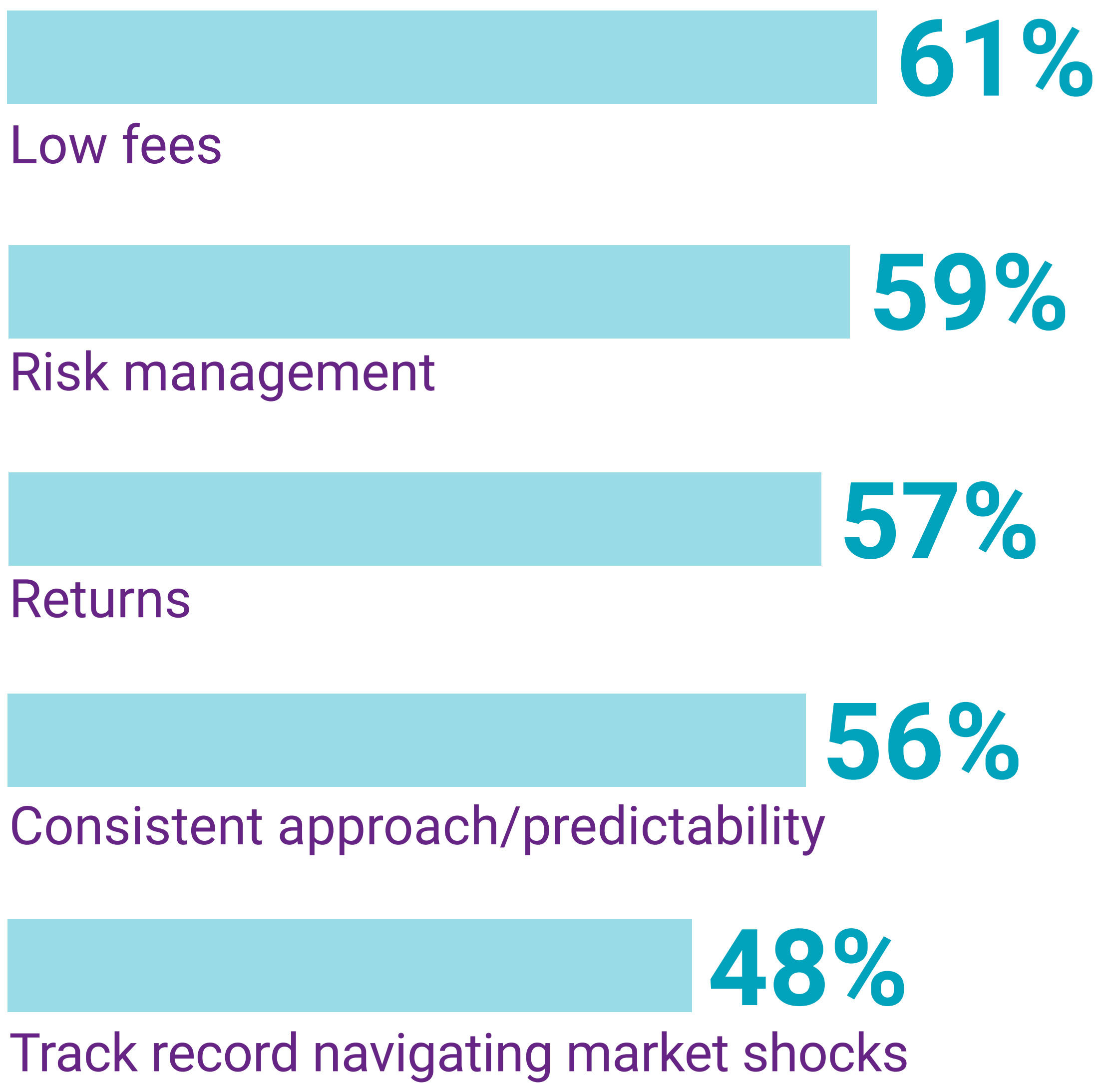
Realizing that the onslaught of rate hikes has the potential to increase bond income down the road, another seven in ten (69%) say it is also the best return opportunity for bonds in 15 years. But there are still some key questions to be answered before many advisors will be ready to fully commit, as only 40% of advisors think inflation and interest rates have reached their peak.

While the Fed's efforts to tame inflation have been successful to a point, the fact remains that 5% inflation is still significantly higher than investors have experienced over the past 30 years and is still two and a half times the Fed's target rate of 2%. It's a scenario that could result in additional rate hikes in the coming months, and that has led to a clear split in advisor sentiment on duration.

Uncertainty with bonds demands active management

Given that the markets present so many uncertainties, eight in ten advisors say it's important to work with an experienced fixed income manager – in fact, half of advisors (48%) say it's important for managers to have a track record in navigating market shocks. Three-quarters also believe active management is as important to generating returns in fixed income as it is to equities.

WHEN IT COMES TIME TO EVALUATE MANAGERS, ADVISORS ARE LOOKING AT FIVE KEY FACTORS:



Source: FRED

Duration. Duration. Duration.

Overall, six in ten (58%) think short duration bonds are likely to outperform in 2023. It's likely these advisors are taking a wait-and-see approach to fixed income as they anticipate additional rate hikes later in the year. On the other side of the equation are the 42% of advisors who project long duration bonds to outperform. In this case, they may be looking to lock in higher yields while uncertainties about central bank policies, inflation, and a possible recession remain.

Inflation concerns vary widely between these two groups. Overall, 40% think inflation and interest rates have reached their peak. That figure is driven largely by the 55% who project outperformance in long duration. Only 29% of those who favor short duration agree.

Similarly, 51% of advisors say they are now investing in bonds because they think inflation will be lower. This breaks down to 65% of those anticipating long duration to come out on top and only 41% of those looking for short to be the right call.

Regardless of where they come down on duration, few advisors (22%) say they are struggling with the decision to get back into bonds. In fact, few advisors actually left bonds altogether in the past few years. Many simply dialed down exposures to interest-rate-sensitive government issues in favor of credit-sensitive high yield bonds and alternatives such as private credit.

With so many questions on the table, about one-third of financial advisors (32%) admit they're worried about missing the entry point on bonds. It's a dilemma that vexes more of those who anticipate long duration to outperform (41%) than those who see short duration bonds outperforming (26%).

As a result, 58% of advisors overall say they are not yet comfortable taking on duration risk. This view is even more clearly split based on their outlook, as 72% of those looking for short duration to outperform say they are uncomfortable with the risk. In contrast, only 39% of those who favor long duration share that concern.

Getting the entry point right will be the challenge for most advisors, and 58% say their fear of duration risk outweighs credit risk concerns. Even with rampant fears of a potential recession on the horizon, it's likely that growth, while slowing, continues to look good to advisors and company fundamentals remain solid so there are few credit concerns.

Even still, advisors will need to look beyond interest rate and duration concerns. After seeing bonds and stocks both lose ground least year, seven in ten (69%) believe bonds have not yet decoupled from equities in 2023.

6 out of 10

advisors say duration risk outweighs credit risk.

Inflation. Rates. Then everything else.

Fixed income risk concerns for 2023 are summed up in two words: inflation and rates.

In fact, inflation (89%) and central bank uncertainty (56%) rank as the two top risks that advisors see for fixed income markets. In the simplest terms, they're worried that inflation remains high at 5%, and it will drive policymakers at the Fed to continue with an aggressive interest rate policy as they shoot for their 2% target.

The challenge is not knowing how high they will need to take rates to actually tame inflation and not knowing when they will be ready to stop. This uncertainty is clearly reflected in the gulf between those who anticipate short duration to win out and those who think long duration will come out on top.

Fewer advisors are as concerned with other fixed income risks: Only 27% see credit spreads as a top risk. This at a time when the spread between 2-year and 10-year Treasuries reached its most inverted level since 1981, and the Federal Reserve's survey of senior lending officers shows banks are tightening their lending standards.[1]

Despite rumblings of a potential recession, even fewer advisors (24%) rank defaults or liquidity as top fixed income risks. The lower degree of concern over these risks makes sense even after the failures of Silicon Valley Bank and Signature Bank. Despite market fears of further credit tightening, corporate credit spreads have remained well behaved after the failures, which is likely due in part to the strength of corporate balance sheets.

What keeps advisors up at night?

Advisors understand the risks presented by inflation and interest rates, but they are grappling with the uncertainty of the direction these risks may take in the coming months. Advisors admit that when it comes to fixed income, their biggest worry is that inflation will linger longer than anticipated. After experiencing average inflation of just 1.88% between 2010 and 2020, advisors witnessed the effects of elevated inflation over the past 2¼ years when it reached 4.7% in 2021 and climbed even higher to 9% in 2022.

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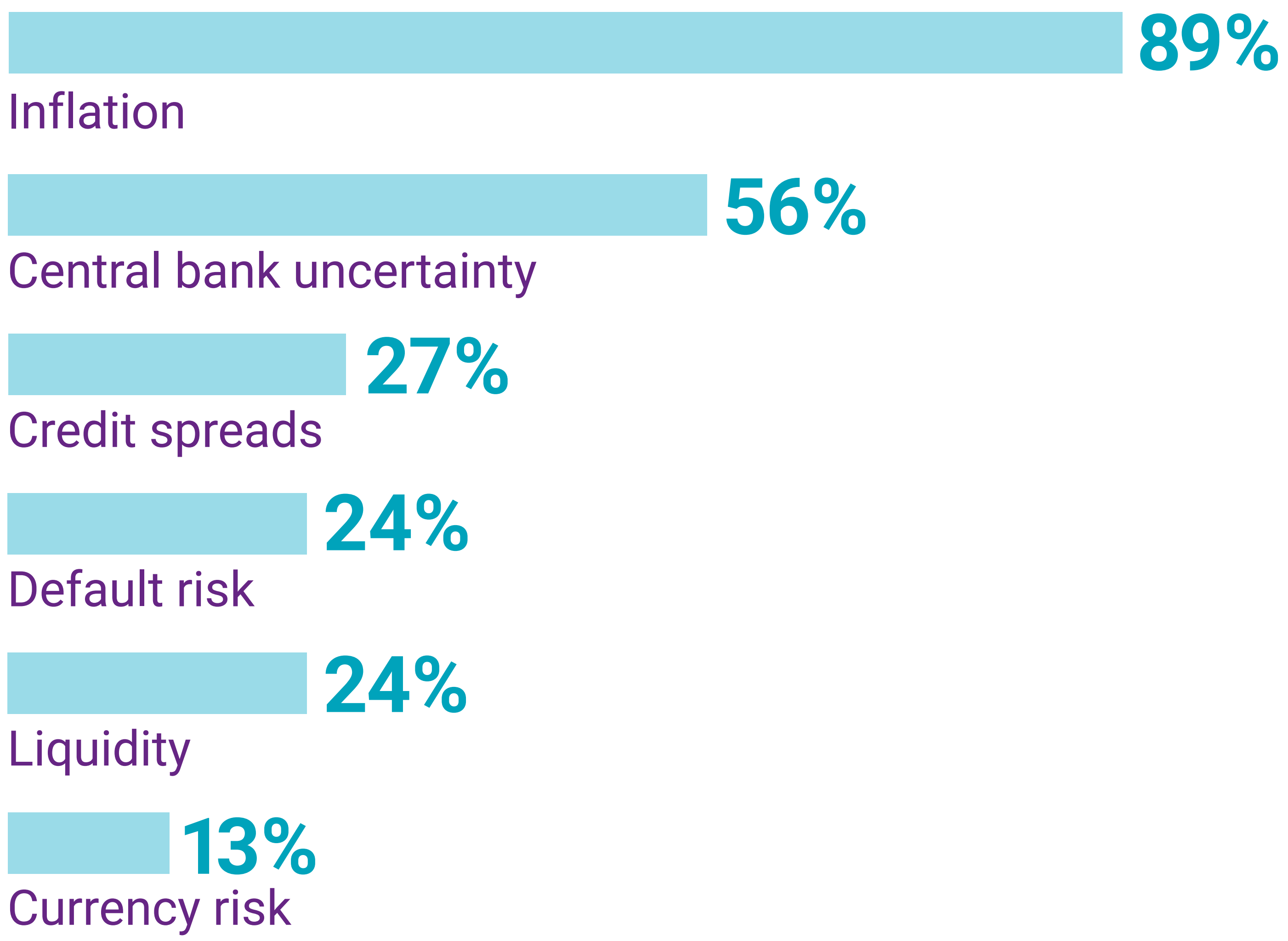
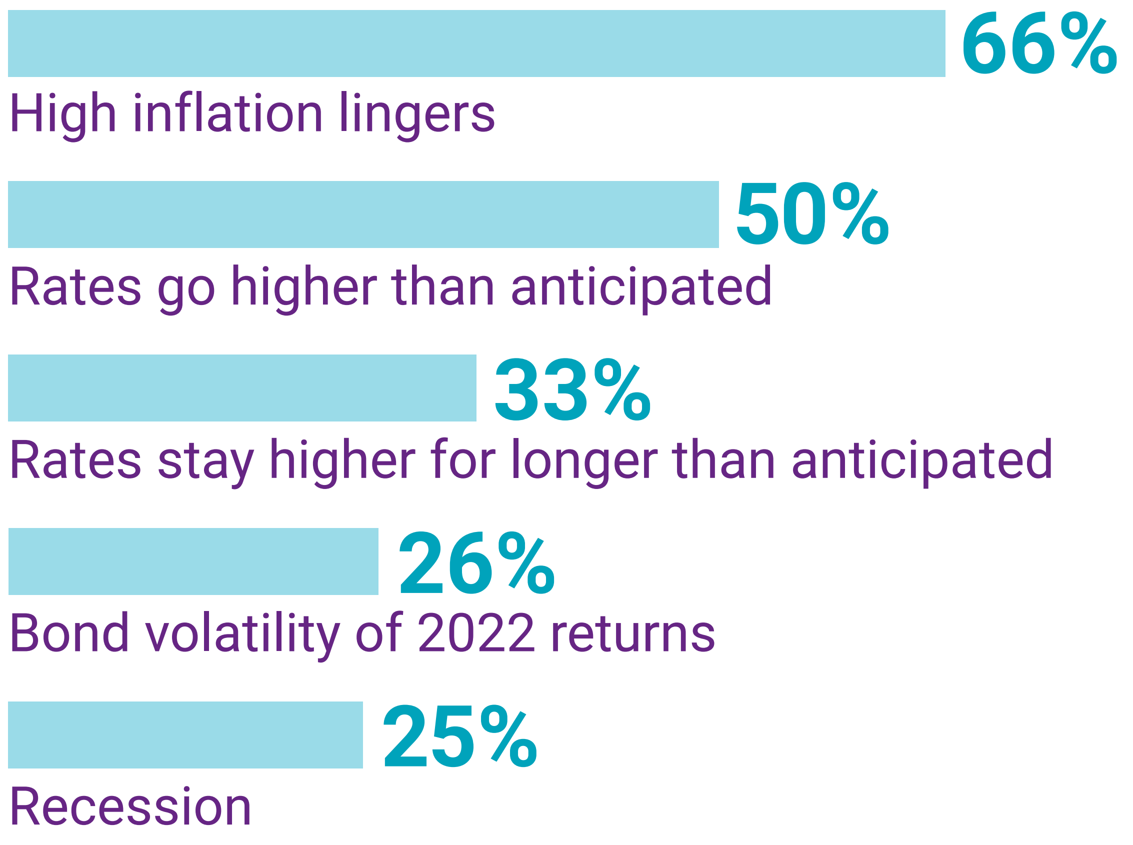
of advisors are worried that rates could go higher than anticipated.

TOP FIXED INCOME RISKS IN 2023



TOP FIXED INCOME CONCERNS IN 2023



It's taken ten rate hikes, six of which were larger than the typical 25 basis point increment, in 12 months for inflation to recede to today's 5%. Recognizing that there is a still a long way to go before inflation reaches the Fed target rate of 2%, advisors are leery about where interest rates could be heading. Half say they are worried that rates could go higher than anticipated. A third (33%) worry that rates could stay higher for longer than the market anticipates.

After 2022's bond market performance, it could be expected that advisors would be worried about continued volatility, but only 26% see it as a concern today. It's likely that many realize the initial shock and pain of rate hikes is over and believe additional increases have already been priced into the market.

Other issues worry them even less. While market watchers worry that the economy could be on a course to recession, only 25% of advisors are concerned about its impact on fixed income investments. In a similar vein, only 16% worry about the impact that corporate defaults and downgrades could have.

Even as the debt ceiling showdown between the Republican-led House and the Biden administration will likely come to a head this summer, less than one in five advisors (15%) are losing any sleep over the impact it could have on bonds. Fewer still worry about how consumer spending (12%) might impact fixed income, or the impact that US-China tensions could have on Treasuries (9%).

Advisors may be less concerned about consumers because they've been resilient since Covid. Debt may be ticking up and savings may be ticking down slightly, but both numbers are stronger than pre-pandemic levels.

Two visions for the future of the economy

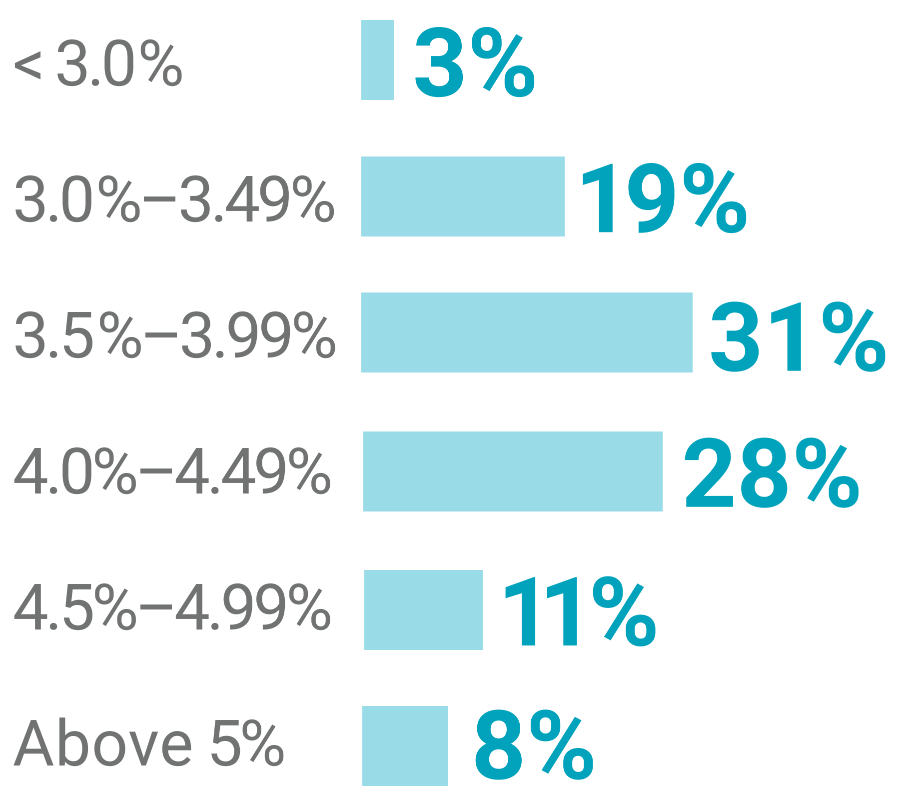
Given that these bond concerns are focused primarily on two connected issues – inflation and interest rates – it's only natural that advisor views on the economy and markets mimic their views on duration. However, given the uncertainties, it should be no surprise that almost eight in ten advisors (77%) believe active investments will outperform passive investments.

8 in 10

advisors believe that active investments will outperform passive.

With the rates on 10-year US Treasuries hovering around 3.5%, and more hikes likely, most advisors see rates between 3.5% and 3.99% (31%) or 4.0% and 4.49% (28%). Both ranges are significantly above levels seen a year ago, but still fall far short of the historical average of 5.89%. Essentially, the results show half of advisors think rates will remain range-bound, which should make one of their biggest challenges easier by reducing the risk of taking on duration.

ADVISOR FORECAST FOR INTEREST RATES AT THE END OF 2023



Even still, advisors have a big difference of opinion on how markets will fare through year-end. Advisors are split as to which markets will outperform, the US (56%) or international (44%). In this case those calling for long duration to win out (62%) were more inclined to project outperformance in the US markets compared to international markets (52%). Following suit, advisors were more inclined to project developed markets (54%) to outperform emerging markets (46%), though there was no clear consensus on the call.

This may be in part the result of a simple home country bias, but it also may suggest that advisors see that the economic cycle is more advanced in the US. If the US enters recession, it's likely that other economies will follow suit. As a result, the US would be poised to recover sooner.

Overall, six in ten believe the US dollar will weaken. This may be as much a reaction to the dollar's meteoric rise of over 27% from mid-2021 through September 2022 as it is a comment on their relative views on interest rates.

Now that yield is back, advisors see a reversal on one key trend of the past ten years, when the hunt for yield led investors to dial down bond exposures in favor of riskier alternative investments. Two-thirds (66%) believe traditional fixed income will outperform alternatives. Six in ten (59%) also project investment grade bonds to outperform high yield bonds (41%), which suggests that in the event of recession, they favor higher quality bonds. However, opinions are not as strong when it comes to picking the top performer between securitized debt (53%) and US Treasuries (47%).

> Two-thirds of advisors believe traditional fixed income will outperform alternatives.

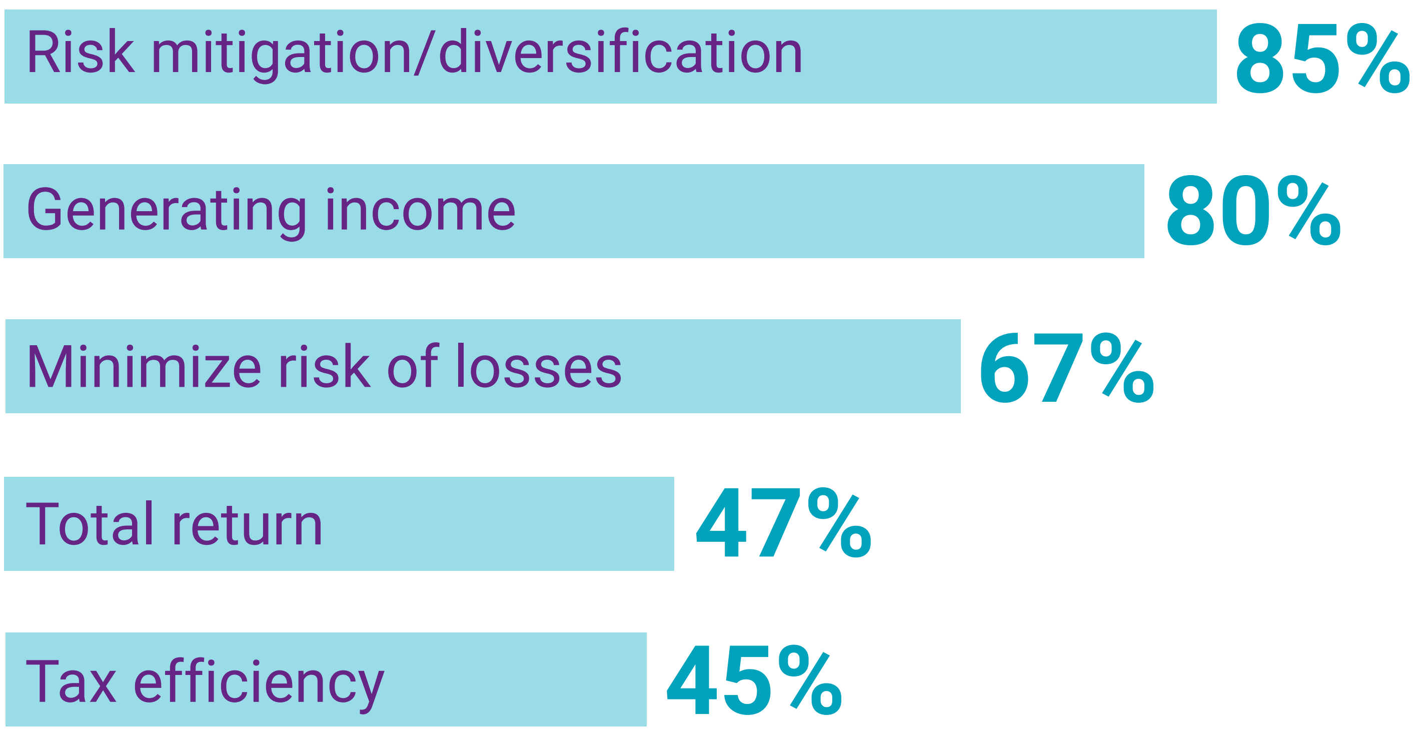
Is it time for a strategic shift?

From inflation and rates to slowing growth, to a potential recession, advisors are faced with uncertainty at every turn. In this environment, advisors are seeing three primary roles for fixed income in their portfolios.

In what they see as the best yield opportunity in years, it's not surprising to see that 80% of advisors are looking to fixed income to generate income for clients. It is surprising to see that advisors were even more likely to look to fixed income as mitigating portfolio risk by enhancing diversification (85%). Similarly, two-thirds of advisors see fixed income as helping to minimize risk of loss.

Given the circumstances, fewer advisors are looking to fixed income to fulfill two of its other traditional roles. Even though they see this as the best return opportunity for bonds in 15 years, less than half of advisors (47%) are looking to pursue total return with their fixed income investments. Only 45% are looking for tax efficiency out of the fixed income holdings.

ADVISORS SEE MANY ROLES FOR FIXED INCOME IN PORTFOLIOS



After a decade of low rates in which advisors have had to move further out on the risk spectrum to generate yield, only 36% say they are actively de-risking their portfolios. This stands in contrast to the 53% of institutional investors who said they were de-risking as a result of recent yield shifts just six months ago, when we conducted our 2023 outlook survey.[2] Recognizing that hikes have been going on for more than a year and the end of the tightening cycle is nearing, it's likely much of the de-risking has been done already.

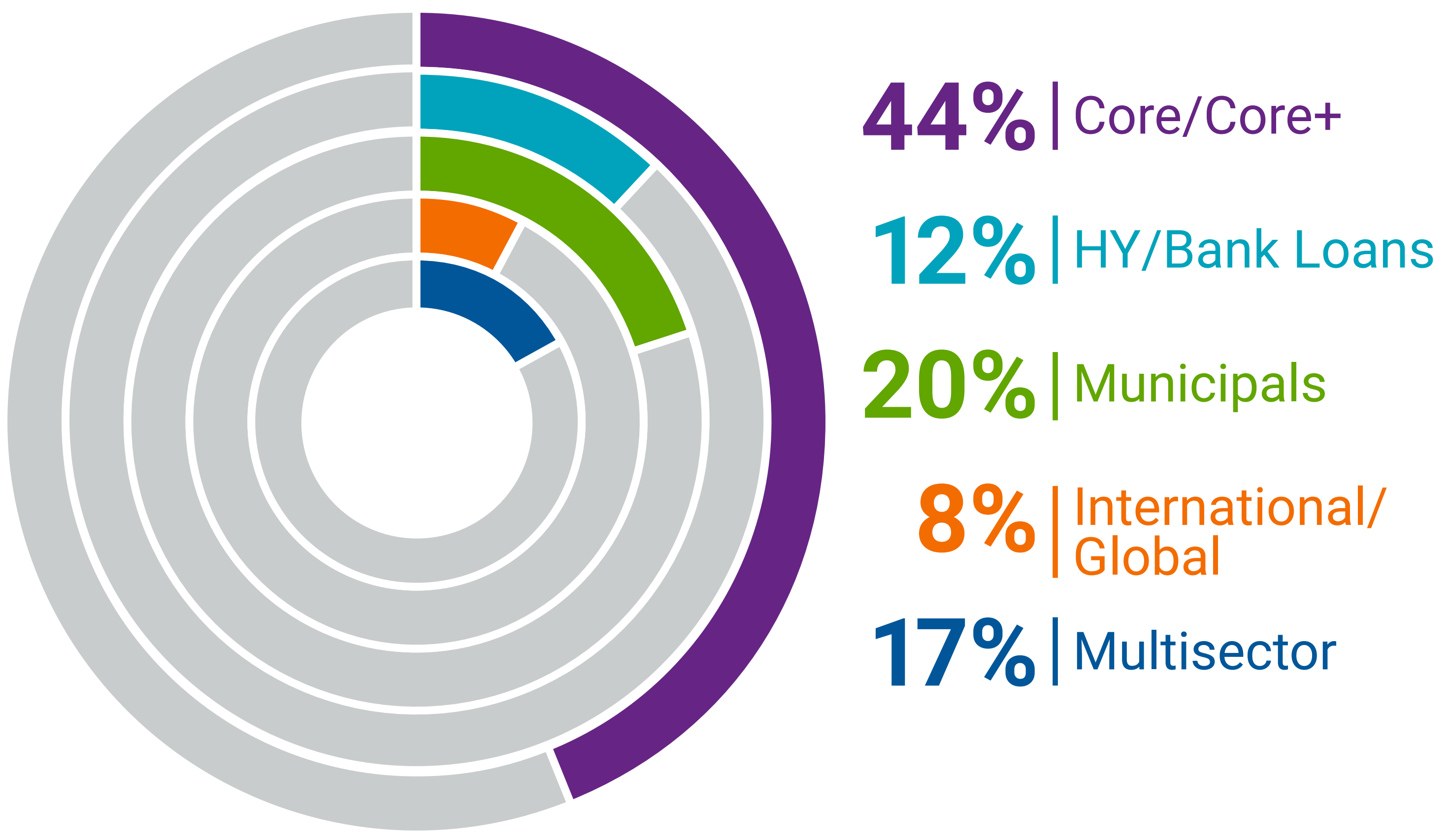
Bond allocations focus on quality

In fact, portfolio allocations currently reflect a focus on quality as 44% of advisor fixed income portfolios are currently allocated to either core or core-plus bonds on average. The shift is most notable among registered investment advisors (RIAs), who have allocated 56% of their fixed income portfolios to these classes of bonds.

If there are any credit concerns, they are further out on the risk spectrum, as advisors have allocated only 12% of fixed income holdings to high yield bonds and bank loans, though they may be getting some exposure through the 17% who allocate to multisector bond funds. Municipals (20%) and international or global (8%) funds comprise the rest of their holdings.

ADVISOR BOND ALLOCATIONS EMPHASIZE QUALITY

Current Fixed Income Product (class)



Active ETFs gaining traction with advisors

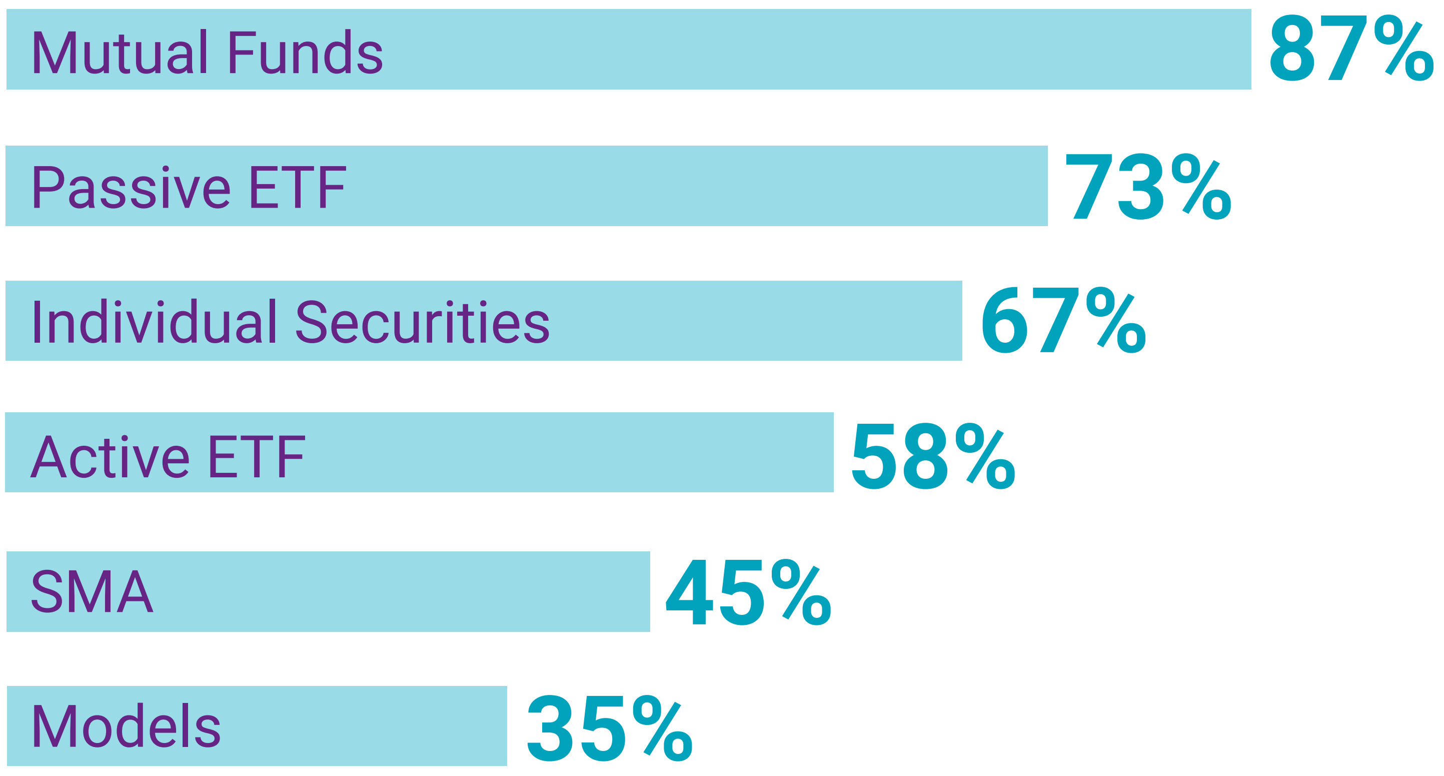
Advisors have a wide range of investment structures available to them and 87% of those surveyed are using bond funds for at least part of their strategy. A large number (73%) are also investing in passive ETFs. But six out of ten (58%) are also finding a place for active ETFs in their portfolios. This goes hand in hand with the two-thirds who say active ETFs are an increasingly attractive option for fixed income.

Two-thirds are keeping it old school with at least a part of their portfolios by investing in individual securities. The industry's focus on customizable and tax-efficient separately managed accounts – and in some ways, direct indexing – is also showing up in product usage as 45% are deploying SMAs in client portfolios. Another 35% see model portfolios as an effective solution for fixed income.

Clients want customization

One reason for advisors to use this broad mix of investment structures is that more than half say their clients are increasingly looking for customized fixed income solutions. Faced with a wide range of portfolio concerns and the broad array of products to choose from, half (49%) say they would like to know more about building fixed income portfolios.

FIXED INCOME COMES IN MANY PACKAGES

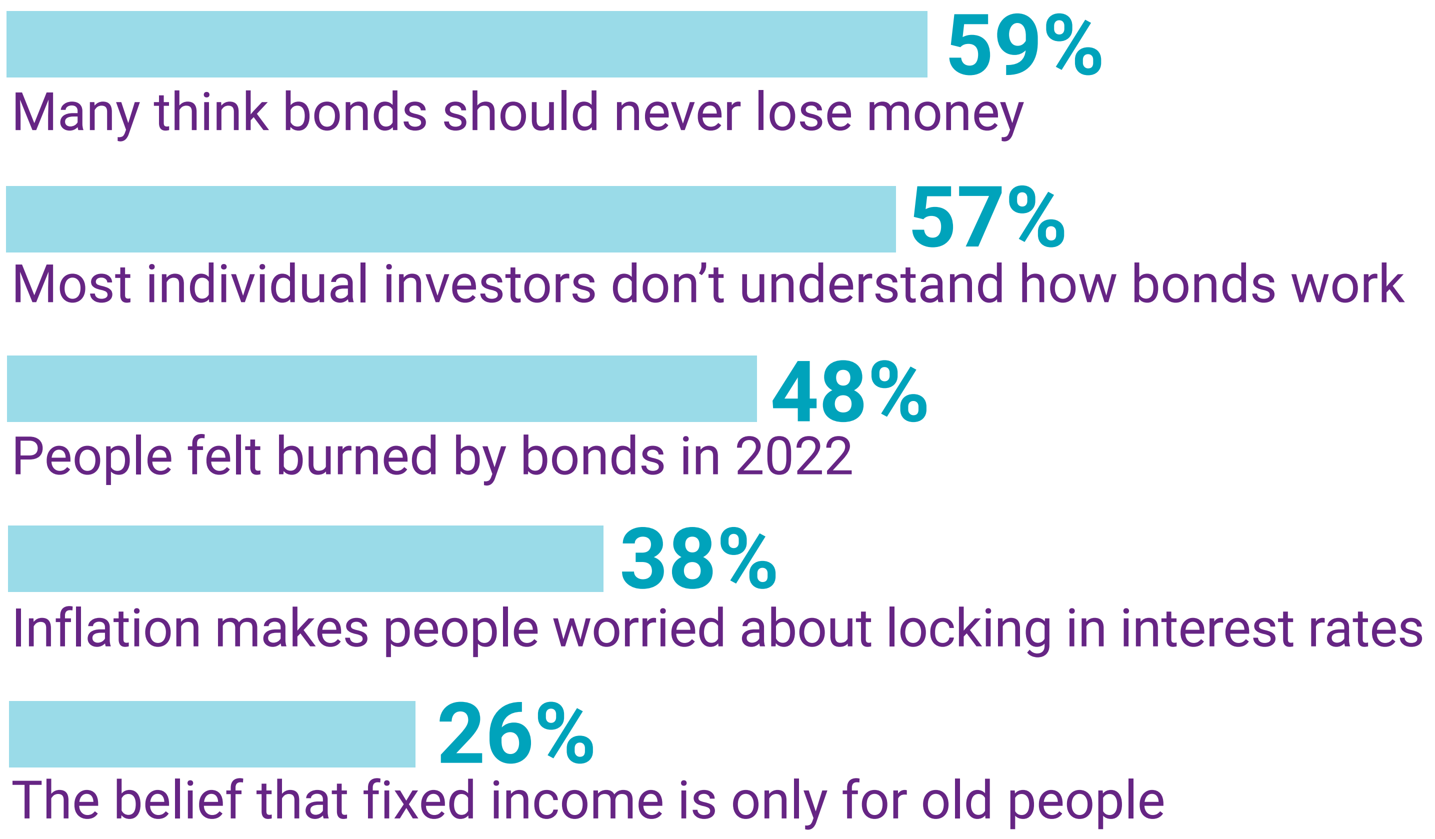


Clients also pose a key challenge in executing fixed income strategy, as advisors find them struggling to understand why, when, and how to invest in bonds. Of all the challenges advisors find in speaking with clients about bonds, recent experience may be the greatest. Last year's losing bond markets confounded many clients, as 59% of advisors said many clients don't think bonds should ever lose money – 48% go so far as to say that people felt burned by bonds in 2022.

This problem leads into the second largest challenge: 57% of advisors also say investors simply don't understand how bonds work. Our own research shows that advisors' perceptions are in line with reality. We surveyed 9,000 investors in 25 countries in 2019 and asked them what happens to bonds when interest rates go up. Only 3% knew that when rates go up, the present value of bonds you own can go down, and the future income you get from bonds will be higher. That's 270 people out of 9,000 who see the whole picture on bonds. In fact, the number-one answer was "I don't know."[3]

From what advisors say, it's clear that many investors do understand at least some part of the bond equation, as 28% say it's challenging to speak with clients about bonds because inflation makes them nervous about locking in interest rates.

BIGGEST CHALLENGES WHEN SPEAKING TO CLIENTS ABOUT BOND FUNDS



Redefining fixed income strategy

Financial advisors in the US find themselves at an inflection point in 2023. With rates at 15-year highs, they say that it is both the best yield opportunity and the best return opportunity for bonds in years. But with inflation still running well above historical averages, more interest rate hikes possible, and a potential recession on the horizon, they still believe duration risk far outweighs credit risk.

While few find it difficult to find an entry point back into bonds, they do recognize that the bigger challenge may actually be to bring clients along in the decision. After a tumultuous year for fixed income investors in 2022, they will need to help clients overcome the post-traumatic stress. They need to re-educate clients on how rates and bonds work and show them why fixed income allocations are essential to a well-diversified portfolio.

Given that they are leery of the uncertainty presented by inflation and rates, many will rely on experienced active managers to guide them through. Many will also want professional support in positioning fixed income portfolios to meet income, return, and diversification goals.

About the Survey

Natixis Investment Managers and Loomis, Sayles & Company, US Survey of Financial Professionals conducted by CoreData Research in February and March 2023. Survey included 350 respondents in the United States split equally between Independent Broker/Dealers, Wirehouse Advisors and Registered Investment Advisors (RIAs).

About the Natixis Center for Investor Insight

The Natixis Center for Investor Insight is a global research initiative focused on the critical issues shaping today's investment landscape. The Center examines sentiment and behavior, market outlooks and trends, and risk perceptions of institutional investors, financial professionals and individuals around the world. Our goal is to fuel a more substantive discussion of issues with a 360° view of markets and insightful analysis of investment trends.

Meet the team:

Dave Goodsell
Executive Director

Stephanie Giardina
Program Manager

Erin Curtis
Assistant Program Manager

Jessie Cross
AVP, Content

Learn more

1. "The January 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices." *Board of Governors of the Federal Reserve System*, https://www.federalreserve.gov/data/sloos/sloos-202301.htm.

2. Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in October and November 2022. Survey included 500 institutional investors in 30 countries throughout North America, Latin America, the United Kingdom, Continental Europe, Asia and the Middle East.

3. Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, February-March 2019. Survey included 9,100 investors from 25 countries.

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Actual results may vary.

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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.

Interest rate risk is a major risk to all bondholders. As rates rise, existing bonds that offer a lower rate of return decline in value because newly issued bonds that pay higher rates are more attractive to investors.

Unlike passive investments, there are no indexes that an active investment attempts to track or replicate. Thus, the ability of an active investment to achieve its objectives will depend on the effectiveness of the investment manager.

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