

Global Fixed Income Team

# Outlook & Strategy

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## Market Recap & Outlook

With the US-Iranian ceasefire extended, investors have moved from the fog of war to the fog of truce. The Straits of Hormuz remain mostly closed. Oil prices will likely remain high or go higher until more progress is made to resolve the conflict and global oil export volumes can revive. In turn, we believe that risks to headline inflation in most countries have increased. We expect midyear hikes in policy rates in Japan and the Eurozone, and probably the United Kingdom, while US policy rates remain at current levels.

Dr. Kevin Warsh will be the new Federal Reserve Chairman and has some ideas about the scope and conduct of Federal Reserve (Fed) policy. He seems to believe that the Fed should have a smaller balance sheet. Currently the Fed holds some \$6.7 trillion, down from about \$8.9 trillion four years ago. Shrinking the balance sheet, i.e., selling or at least not replacing Treasuries, is arguably contractionary. It is quantitative tightening. A cut in total Treasuries held by the Federal Reserve can be neutralized in theory by cutting short-term interest rates. This would be popular with the Treasury, whose hopes for improving US solvency resides in the expectation that  $G$ , the nominal growth rate of GDP, can exceed  $R$ , the nominal interest rate.

The argument is not just academic. Total Federal debt held by the public is about 100% of GDP, or about \$30 trillion. The flow deficit for the next two years is guesstimated at about 6% of GDP, or \$1.8-\$2 trillion or so per year. Debt service is 3% of GDP and trending up. Orthodox ideas of fiscal sobriety would look to at least balance the primary deficit, which would require revenue hikes and spending cuts totaling some 3% of GDP, in our view. We see not a flicker of movement in this direction from Congress, so the private markets will have to own increasing volumes of Treasuries.



**DAVID ROLLEY, CFA**  
Portfolio Manager

Already the government must roll over about \$7 trillion in short paper yearly, and this is likely to rise, unless bond coupon sizes are increased.

If the Fed ultimately owns less total Treasury duration, the private sector will have to own more. This likely implies a steeper yield curve and higher term premium, in our view. The term premium will also have to compensate investors for a different sort of inflation risk. If Treasury issuance becomes increasingly concentrated in short maturities, the fiscal pain of a future Fed interest rate hike will rise. We believe this may give rise to concerns that this fiscal risk might weigh on policymakers in the future, and tightening for future inflation control may ultimately prove inadequate. This risk is not currently priced, as 10-year inflation swaps are stable at about 2.6%. The longer-term inflation markets are not really worried about either the oil market or new procedures in Fed policy or Treasury funding.

## Our Strategy

Perhaps the inflation markets are optimistic about  $G$ . If productivity from AI, robots, etc., can raise growth rates for GDP, we believe the US can escape from its current fiscal dilemma without sacrifice. But if productivity growth disappoints, the country may face a future of higher inflation, a bond bear market, a painful pro-cyclical tightening in fiscal policy, a weaker US dollar, or all of the above at once. Greater diversification by investors from USD assets still seems a likely long-term prospect, in our view.

## Important Disclosure

### Key Risks:

*Credit Risk, Issuer Risk, Interest Rate Risk, Liquidity Risk, Non-US Securities Risk, Currency Risk, Derivatives Risk, Leverage Risk, Counterparty Risk, Prepayment Risk and Extension Risk. Investing involves risk including possible loss of principal.*

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***There is no guarantee that the investment objective will be realized or that the strategy will generate positive or excess return.***

***Past market experience is no guarantee of future results.***

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## About the Team

Our strength is rooted in decades of honing our research and investment processes to consistently navigate ever-changing global markets.

1986

Global Bond Portfolio Established

85

Institutional Accounts & Commingled Vehicles

\$37.3

Team Assets Under Management\* (Billion USD)

*As of 3/31/2026*

