Fixed Income Macro Outlook

American Century Investments®

Our Global Macro Strategy Team's Perspective

FOURTH QUARTER 2015

U.S. Economy

Moderate growth in face of global macro headwinds

- **Moderate Growth in Face of Global Macro Headwinds:** Our most likely (61% probability) scenario continues to call for moderate growth, producing near-term annualized economic growth rates of 2.0% to 3.0%. The possibility of an upside breakout of over 3.0% growth has declined to 29%.
- **U.S. Fundamentals Support Moderate Growth:** The U.S. economy continues to grow at a moderate pace, despite global economic weakness stemming from China and other emerging markets. We see strong bifurcation between the services and manufacturing sectors of the U.S. economy, with services expanding and manufacturing contracting.

U.S. Inflation

Muted in near term but still long-term concerns if economic conditions improve

- **Muted in Near Term:** A 1.5% to 3.0% increase over 12 months in the overall CPI appears most likely to us (66% probability). (CPI is a government index derived from detailed consumer spending information.)
- **Long-Term Concerns if Economic Conditions Improve:** We still believe higher inflation (a 12-month CPI change over 3.0%) could occur in the coming three to five years because U.S. economic growth combined with monetary and fiscal policies enacted since 2008 could eventually spur stronger global economic growth and asset bubbles.
- **Valuations on Inflation-Linked Investments Look Relatively Attractive:** We believe strongly that some level of inflation protection be incorporated into investor portfolios.

U.S. Monetary Policy

Interest rate normalization depends on data—particularly inflation and wage growth—and market expectations

- **QE3 Completed but Other Stimulus Continues:** The Federal Reserve's (the Fed's) third bond-purchase program (quantitative easing, QE) since 2008 ended in October 2014. But the Fed still owns a large portfolio of bonds it purchased through QE, and will continue to reinvest its coupon income. And short-term interest rates remain very low, even if the Fed starts raising them.
- **Rate Normalization Expected; Timing, Magnitude Are Data- and Market Expectation-Dependent:** The Fed is expected to begin raising short-term interest rates from their near-zero level some time in the next 12 months. But we think global economic weakness and low inflation will allow the Fed to temper the timing and magnitude of possible rate increases. We don't expect the Fed to raise rates until market and inflation expectations move higher.

U.S. Interest Rates

Range-bound, supported by U.S. economic fundamentals but constrained by global macro headwinds

- **Range-Bound:** Given our expectations for moderate U.S. economic growth in the face of global macro headwinds, we expect the 10-year U.S. Treasury yield to rise to between 2.20% and 3.00% in the next 12 months. We think this longer-term trend is fundamentally supported, assuming the U.S. economy continues to grow. We expect an eventual normalization of long-term interest rates after years of artificially low levels caused in part by the Fed's QE programs.
- **Global Macro Headwinds for Higher Interest Rates:** Weaker global economic fundamentals, aggressive non-U.S. monetary policies, low inflation, a strong dollar, uncertain global geopolitical factors, and demand due to the wide yield disparity between U.S. bonds and those of other developed countries are working together to keep interest rates low in the near term, despite U.S. economic fundamentals that support higher rates.

Global Economy

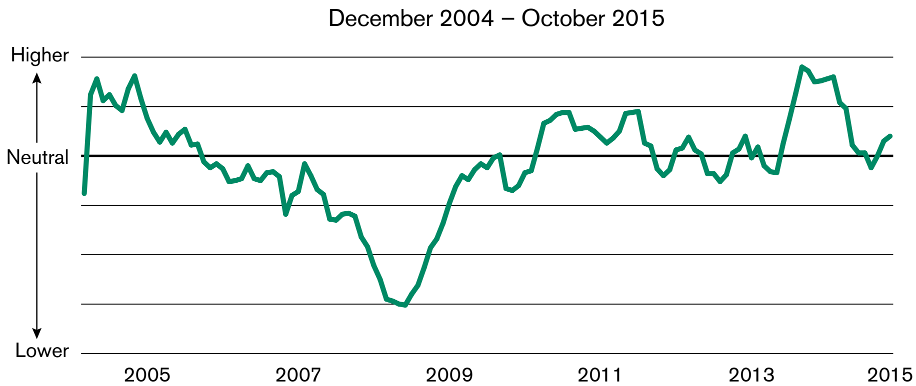
Divergence from the U.S. in terms of weaker economic growth and more aggressive monetary policies

- **Global Divergence in Economic Growth:** Outside of the U.S., the global economy is mostly struggling. Europe has required monetary stimulus to fight deflation, Japan is slowly easing out of recession, and Russia, China, and Brazil are slowing.
- **Global Divergence in Monetary Policies:** While the Fed is contemplating tighter monetary policy, most of the world's other central banks in developed economies are still considering or implementing additional monetary easing.
- **Low Inflation:** As in the U.S., inflation is not a near-term threat. However, the amount of monetary and fiscal stimulation that has been prescribed could create longer-term inflationary pressures.

Fundamental U.S. Economic Trends

Quantitative Inputs From Our U.S. Interest Rate Outlook Model

Figure 1 — U.S. Interest Rate Outlook: Aggregates all other outlooks. Identifies potential interest rate trends.



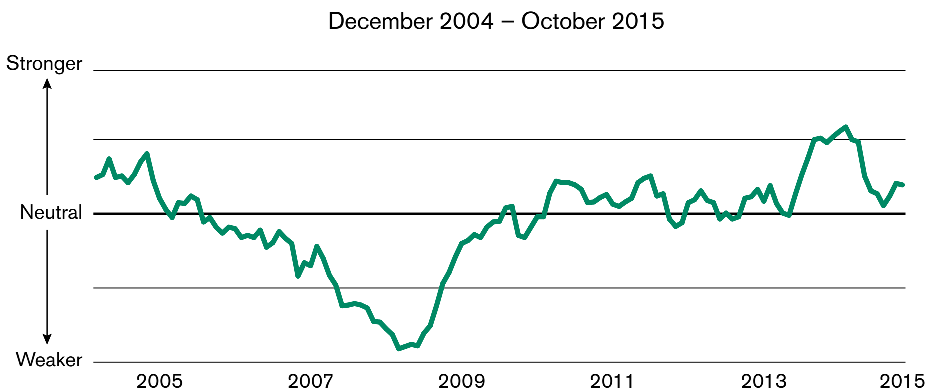
Trend:

Key Points:

- Our U.S. Interest Rate Outlook has been mostly range-bound near neutral since 2010. Like U.S. economic growth, it peaked in mid-2014, reaching its highest level since 2005, but since then it has returned to more moderate levels.
- U.S. economic fundamentals and expectations for future Fed rate hikes continue to support higher rates in the longer term.
- But near term, global macro headwinds have dominated the U.S. factors, keeping rates low.

Our anticipated ranges for the 10-year U.S. Treasury note yield:
Next 3-6 months: 1.80% to 2.30%
Next 12 months: 2.20% to 3.00%

Figure 2 — U.S. Economic Outlook: Aggregates our consumer and business outlooks. Suggests economic growth trends.

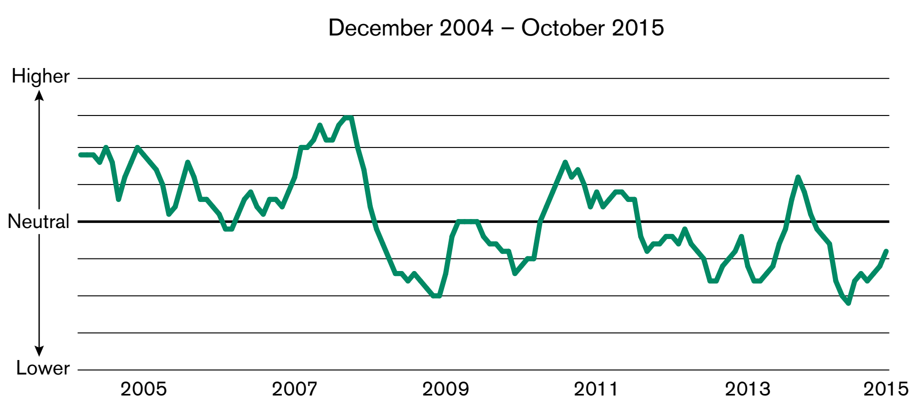


Trend:

Key Points:

- This continues to illustrate the U.S. economy's subpar "square root sign" growth pattern since the Great Recession—a big dip followed by a mostly sideways pattern. (Past post-recession recoveries have shown more of an upswing after the big initial dips.)
- In January 2015, the model reached its highest level since 2004, but has returned to more neutral levels since then.

Figure 3 — U.S. Inflation Outlook: Aggregates data from our quarterly Inflation Monitor. Suggests inflation trends.



Trend:

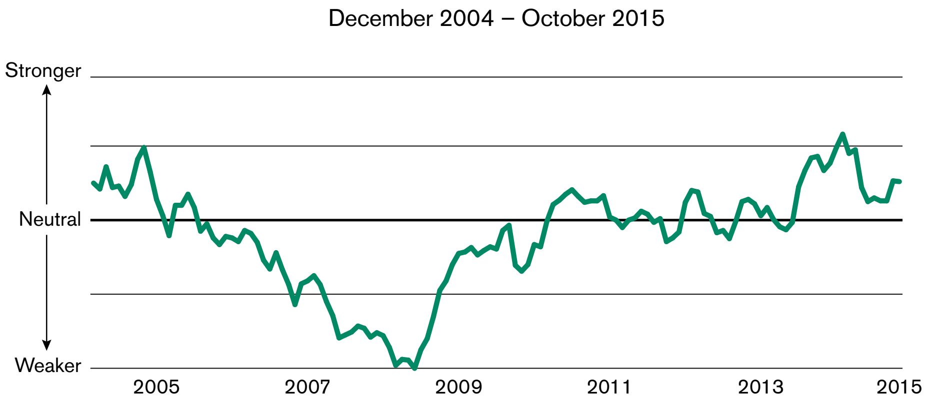
Key Points:

- There's little indication of inflation in the near term. We expect inflation to remain largely contained for the next 12 months, mostly because of subdued global growth, depressed commodity prices, and a stronger U.S. dollar.
- For more information on the components of our Inflation Outlook, please see our quarterly *Inflation Monitor.*

Fundamental U.S. Economic Trends (continued)

Quantitative Inputs From Our U.S. Interest Rate Outlook Model

Figure 4 — U.S. Consumer Outlook: Includes employment, retail sales, housing, and consumer confidence.

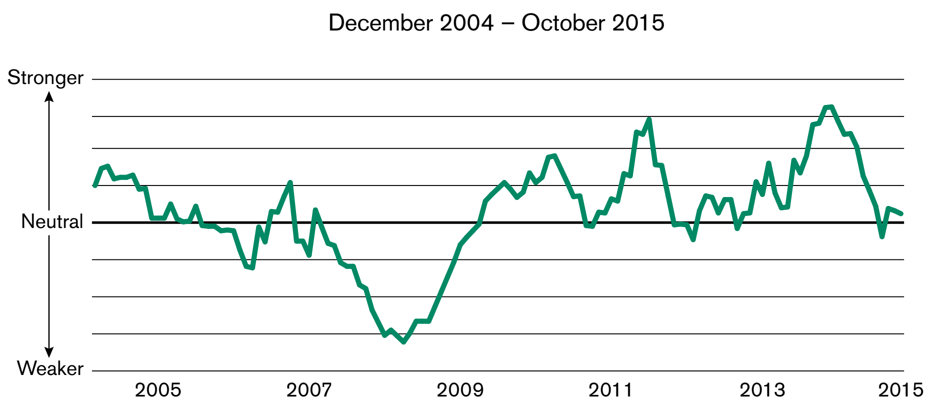


Trend: ↔

Key Points:

- January 2015 marked the highest level for this model since 2004. Since then, it has retreated as the stock market and consumer confidence have declined.
- The consumer sector has struggled to recover since 2008. Unemployment, the housing market, high debt levels, and low wage growth have weighed on consumers.
- Labor market improvement is critical to this sector. U.S. employment is improving, but wage growth is still lagging.

Figure 5 — U.S. Business Outlook: Includes suppliers, production, capacity utilization, and corporate profits.



Trend: ↔

Key Points:

- November 2014 marked the highest level for this model since 2004. But it has reverted toward neutral since QE3 ended.
- Businesses fared better than consumers for much of the post-2008 recovery period, helped by monetary and fiscal stimulus.
- The business outlook has grown cloudier, with weakened global economic growth, a strong dollar (which affects exports and earnings), and the possibility of higher interest rates in the U.S.
- The business sector has become sharply bifurcated, with the service sector much stronger than manufacturing.

Background: How the Global Macro Strategy Team uses this data.

Figures 1-5 represent output from our proprietary Interest Rate Outlook Model, which provides a systematic, disciplined way to review fundamental economic indicators and policy trends in a purely quantitative manner.

Our model measures and quantifies long-term trends in economic activity, then processes that data to suggest long-term fundamentally based trends for interest rates.

The model examines selected U.S. economic indicators over an extended time frame, typically since the early 1980s, and evaluates them on two metrics:

1. Relative levels compared with historic averages, and

2. Directional trend.

The model establishes a neutral level for each indicator, then measures whether it is high or low compared with historic averages and whether it is trending higher or lower. Then, the model weighs and aggregates these multiple indicator levels and trends into Figures 2-5. The levels and trends in Figures 2-5 are weighted and aggregated to create Figure 1.

(Important Note: This model represents just one set of inputs used by the Global Macro Strategy Team in its overall outlook-creating and strategy-setting processes. The model is not the final determinant of our macro strategy—it is carefully weighed and vetted with other inputs, both qualitative and quantitative. But we believe the graphs are useful to show and share, as part of our fundamental and proprietary view of the bigger macroeconomic picture. Also note that Figures 1-5 do not display the full time frame of the model, just 2004 to 2015. This helps show recent trends more clearly.)

Source (for all graphs): American Century Investment Management. Outlooks and interest rate ranges are based on proprietary evaluations of information. This information is not intended to serve as investment advice.

Macro Observations — Changes Since Last Quarter

- ***China Turmoil, Fed Uncertainty, Market Volatility:*** Investors faced an unsettling confluence of factors during the third quarter, including sudden, sharp market reactions to China's economic slowdown and currency devaluation, questions about when the Fed would finally start raising short-term interest rates and by how much, and big swings in the price of crude oil, which tested previous lows, then sharply rebounded. Equity markets declined globally while bond returns were mixed.

G. David MacEwen & Victor Zhang* — China- and Fed-Related Volatility Opens Opportunities for Active Managers

- Market volatility stemming from China's economic slowdown and uncertainty about Fed interest rate policy ties closely to four themes we've outlined during the past year: 1) global divergence between the U.S. and the rest of the world in economic growth rates and central bank policies; 2) normalization—more two-way market risk and higher interest rates as the Fed withdraws monetary stimulus; 3) more volatility as markets normalize, and 4) increased opportunities for active investment managers to add value with security selection as market volatility rises.
- China, the world's second-largest economy after the U.S., was central in the market volatility. Chinese economic growth, as measured by 12-month changes in real gross domestic product (GDP)[1], has slowed from the 10-14% range through the middle of the last decade to approximately 7% this year. This had a deflationary impact on commodities and on the GDP growth of emerging markets that rely on China for exports and imports.
- We do not expect China's slowdown to change the U.S. economy's moderate growth pace significantly in the near term. Global growth is weaker than in the U.S., but there are signs of improvement in key developed areas like Europe and Japan.
- The Fed has fostered uncertainty and volatility by postponing rate normalization. This has disrupted capital market movements and financial plans, and put the Fed and its deliberations in the macroeconomic foreground, forcing everyone to watch, wait, and wonder. We believe the Fed should start raising rates.
- A market environment in which volatility is being driven as much by sentiment as by fundamentals opens opportunities for active investment managers to find fundamentally solid issuers whose securities have been beaten down by adverse headlines.

G. David MacEwen — Opportunities and Risks in the Bond Market as Volatility Increases

- Market volatility has increased after years of being suppressed by the Fed's bond purchases. Market volatility can be a favorable factor for fundamentally driven active investment managers seeking value and other opportunities amid the gyrations. However, more volatility means more risk, and a more-pronounced tendency for certain types of bonds and bond portfolios to behave like stocks.
- The third-quarter stock and high-yield credit sell-off served a productive purpose in terms of demonstrating where investors had risk exposure and/or lacked diversification. Many investors thought they owned diversified bond portfolios (or diversified overall portfolios) when they actually didn't.
- The glaring proof that they didn't: When the stock market plunged, did they see positive performance in any parts of their portfolios? For average investors, probably not, unless they had high-quality core bond holdings. High-quality core bond sectors tend to be non-correlated to the stock market and are important components of diversified investment strategies.
- In this environment, it's important to balance opportunistic risk-taking with respect for fundamental credit quality and a diversified investment approach. We suggest a three-step approach for attaining appropriate risk levels for fixed income investments in today's markets: 1) seek true diversification—bond vehicles that are non-correlated with stock market movements (bond portfolios that act like bonds, not stocks); 2) seek bond vehicles that offer some protection from rising interest rates (by using short-to-intermediate maturities) and from credit-related volatility (by focusing more on credit quality than yield); and 3) seek transparency (visible and comprehensible portfolio positions) and liquidity (positions can be sold in an orderly fashion, if needed).

**MacEwen and Zhang are Co-Chief Investment Officers at American Century Investments.*

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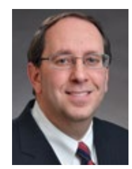

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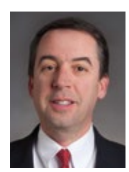

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[1] Real GDP is a measure of the total economic output in goods and services for an economy, adjusted for inflation.

The opinions expressed are those of the Global Macro Strategy Team at American Century Investments and are no guarantee of the future performance of any American Century Investments fund. This information is for educational purposes only and is not intended as investment advice.

Generally, as interest rates rise, bond prices fall. The opposite is true when interest rates decline.

Diversification does not ensure a profit nor does it protect against loss.

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