

Seeking Value as the Dust Settles

By the Multisector Full Discretion Team
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KEY TAKEAWAYS

- Global growth concerns sparked by the Chinese market meltdown have caused intense market volatility.
- After three years of rich valuations, recent market action has created opportunities.
- As long-term, value-oriented investors with a flexible mandate, this is our kind of market.

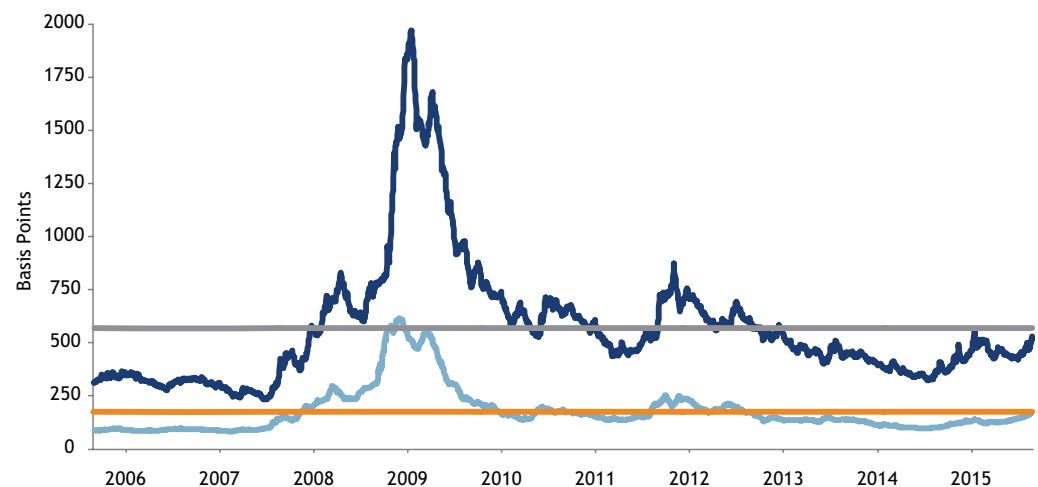
Up and down markets are a gut-wrenching ride, but they can uncover attractive value. The dust from recent volatility is settling, and we believe valuations—particularly for corporate bonds—have improved. As long-term, value-oriented investors with a flexible mandate, this is our kind of market.

Corporate bond spreads have returned to their long-term averages, as shown in the chart below. Energy-related credits accounted for the most dramatic spread widening, but selling pressure in all sectors was strong due to lower summer liquidity and global growth concerns. As a result, some investment grade and high yield corporates have traded away from what we consider fundamental value. Since our mandates generally have the flexibility to go anywhere across global fixed income markets, we are leveraging our in-depth research to help uncover opportunities we believe could represent long-term value. We are emphasizing security-specific risk, a yield advantage and diversification—portfolio themes that have been in place for some time. Here is how we see value-creation drivers in the market.

US INVESTMENT GRADE & HIGH YIELD OPTION-ADJUSTED SPREADS (OAS)

Source: Barclays.
Data as of 8/26/2015.

- High Yield OAS
- Investment Grade OAS
- High Yield 10-year Average OAS
- Investment Grade 10-year Average OAS





- **Liquidity:** [Bond market liquidity](#) is strained based on where we are in the credit cycle and due to structural and regulatory changes. Deteriorating liquidity often amplifies market dislocations and price distortions. We seek to be a provider of liquidity when fundamentally strong credits trade at significant discounts, one method of adding security-specific risk to portfolios. We believe the opportunities we have identified in energy, metals and mining, healthcare and financials can help support long-term returns.
- **The Tide of Investor Sentiment:** If concerns about China and global growth remain acute and volatility persists, investors may move to reduce risk. We think corporate bond yields are compelling, and given our view of the credit cycle, defaults are likely to remain low. We believe these higher yields could support demand for the asset class and that would help prices rebound.

In the meantime, market dislocation has enhanced opportunities to add yield and attractive security-specific risk to our portfolios, which we have been identifying through our deep fundamental research. As the chart below illustrates, US high yield and emerging market sovereign bonds currently offer higher yields relative to similar-duration Treasuries; however, careful credit selection is key—particularly for emerging markets, which could face fundamental growth challenges. Security-specific opportunities in financials and industrials have also emerged due to improved valuations.

CURRENT YIELDS ACROSS SECTORS

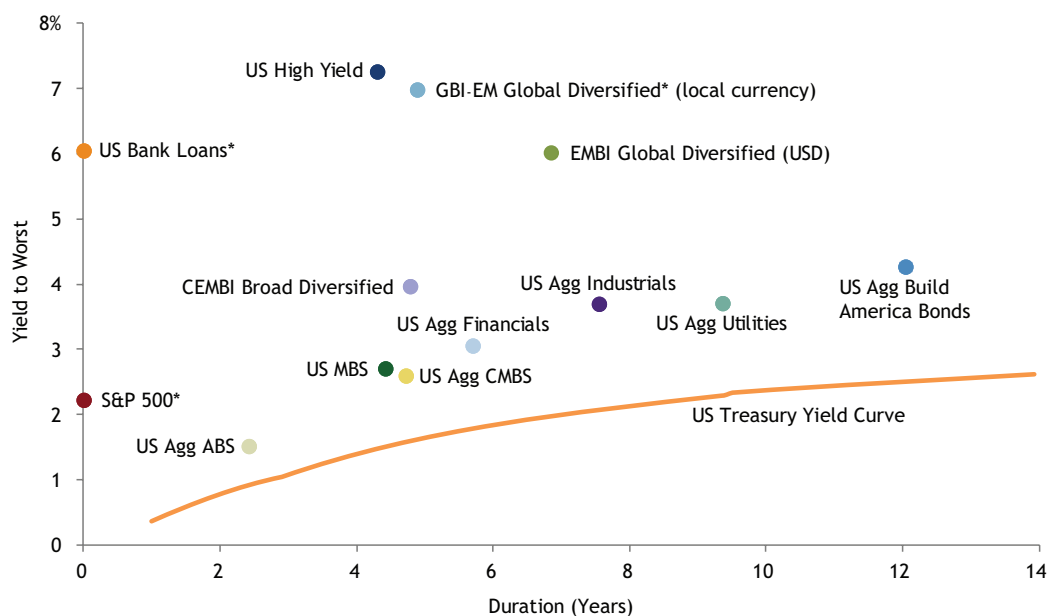
Sector Yields vs.
Similar-Duration Treasuries

*Bank loan current yield, GBI-EM Global Diversified yield to maturity and S&P dividend yield replace yield to worst.

Source: JPMorgan, Barclays, S&P/LSTA and Bloomberg. Data as of 9/4/2015.

Indexes are unmanaged and do not incur fees. It is not possible to invest directly in an index. Data shown does not represent the actual or future performance of any Loomis Sayles investment product.

Past performance is no guarantee of future results.





- **Fed Lift-Off:** We think the US economy is healthy enough for the Fed to raise rates, but the decision will ultimately be data dependent. We believe the pace of tightening is more important than the timing, given the global backdrop. For some time, we have been adding higher-yielding bonds to our portfolios. Gradual upward rate pressure puts more emphasis on a security's yield component to dampen the impact of rising interest rates and help preserve income levels. We also use our flexibility to build diversification into our portfolios by using "plus sectors" including high yield, convertibles and non-US-dollar exposure. These asset classes have historically had a low or even negative correlation with rising rates, so securities may appreciate in price as rates move higher.

To be sure, bouts of extreme market turbulence make for a bumpy ride. For example, our plus sector exposures have detracted recently. Despite these challenges, we maintain conviction in our best ideas and overall portfolio positioning even when markets move against us. We believe our flexible approach and deep fundamental research will help us take advantage of market upsets as we seek to capture long-term value.

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About Risk

Mutual funds that invest in bonds can lose their value. When interest rates rise, bond prices usually fall and vice versa. Investing involves risk including possible loss of principal.

Additional risks include credit risk, issuer risk, interest rate risk, liquidity risk, non-US securities risk, currency risk, prepayment risk and extension risk.

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