PIMCO

Joachim Fels
January 2017

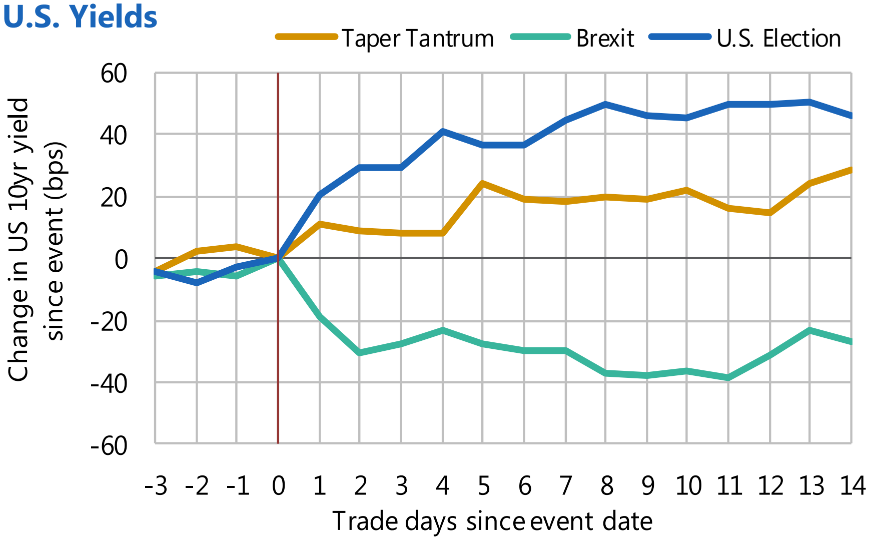
Into the Unknown

For institutional investor use only

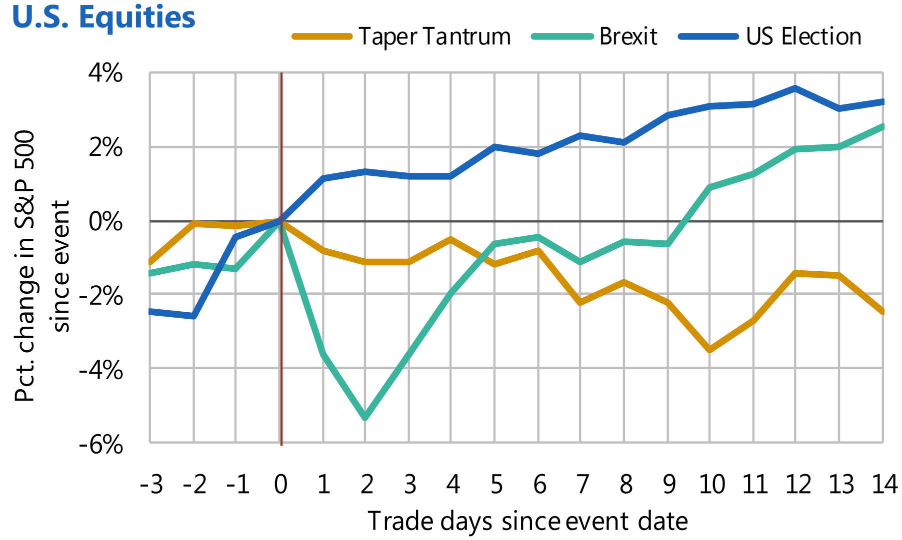
Post-election market verdict:

Stronger growth, higher inflation

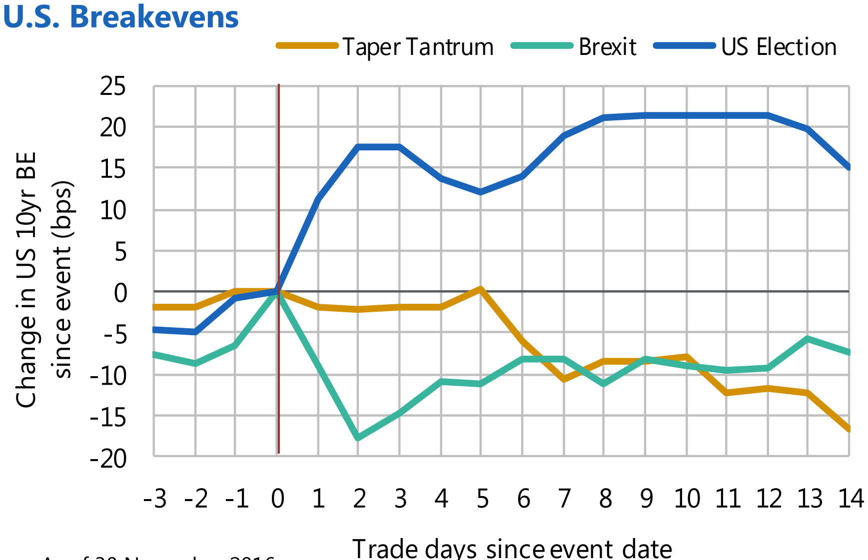
U.S. Yields



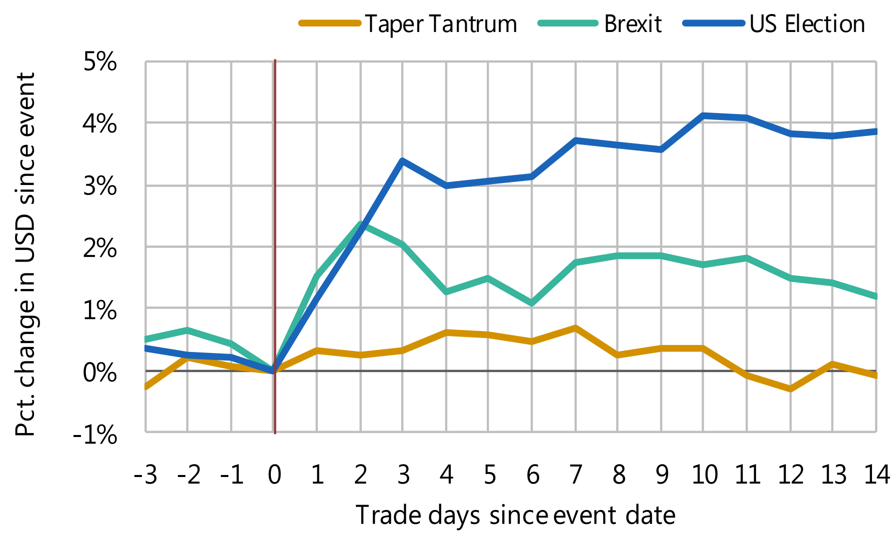
U.S. Equities



U.S. Breakevens



U.S. Dollar



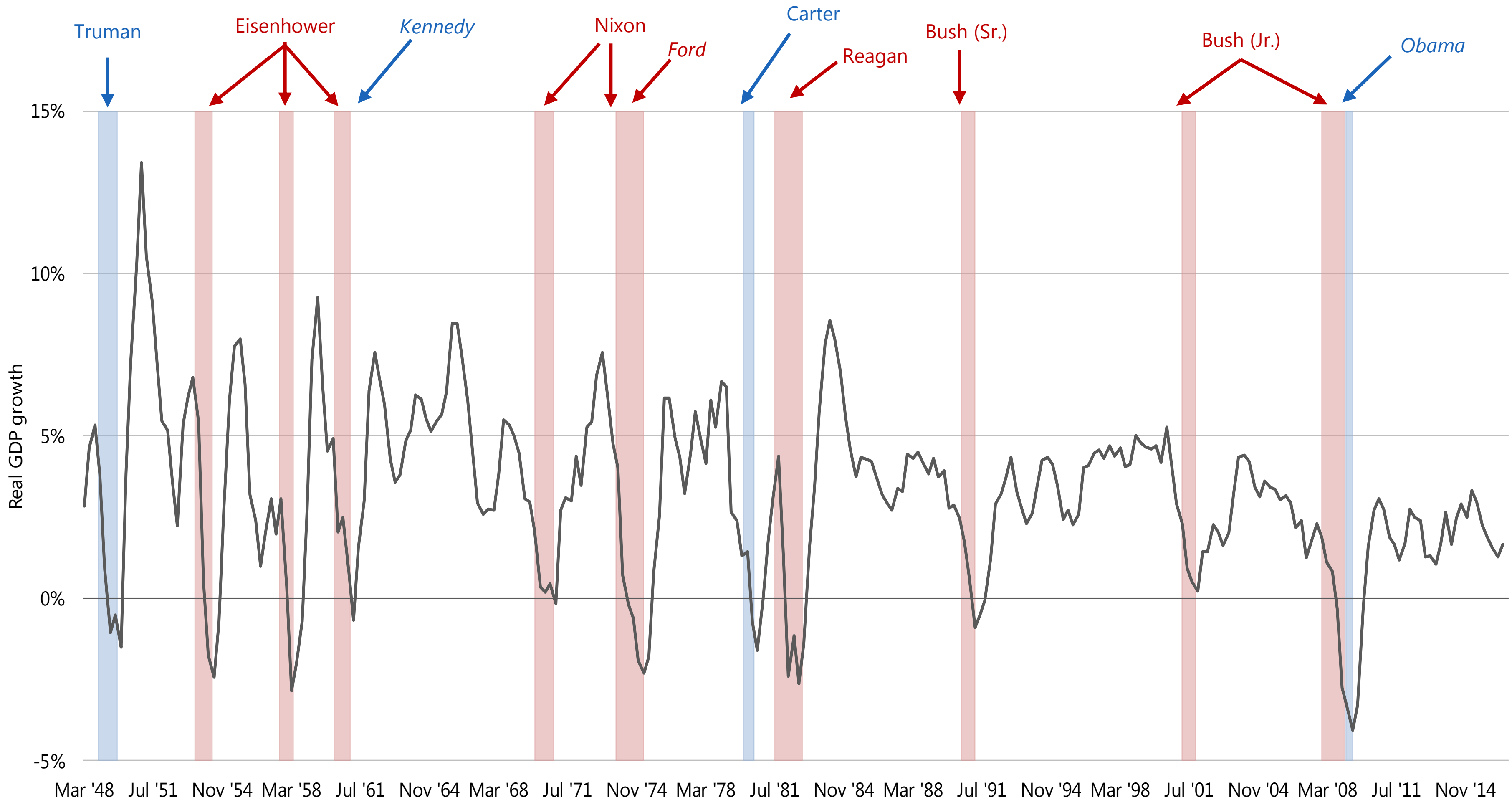
As of 30 November 2016

SOURCE: Bloomberg. Relevant dates: Taper: 22 May'13 | Brexit: 23 Jun'16 | U.S. Election: 8 Nov'16. US dollar reflects the trade-weighted broad currency index.

Will Trump break with yet another tradition?

Six Republican presidents, nine recessions..

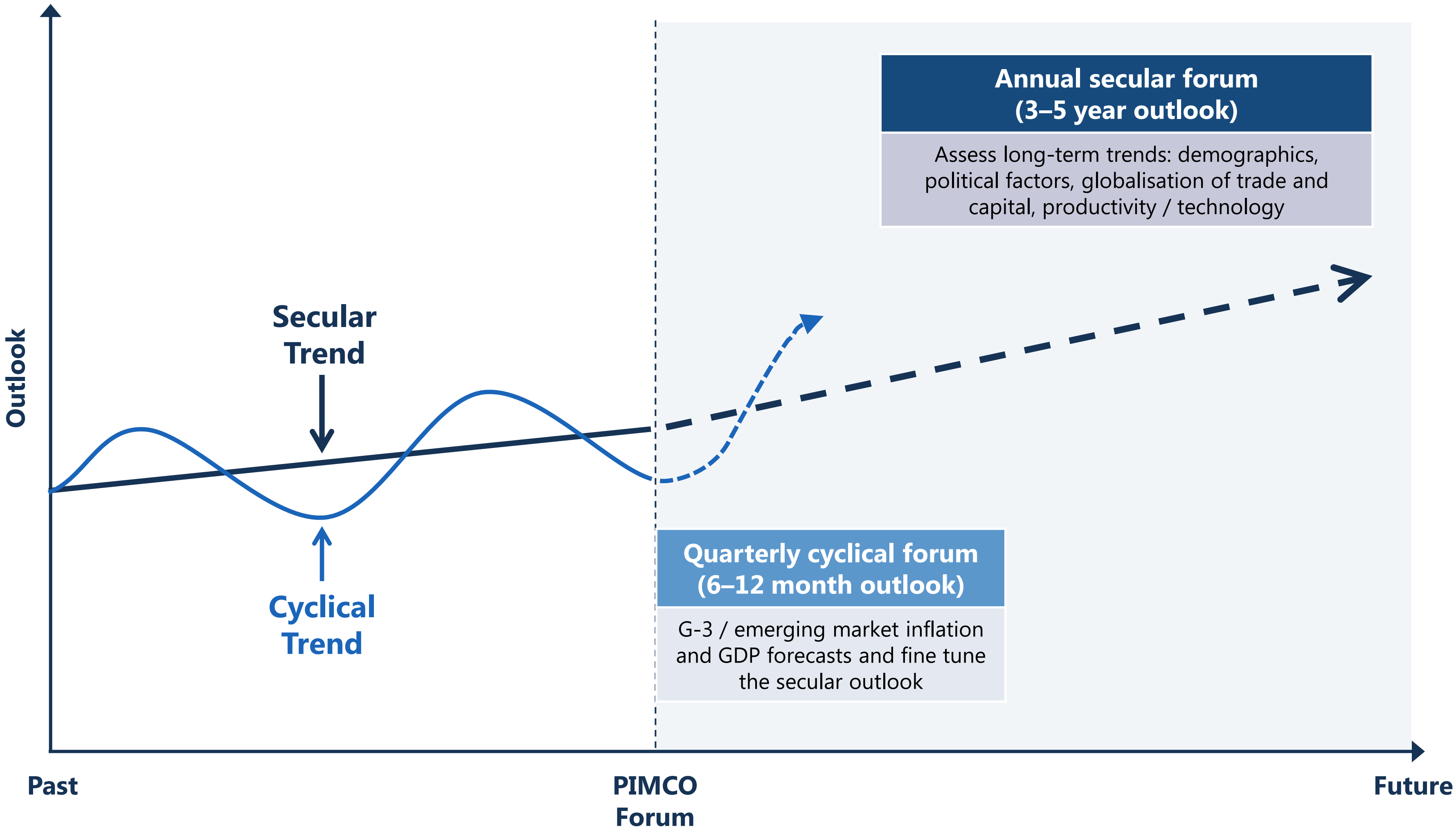
US GDP growth and recessions since World War II



As of 31 December 2016. SOURCE: PIMCO, Haver Analytics, BEA.
Shaded areas denote recessions. The color of the shading provides the party affiliation of the president (blue = Democrat, red = Republican). Italics reflect presidents who took office while a recession was already underway.

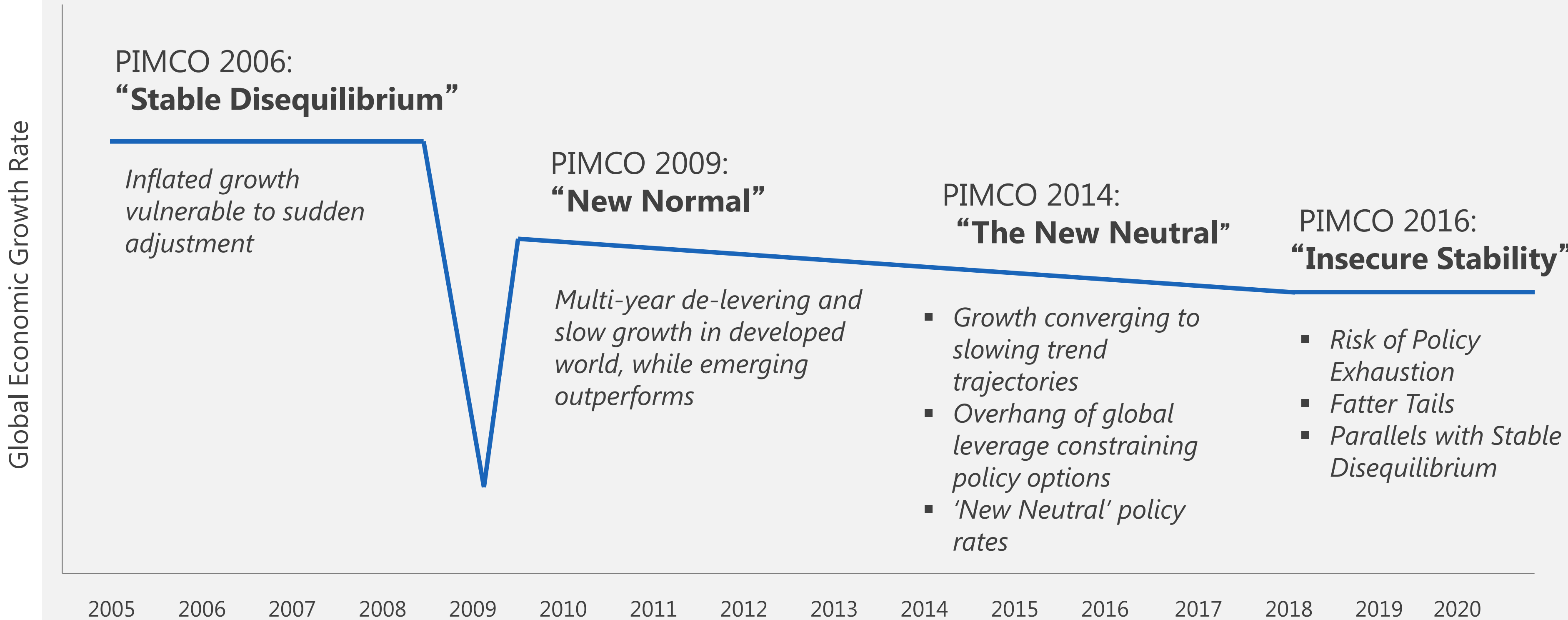
PIMCO's investment process

Forums: Themes that anchor portfolio construction



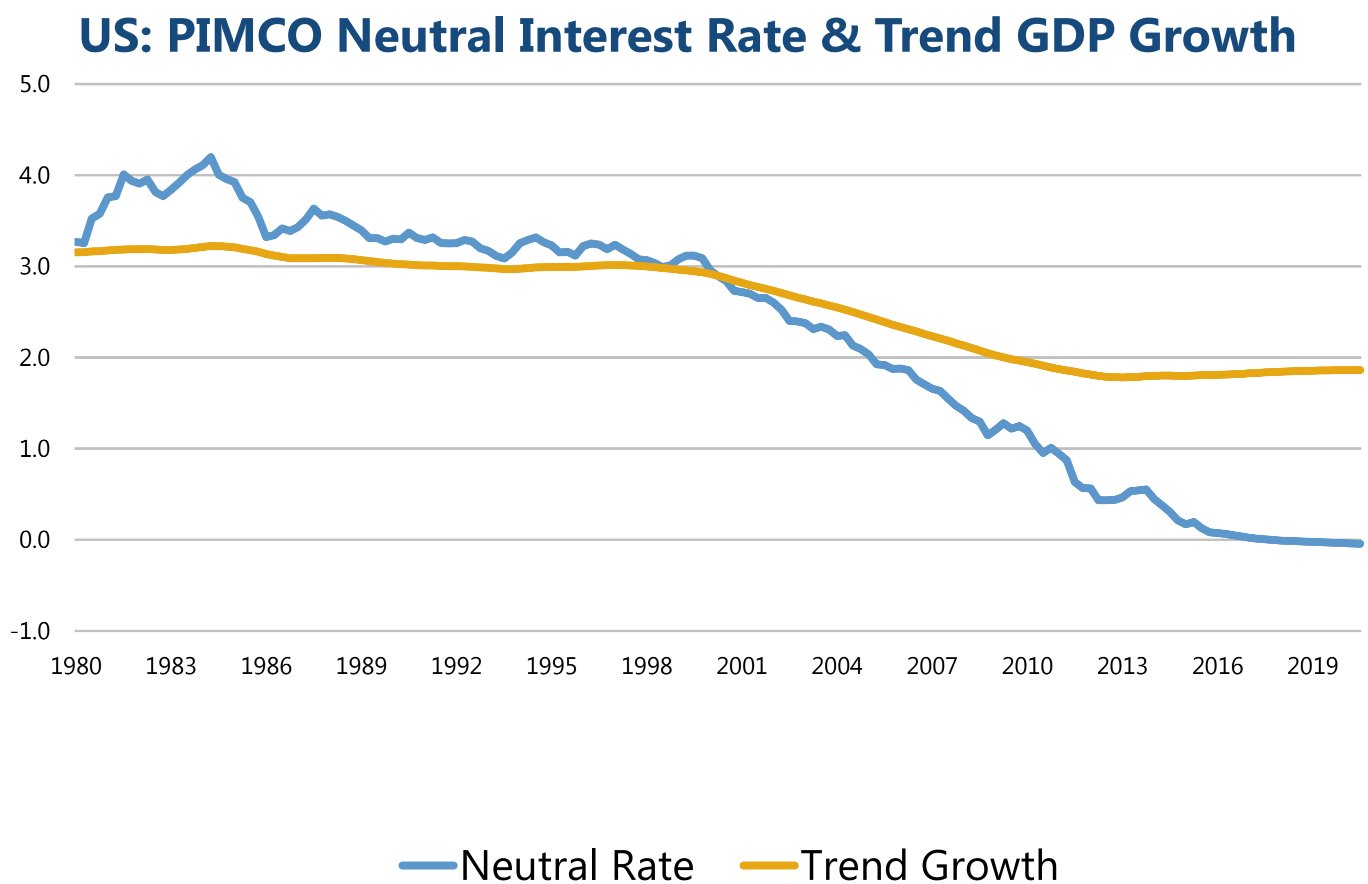
SOURCE: PIMCO
Refer to Appendix for additional investment strategy, outlook and risk information

Evolution of PIMCO's secular themes



As of 31 May 2016
SOURCE: PIMCO

The New Neutral real policy rate (r*) is around zero



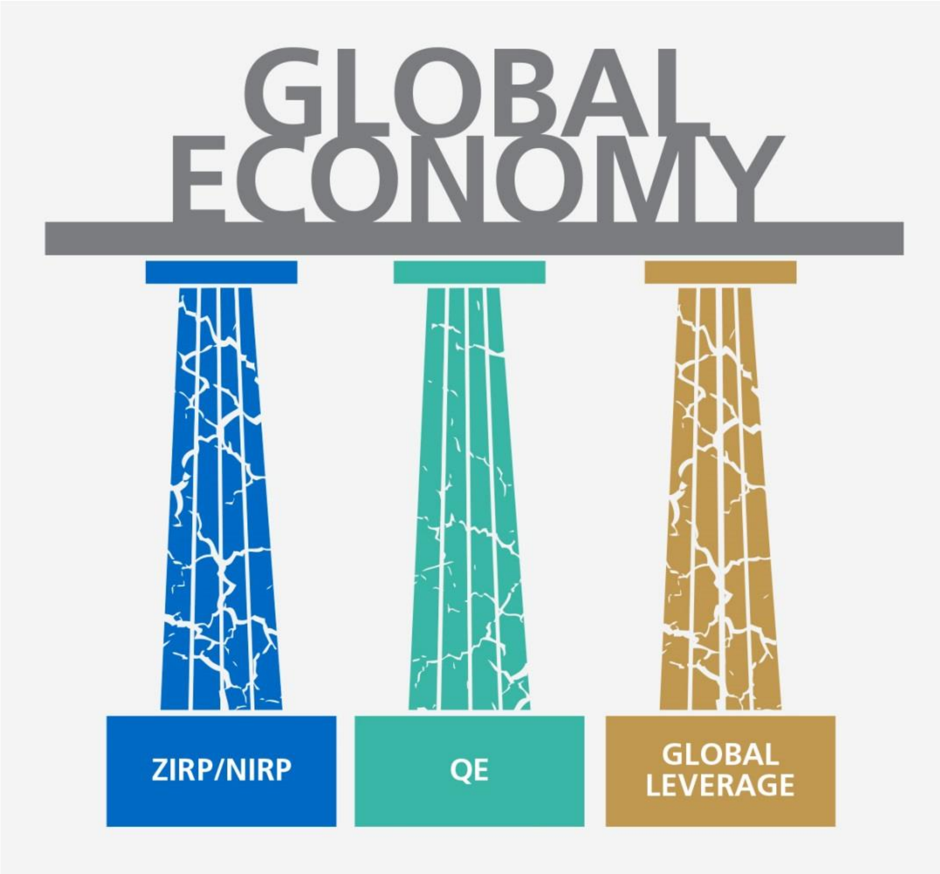
Secular drivers of r*

Decomposing the Fall in Long-term Real Rates (in bps)

Decline in world real rate since 1980s	-450
of which:	
Lower trend growth	-100
Factors raising Saving	-160
- Demographics	-90
- Inequality	-45
- EM C/A surpluses	-25
Factors depressing Investment	-140
- Lower rel. price of capital goods	-50
- Lower public investment	-20
- Higher risk spreads	-70
Unexplained	-50

Source: L.Rachel, T.Smith, Bank of England

PIMCO's secular theme:
Stable but not secure

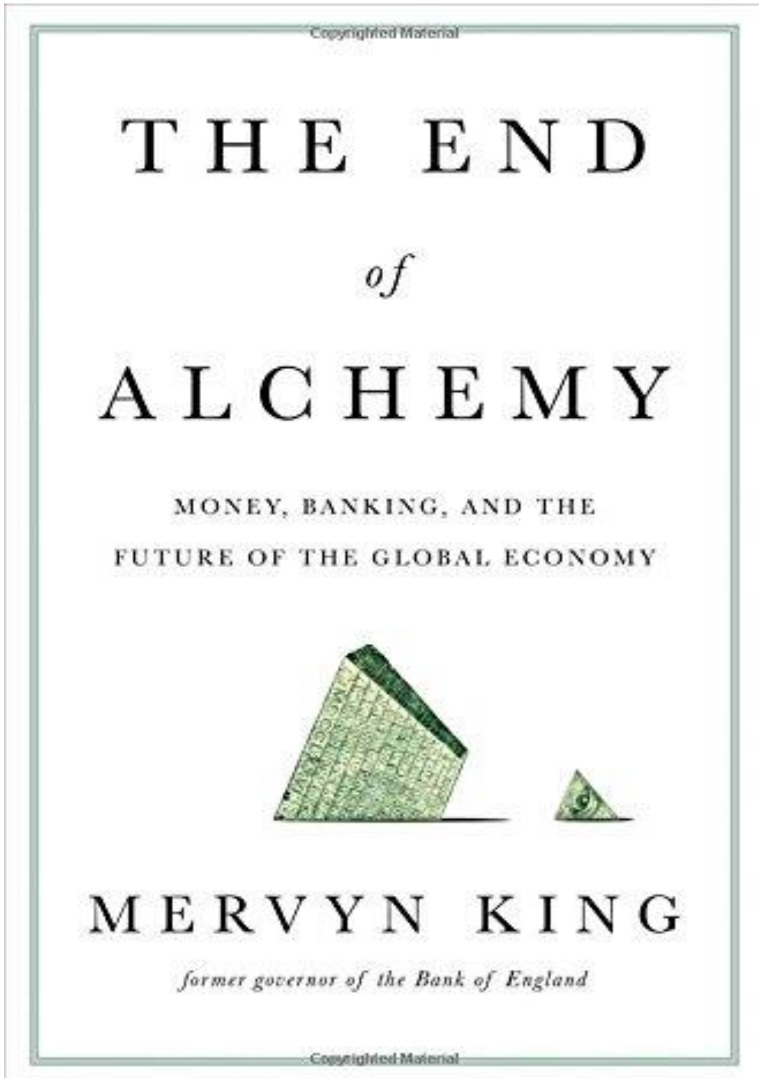


- Post-crisis global economy in which growth is just fast enough to avoid stall speed
- Three policy props have maintained stability: near-zero interest rate policy,
  QE, and levering up in some economies
- All three policies face diminishing returns as costs of unconventional policy are rising
- Baseline outlook for **a stable disequilibrium to persist, but with elevated left-tail risks**

Policy props facing diminishing returns, leaving a fragile global economy to confront rising risks

ZIRP: Zero Interest Rate Policy; NIRP: Negative Interest Rate Policy; QE: Quantitative Easing

Radical Uncertainty: "Stuff Happens"



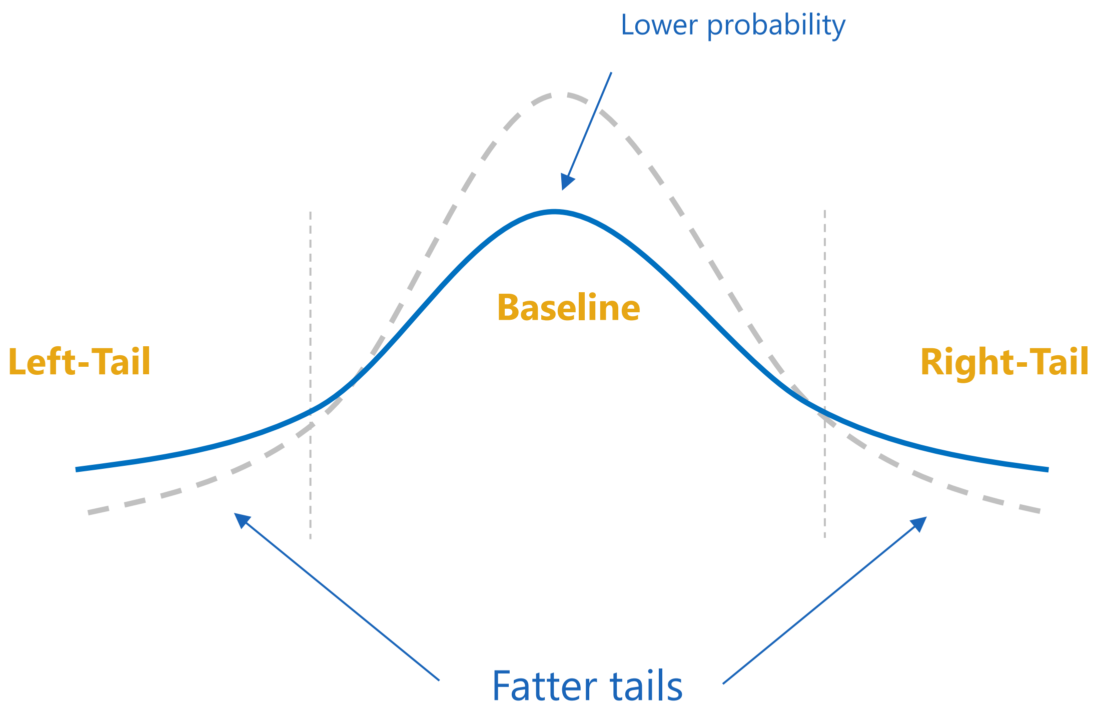
".. uncertainty that is so profound that it is impossible to represent the future in terms of a knowable and exhaustive list of outcomes to which we can attach probabilities." (p.9)

PIMCO's cyclical outlook
Into the Unknown

GUIDING PRINCIPLES

- Blurring of secular and cyclical outlooks
- "New Normal/New Neutral" trumps "New Paradigm"
- Cyclical over- and under-shoots
- "Radical Uncertainty"
- Tricky Transitions:
  - Monetary → fiscal policy
  - Globalization → de-globalization
  - China's currency regime transition

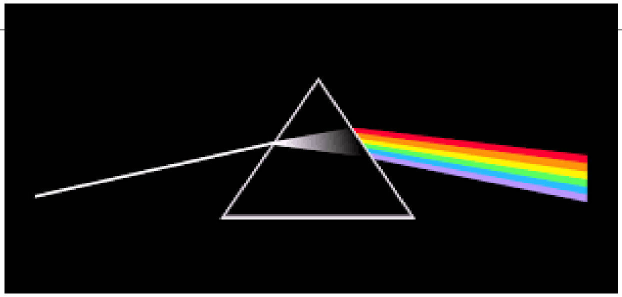
MACRO OUTCOMES OVER THE CYCLICAL HORIZON



As of December 2016
SOURCE: PIMCO
Refer to Appendix for additional outlook and risk information

Global scenarios:

Bear



Dark Side of the Moon

Disruptive transitions:

- Fiscal under-delivers
- Severe trade tensions
- RMB -15%

Global recession returns:

- World GDP growth <2%
- US, EZ stagnate
- BRZ, RUS contract again

CBs throw in the towel:

- Fed on hold
- ECB, BoJ ease more
- EM CBs struggle

Baseline

Stayin' Alive

Orderly transitions:

- Moderate fiscal boost
- Trade war avoided
- RMB -7% gradually

Expansion continues:

- Nominal GDP accelerates
- DM inflation inflects up
- EM recessions end

CBs supportive:

- 2-3 Fed hikes in 2017
- ECB, BoJ stay the course
- Brazil -450bp/MX +150

Bull

Here Comes the Sun

Smooth transitions:

- Bigger fiscal boost
- Trump-Xi trade bargain
- RMB stable

Reflation rules:

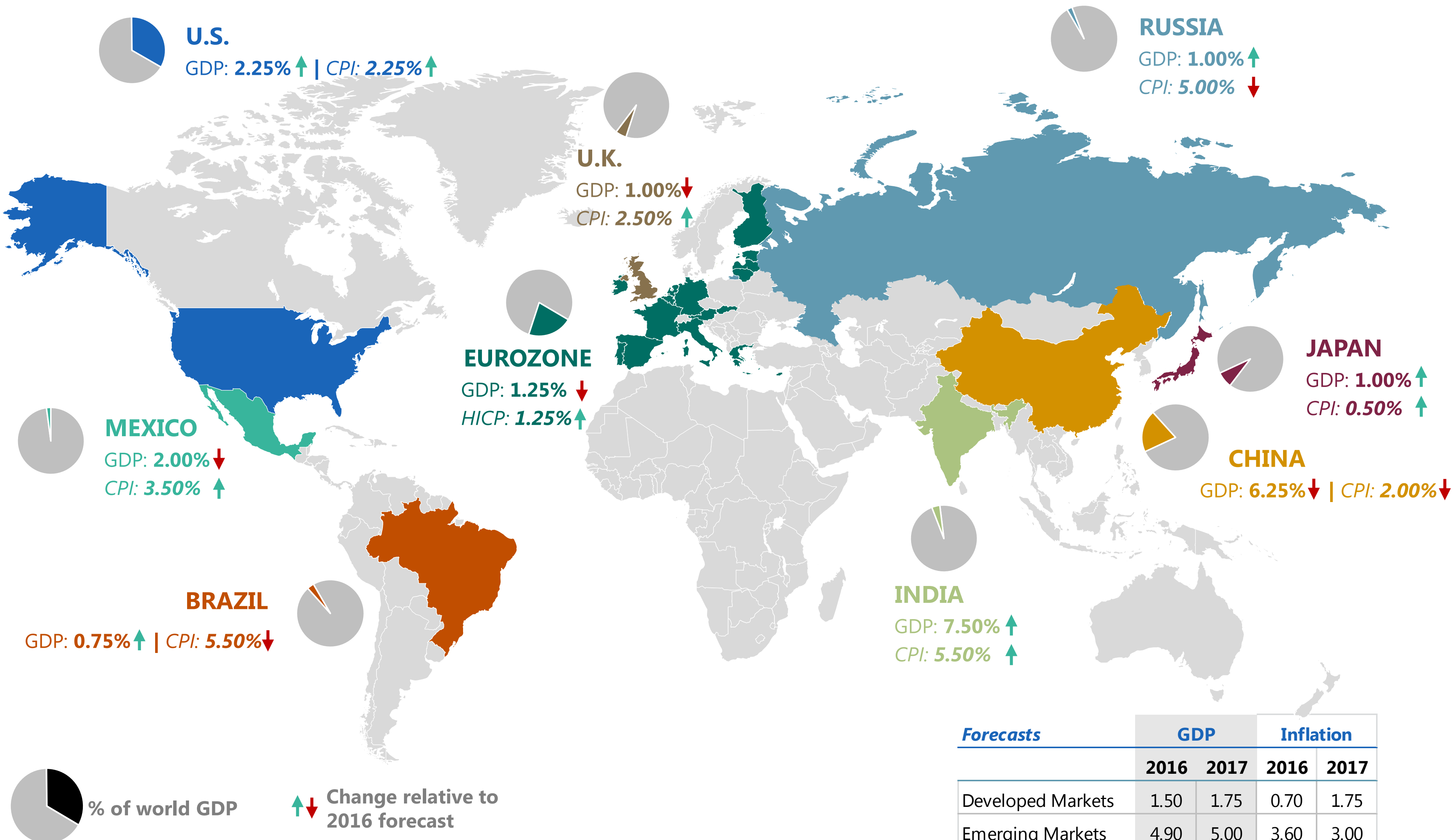
- Animal spirits
- US GDP, CPI 3%Y
- EM shines

Escape velocity for CBs:

- Fed hikes 4x in 2017
- ECB taper, BoJ ups 10Y
- EM CBs can relax

Refer to Appendix for additional outlook and risk information

PIMCO's 2017 baseline forecast:
"Stayin' Alive"

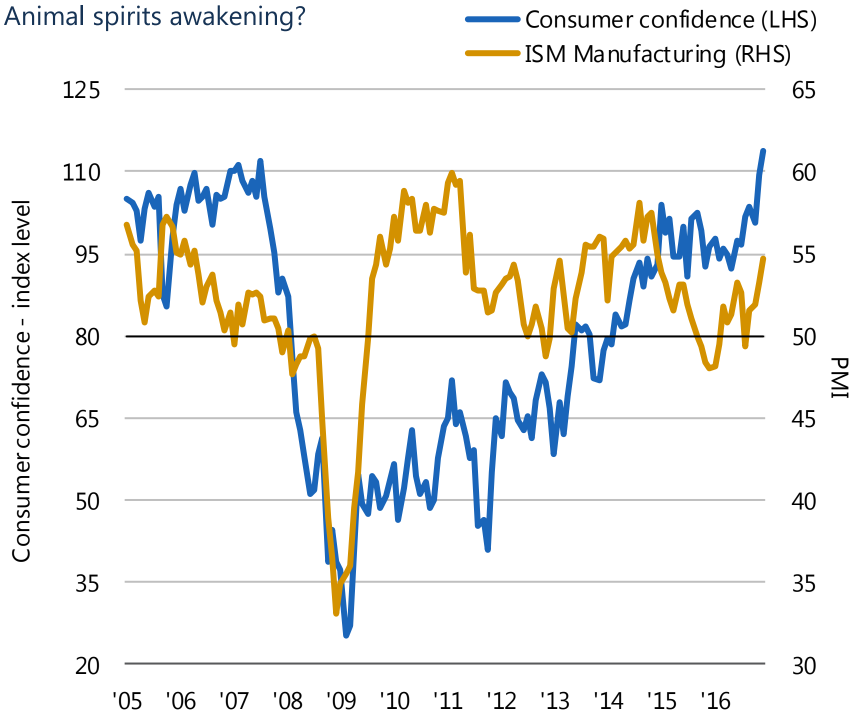


Forecasts	GDP		Inflation	
	2016	2017	2016	2017
Developed Markets	1.50	1.75	0.70	1.75
Emerging Markets	4.90	5.00	3.60	3.00
World	**2.60**	**2.75**	**1.60**	**2.25**

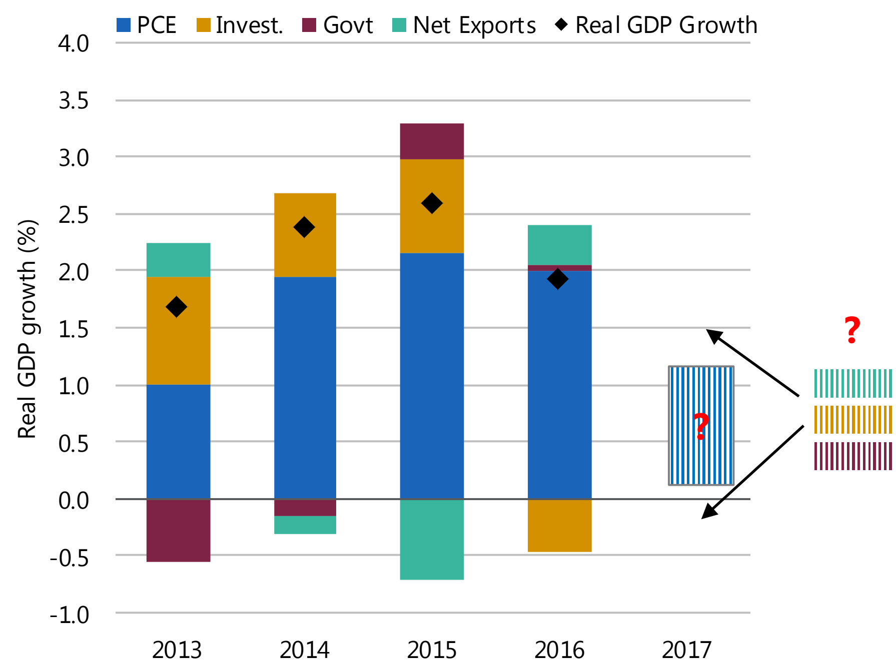
PIMCO forecast ranges as of December 2016. Real GDP and inflation projections reflect midpoints of PIMCO's forecast ranges for 2017
Refer to Appendix for additional forecast information

United States:
Bullish sentiment, but uncertainty remains

Animal spirits awakening?



The "hard" data



Consumer and business sentiment has improved with anticipation of pro-growth fiscal policies, tax cuts, and deregulation

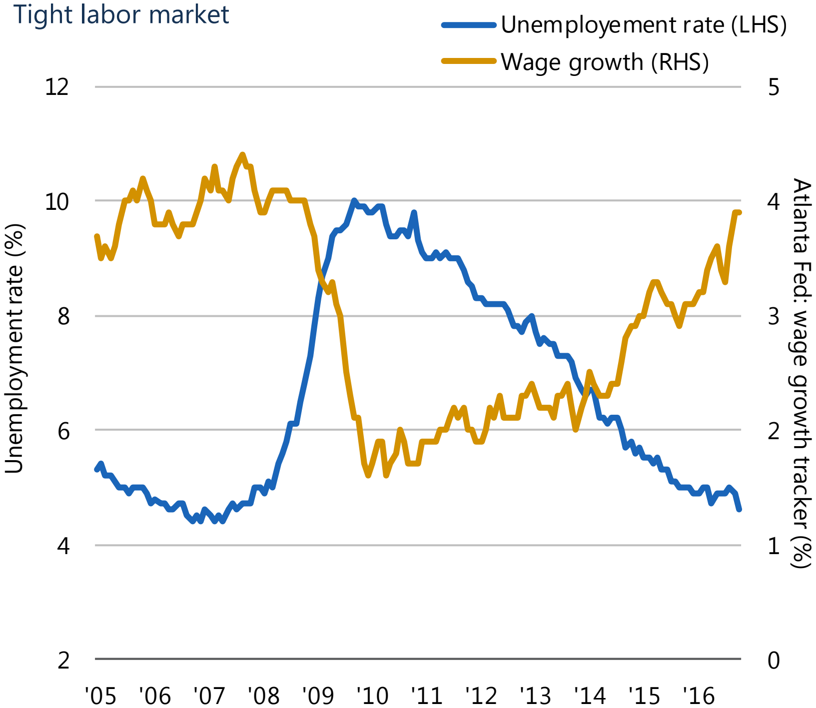
Despite the initial optimism, much uncertainty remains around policy details and whether they can translate into stronger growth

Confidence in the economy could bolster growth, but the evolution of actual policy—and macro conditions—will be key

As of 31 December 2016
SOURCE: PIMCO, Bloomberg, Haver Analytics, Bureau of Labor Statistics, Federal Reserve Bank of Atlanta

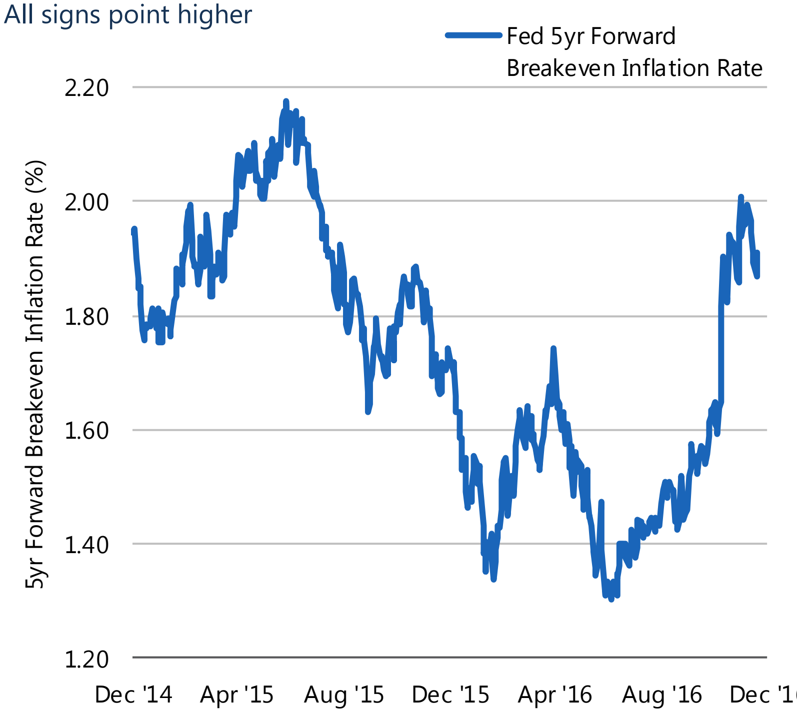
United States :
Inflation returns

Tight labor market



Robust job gains have pushed unemployment lower to pre-recession levels, which in turn has led to building wage pressures

All signs point higher



While details on policy and subsequent growth outcomes remain uncertain, the likelihood of higher inflation has risen

Fundamentals and policy expectations both support higher inflation, potentially warranting a steeper path for Fed rate hikes

As of 31 December 2016
SOURCE: PIMCO , Bloomberg, Haver Analytics, S&P, CoreLogic, MacroMarkets LLC
Refer to Appendix for additional outlook and risk information

United States :

New Faces at the Fed?

Janet L. Yellen

Chair Term: Feb 2018

Governor Term: Jan 2024

Stanley Fischer

Vice Chair Term: Jun 2018

Governor Term: Jan 2024

Daniel K. Tarullo

Governor Term: Jan 2022

Lael Brainard

Governor Term: Jan 2026

Jerome H. Powell

Governor Term: Jan 2028

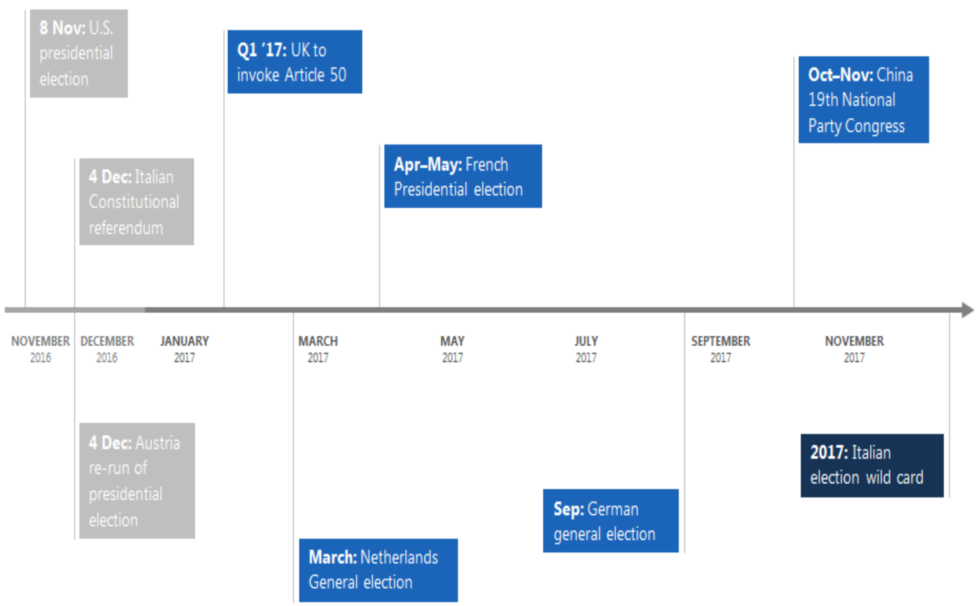
Vacant

Vacant

As of 30 November 2016
SOURCE: Federal Reserve

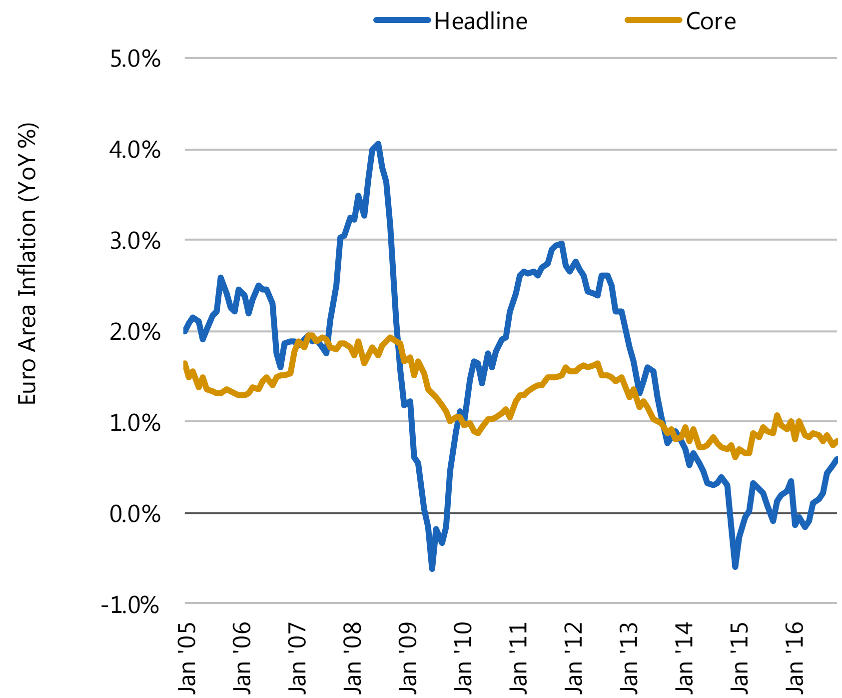
Eurozone:
Uncertain politics, exhausted ECB

Potential for populism



Surprise populist outcomes in 2016 raise the specter for more such surprises in 2017 given the busy political calendar ahead

Is 1% the new 2%?



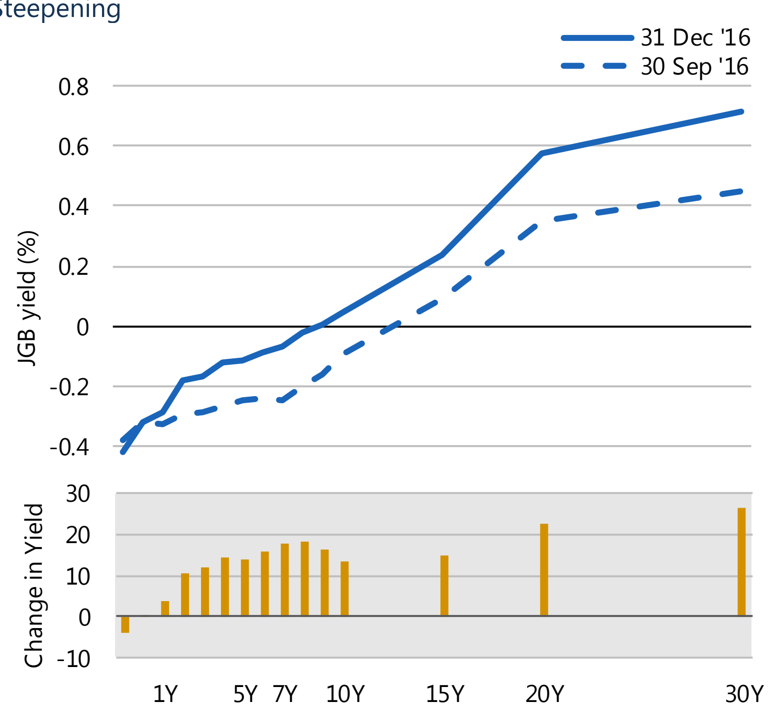
Diminished QE purchases even as inflation remains below target may be an indication of the ECB reaching limits of policy support

Fragility of eurozone economy underscored by political uncertainty and ECB confronting limits to monetary policy

As of 31 December 2016
SOURCE: PIMCO, Bloomberg

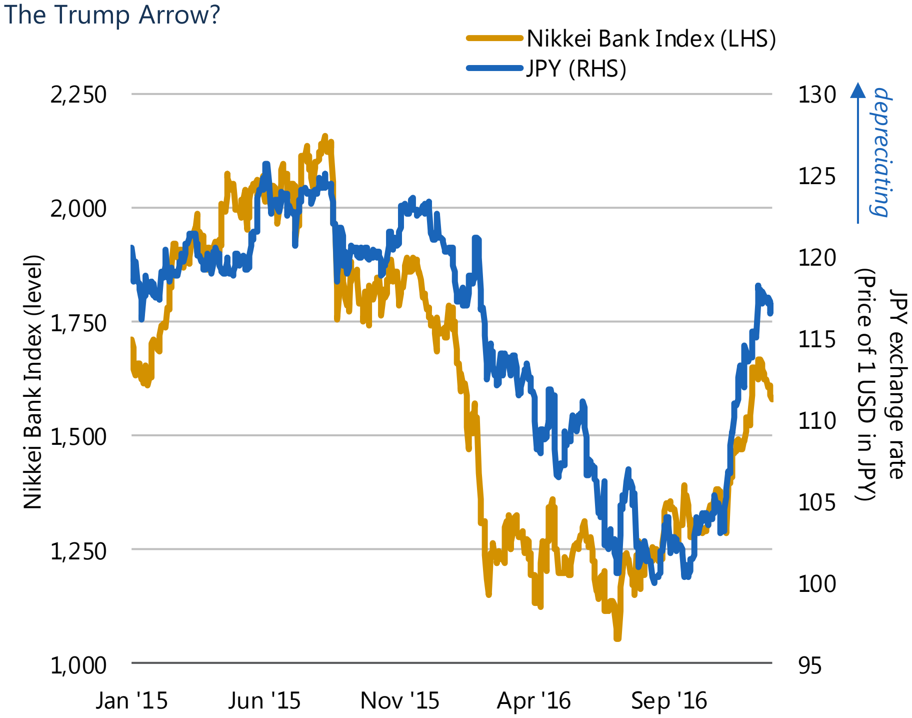
Japan:
The secret winner?

Steepening



The BOJ's shift to yield curve targeting has helped steepen the curve and anchor front-end rates despite the global rates sell-off

The Trump Arrow?

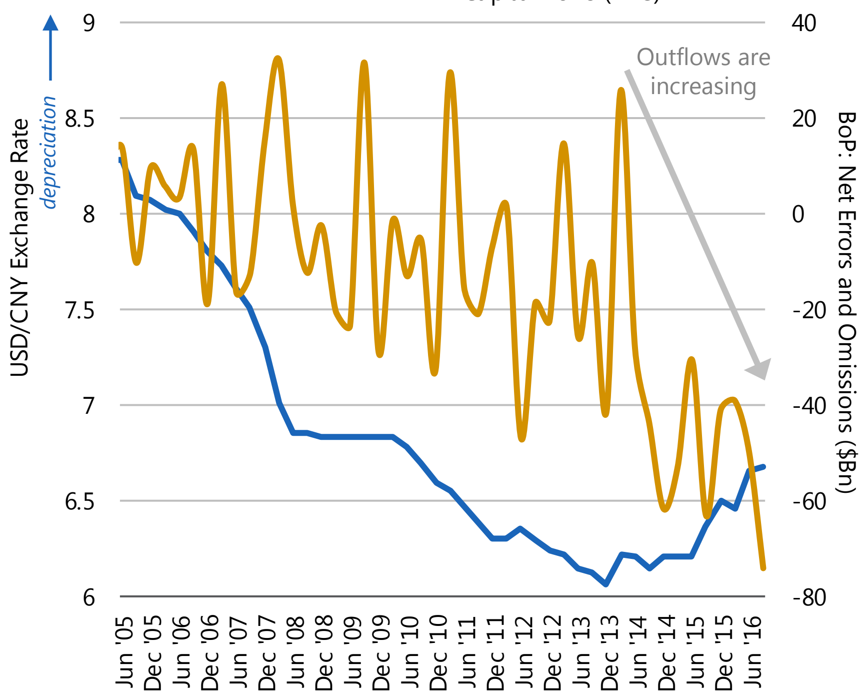


Both the yield curve steepening and weaker yen—pushed lower by widening rate differentials—have helped the financial sector

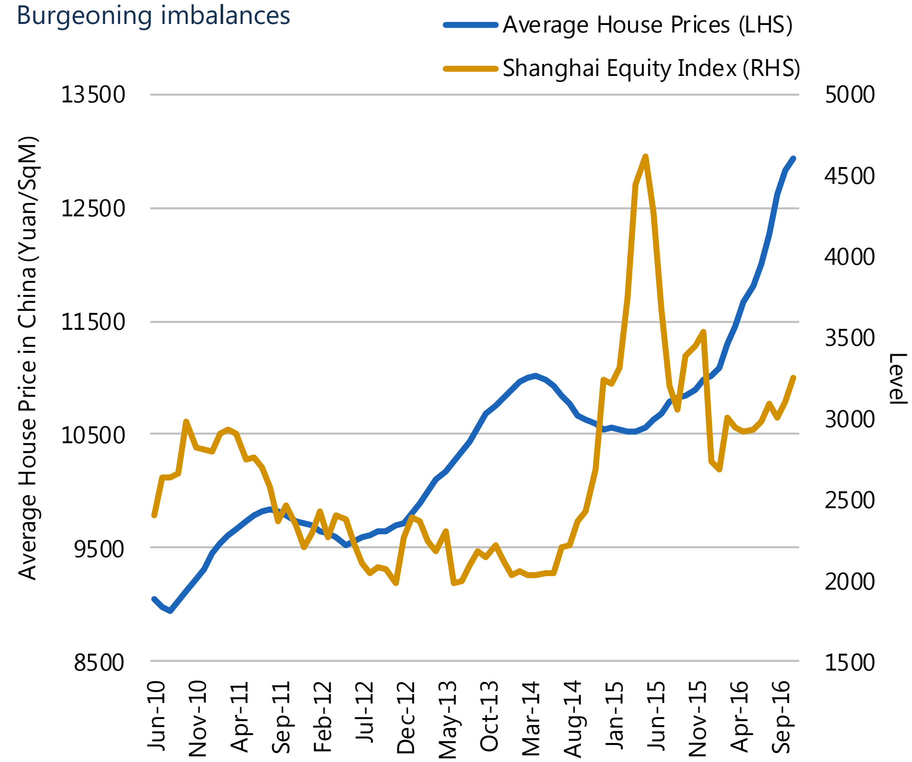
The BoJ's new yield curve targeting regime has proven beneficial (so far)

As of 31 December 2016
SOURCE: PIMCO, Bloomberg

China:
Riding the debt bubble



Capital outflows have placed downward pressure on the CNY and highlight risks to the Chinese economy



Credit fueled stimulus has contributed to imbalances in various markets, adding to policymakers' challenges

Concern remains that capital outflows and asset bubbles could disrupt policymakers' attempts at achieving a soft landing

As of 31 December 2016
*A common practice is to regard the net errors and omissions entry in the balance of payments as a measure of private capital flows
The Average house price in China is calculated using the average house price in 100 cities weighted by each city's floor space of new homes created.
SOURCE: PIMCO, Haver Analytics, Bloomberg

Emerging Markets:
Trade and Fed policy will dictate impact on EM

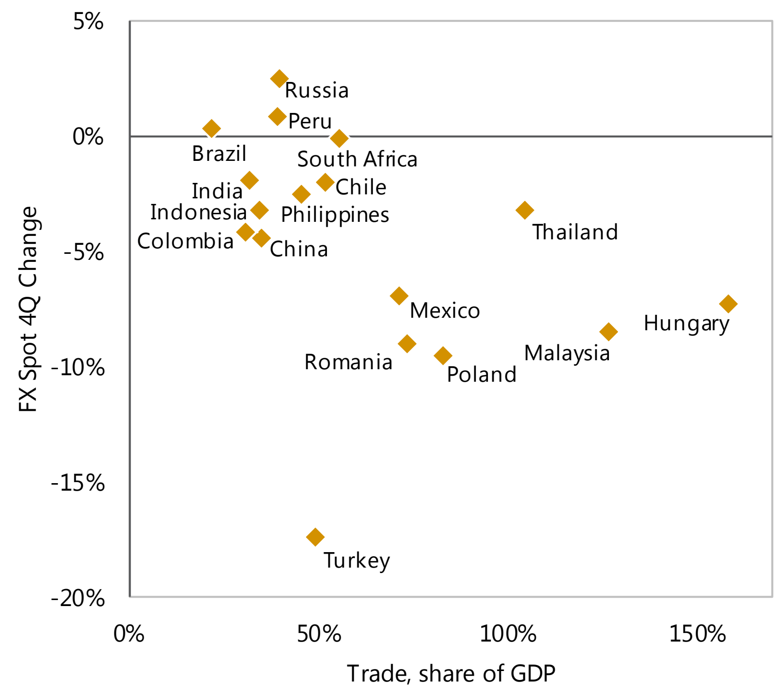
A framework for evaluation

	Hawkish Fed (USD Positive)	Dovish Fed (USD Negative)
Benign Trade Policy	**EM Outcome:** Mixed Strong external balance sheet, lower exposure to US, minimal FX mismatch	**EM Outcome:** Positive Reliance on portfolio flows, higher exposure to global trade cycle
Protectionist Trade Policy	**EM Outcome:** Negative Lower debt levels, domestically-oriented economy, minimal FX mismatch	**EM Outcome:** Mixed Strong external balance sheet, lower debt levels, domestically-oriented economy

Boxes describe what types of EM countries are likely to outperform in each scenario

Emerging markets will likely be impacted by the extent of protectionism as well as any hawkish tilt in Fed policy

Disperse dynamics



Reliance on global trade – along with domestic conditions – may drive dispersion among emerging market economies

The nature and composition of any shift in the U.S. policy mix will likely create differentiation among emerging markets

As of 31 December 2016
SOURCE: PIMCO, International Monetary Fund, Bloomberg

Investor Takeaways

- Respect the uncertainty: focus on capital preservation and tail risks, not just the most likely baseline scenario
- De-emphasize trades that rely on a high level
of central bank support
- Guard against the asymmetric risk of rising yields
- Focus on bottom-up security selection
- Maintain a very selective approach toward the eurozone
- Leverage liquidity to take advantage of periods of volatility and market dislocation

Refer to Appendix for additional investment strategy and risk information

Appendix

Past performance is not a guarantee or a reliable indicator of future results.

CHART
Performance results for certain charts and graphs may be limited by date ranges specified on those charts and graphs; different time periods may produce different results.

FORECAST
Forecasts, estimates, and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fees, and/or other costs. In addition, references to future results should not be construed as an estimate or promise of results that a client portfolio may achieve.

INVESTMENT STRATEGY
There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market.

OUTLOOK
Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

RISK
Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Current reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Investing in **foreign denominated and/or domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in **emerging markets**. **Mortgage and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and their value may fluctuate in response to the market's perception of issuer creditworthiness; while generally supported by some form of government or private guarantee there is no assurance that private guarantors will meet their obligations. **High-yield**, lower-rated, securities involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. **Derivatives** may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. **Diversification** does not ensure against loss.

It is not possible to invest directly in an unmanaged index.

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