Loomis Sayles Global Diversified Corporate Bond Funds

FUND COMMENTARY

FIERA INVESTMENTS

THE GLOBAL ECONOMY SAW MIXED RESULTS IN THE FOURTH QUARTER

MARKET ENVIRONMENT

Composite PMIs for the US, Germany, France, and major emerging markets (e.g. Brazil, China, India) are all up from lows hit earlier this year. The modest uptick in China's PMI was a particularly pleasant surprise as consensus estimates were expecting a disappointing result. The PMI recovery was broad-based with rises in new orders, new export orders, imports, and production. This was a significant development given China's manufacturing is a barometer for global demand. However, there is not definitive evidence of a cyclical upturn just yet.

Macroeconomic risks have diminished since last quarter with recession fears fading along with better news on US-China trade relations and Brexit. Nevertheless, corporate credit valuations remain stretched and fundamentals have modestly deteriorated. Generally good cash flow generation has helped keep spreads tight despite the increased pressure on profit margins. Tepid economic growth remains a concern though, particularly in the Eurozone and the United Kingdom.

The Federal Reserve's Federal Open Market Committee (FOMC) left its policy rate unchanged at its December meeting as we and the market expected. In its policy statement, the FOMC indicated that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the committee's 2% objective. Accommodative monetary policy has been supporting growth while the manufacturing driven downturn runs its course.

PORTFOLIO REVIEW

The Fund outperformed its benchmark by 12 basis points (gross of fees) for the period ended 12/31/2019. Net of fees, the fund underperformed by 24 basis points[1].

The bottom-up derived overweight to the communications sector helped given the initial yield advantage and ensuing spread narrowing in the sector. Communications was among the top performing investment grade credit sectors as top issuers in the space remain committed to preserving, or even improving their credit ratings. Profits have been aided by strong consumer demand for internet connectivity, which offers more favorable margins to video subscriptions.

Selections in consumer staples – especially healthcare and food and beverage – added value. In healthcare, the fund benefited from positions in favored issuers that possess high quality assets, industry leading profit margins, and good cash flow generation. In the food and beverage sector, we remain focused on companies with well-diversified business portfolios, global scale, and a demonstrated commitment to reducing leverage.

The underweight to the metals and mining sector was an opportunity cost given its outperformance relative to the broader investment grade corporate market. We have remained underweight given our view that the macroeconomic environment is unfavorable for this industry to outperform and valuations are not particularly attractive.

MARKET OUTLOOK

We believe the US will exit the manufacturing slowdown without dipping into recession. The three FOMC rate cuts will provide support to an economy that has been hampered by trade conflict, slumping exports, and a build-up in inventories. Global PMIs have been improving and we are seeing green shoots in other survey-based economic indicators, but need to see more evidence for stabilization in hard data.

Credit spreads are tight, but should continue to receive support. Improvement in economic data and the Federal Reserve remaining relaxed and accommodative in a low growth, low inflation environment should enable credit spreads to stay well contained. Higher wages and employment costs are pressuring profit margins, but top line revenue growth has been respectable.

Stability in economic growth should lead to better profit growth in 2020, albeit in the low single digit range. We expect S&P 500 profits to grow around 5% in 2020, up from low single digits in 2019. A profits recession – with profits down 10% or more – would substantially increase recession risks, but that is not our base case.

We do not expect further escalation in the trade conflict between the US and China. The phase one trade agreement is an important step in the right direction and a key support to risk appetite. The deal could deliver upside surprise as it is more comprehensive than expected, but the general truce has been enough to keep risk assets moving in a positive direction.

[1] Loomis Sayles Global Diversified Corporate Bond Fund, Series A.

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IMPORTANT DISCLOSURES

As of December 31, 2019. Performance for the Loomis Sayles Global Diversified Corporate Bond Class, Dividend, Series A — 1 month: 0.1%; 3 months: 0.4%; 6 months: 2.7%; 1 year: 10.7%; 3 years: 3.6%; 5 years: 2.2% and SI*: 2.1%. Performance for the Loomis Sayles Global Diversified Corporate Bond Fund, Series A — 1 month: 0.2%; 3 months: 0.5%; 6 months: 2.8%; 1 year: 10.8%; 3 years: 3.6%; 5 years: 2.3% and SI*: 2.2%.

* Since Inception: June 1, 2012.

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