NEUBERGER BERMAN

Fixed Income Investment Outlook 1Q 2022

Persistent Inflation, Policy-Driven Volatility

With inflation top-of-mind for investors, we believe the Federal Reserve's reaction function will likely be a key driver of real yields, the dollar and risk markets this year. Although we anticipate that inflation levels will ease, the decline will likely be shorter-lived and shallower than some expect. Meanwhile, policy actions by the Fed and other central banks are likely to drive increased levels of market volatility, and thus impact investment strategy moving forward.

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Investment Implications

- Inflation could start to decline as some key drivers begin to moderate; however, reductions could be shorter-lived and shallower than some expect.
- The evolution of inflation and central bank policy will likely drive higher market volatility in 2022.
- Investors should maintain defensive positioning to interest rates, particularly in the U.S.
- We favor overweighting credit markets, although less than in 2021. Fundamental credit risk remains limited, benefiting high yield over investment grade. European credit offers slightly more value than U.S. credit.
- Emerging markets hard currency debt appears attractive given EM's earlier start on tightening and last year's underperformance.
- Cash and floating-rate securities in the ABS, CLO, bank loan and corporate credit markets offer flexibility in the event of enduring inflation; TIPS seem fully priced at these levels.

Persistent Inflation, Policy-Driven Volatility

As we wrote last quarter, we expect higher volatility in bond markets this year. Drivers of volatility are unlikely to be fundamental—household and corporate balance sheets remain strong, and, with the possible exception of China (as we discuss in more detail below), the global growth cycle remains supportive of both corporate and securitized credit markets.

Rather, the drivers of volatility in 2022 will likely be macro and policy trends—specifically, the evolution of inflation and central bank policy.

Inflation is top-of-mind for global bond investors. We enter 2022 with core inflation in regions as varied as the U.S., Europe and emerging markets at elevated levels. With the U.S. at 4.9% core inflation, Germany at 4.1%, Mexico at 5.7% and Poland at 4.7% (as a few examples), the debate is not about whether inflation will exceed central bank targets, but for how long.

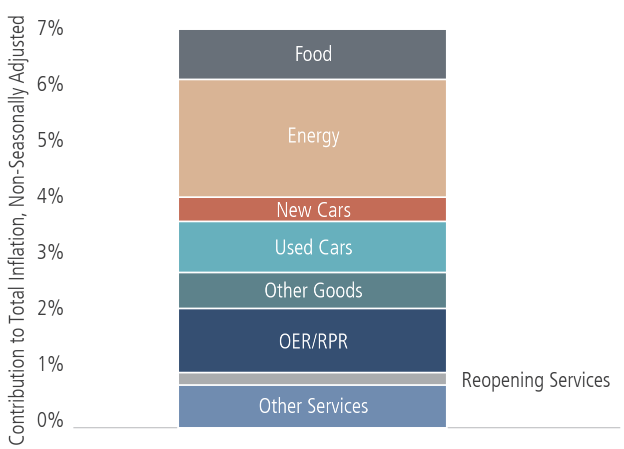
We expect that the movements in U.S. inflation will be the most critical for markets in the first quarter. With emerging markets already responding to higher inflation prints with policy adjustments, and the European Central Bank clearly "looking through" the elevated prints, we believe it is the Federal Reserve's reaction function that will be most important as a driver of real yields, the dollar and risk markets in general.

What do we expect for U.S. inflation? We agree with market consensus that inflation measures will start to decline as some key drivers of higher inflation, particularly car prices, start to moderate. However, we think the declines in inflation will be shorter-lived and shallower than Street expectations. The key reason is housing inflation; we expect persistent levels in this area as well as pressure from wages on other goods and services. As a result, we believe inflation could easily remain at 3% or more throughout the year.

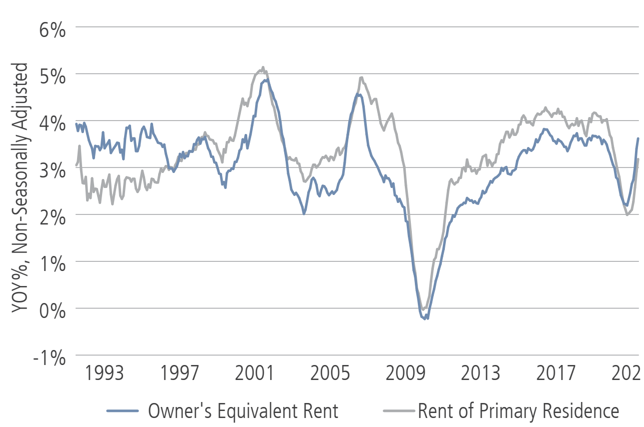
INFLATION PERSISTENCE COULD MEAN LOWER—BUT ABOVE PRE-PANDEMIC—LEVELS

Even if energy and autos go to 0%, CPI could be over 3.5%, with risk to the upside if rents accelerate.

November Inflation: Key Contributions From Energy and Housing (OER/RPR)



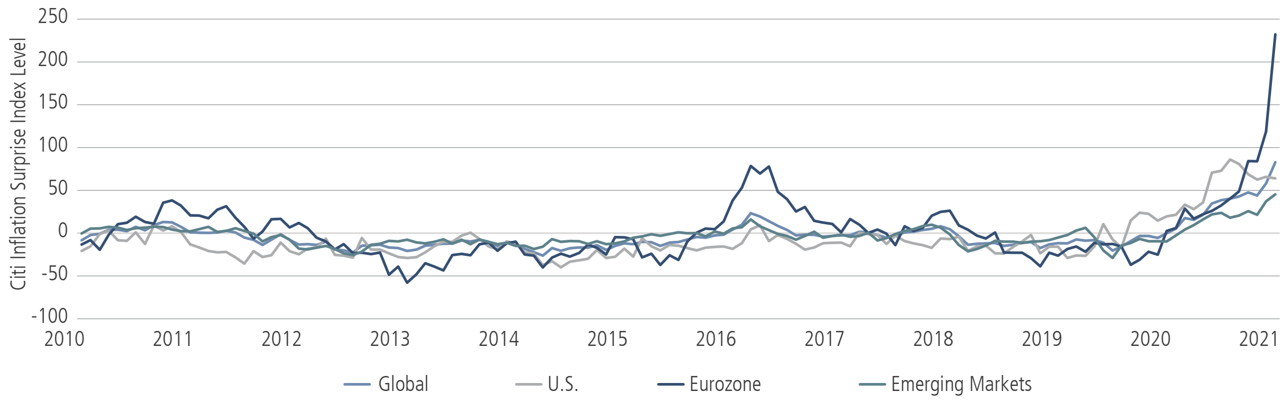
Housing Inflation May Not Peak Until 2H22: It remains below pre-pandemic and pre-Global Financial Crisis highs.



Source: BLS, Bloomberg. As of November 2021.

INFLATION SHOULD NOT BE AN UPSIDE SURPRISE IN 2022

Rates markets and central banks have repriced short-term rates on the back of inflation; it may be difficult to do so by as much this year.



Source: Bloomberg. As of December 2021.

Forward Rate Levels May Suggest Front Ends Are Fairly Priced

	Actual YE20	Year-End 2020		Current	
		2022	2023	2022	2023
United States (Fed Funds/Futures)	9bps	14bps	14bps	81bps	136.5bps
Eurozone (Euribor/Futures)	-54.5bps	-53bps	-47bps	-31.5bps	6bps
United Kingdom (Sonia/Futures)	3.9bps	-8bps	-0.05bps	117bps	130.5bps
Canada (Bankers Acceptances/Futures)	48bps	65.5bps	93.5bps	176bps	218.5bps

Source: Bloomberg. As of December 2021.

Major Emerging Market Banks Hiked in 2021

	Policy Rates (%)	
	End 2020	End 2021
Mexico	4.25	5.50
Brazil	2.00	9.25
Russia	4.25	8.50
Poland	0.10	1.75
South Africa	3.50	3.75

A second potential driver of volatility, related to persistent higher inflation, is the market's expectation for a global hiking cycle. It's important to note that this is primarily a developed market theme for 2022, as many large emerging market central banks have already begun tightening. This year, it will be the Fed's and other G7 central banks' turn to raise short-term rates.

What do we expect from these central banks? The table on page 4 highlights our expectations for many of the G7 countries. A few key themes are apparent in our expectations:

- We expect three to four hikes from many of the key central banks, including the Fed, Bank of England and Bank of Canada. Generally, we expect slightly more hiking than markets are currently pricing.
- The ECB is a notable exception to the global developed market hiking cycle—similar to other periods over the past decade; while other central banks are on the move, we expect no changes to the ECB's negative overnight rate setting.
- The hiking cycle in 2022 will be much more about ending "emergency" policy than attempting to significantly slow global growth—this is about a partial return to pre-COVID policy rather than anything more significant. As such, although policy will be in motion, we don't expect these changes to drive fundamental changes in the global growth environment.

KEY VIEWS ON DEVELOPED MARKET CENTRAL BANKS POLICY RATES IN 2022

We anticipate continued balance sheet adjustments and transition to higher policy rates.

Central Bank	Market-Implied Pricing	Our View
Fed	Three 25bps hikes for 2022	With the tapering decision out of the way, market is aggressive in pricing start (March 2022) of rates liftoff despite limited number of hikes for the cycle. **We expect three 25bps hikes in 2022 with a later start date (June 2022) than consensus expectations while the level of the terminal rate for the cycle remains uncertain until rates liftoff is underway.**
ECB	No rates adjustment for 2022	With ECB recent announcement to end PEPP in March 2022, adjusting APP in Q2/Q3 2022 before returning to purchases of €20bn per month from October 2022 and inflation forecast at 1.8% from Q2 2023 through Q4 2024, **we think policy rates liftoff is unlikely until Q4 2023 at the earliest.**
BOE	Three to four 25bps rate hikes	At the most recent meeting, majority of MPC members voted to increase the bank rate from 0.10% to 0.25% and called for further tightening ahead. Contrary to market expectations, **we expect rate hikes of 25bps only in February and May 2022.** Uncertainty around Covid-19 could lead to weakness in demand.
BOJ	No rates adjustment for 2022	BOJ has only given a slight indication of less funding support, but absent a major development, **we expect no policy rate changes in 2022.**
BOC	Four to five 25bps rate hikes	We think the market is pricing an over-aggressive rates adjustment, and anticipate the BoC to provide forward guidance early in the year ahead of the hiking cycle. **We expect three quarterly 25bps rate hikes in 2022 with the first coming in April,** taking the policy rate to 1.0% for the year.
RBA	Three 25bps rate hikes	Market pricing is too aggressive, in our view. We do not expect RBA to lift rates until a robust acceleration in demand, with realized and expected inflation returning to the 2 – 3% target. Thus, **we expect no policy rate changes in 2022.**
RBNZ	Six 25bps rate hikes	With RBNZ already having started a hiking cycle, and elevated risk of a sustained inflationary pressure due to strong domestic demand, in line with market expectations, **we expect a sustained series of rate hikes over the coming year, with the OCR reaching 2.75 – 3.00% around Q3 2023.**
Norges	Four 25bps rate hikes	Norges Bank has entered a hiking cycle, supported by both growth and inflation. **We expect the policy rate to be raised by 25bps per quarter in the next year, in line with market expectations, to reach the 1.5% pre-pandemic level by end-2022.**
Riksbank	One to two 25 bps rate hikes	Elevated inflationary pressures point to an eventual Riksbank's policy shift; **we anticipate tapering, then liftoff forward guidance by Q3 2022, and expect one hike by the end of the year, broadly in line with market expectations.**

Source: Bloomberg, Neuberger Berman. As of December 17, 2021. Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior. For illustrative and discussion purposes only.

In addition to raising short-term rates, both the Fed and ECB have already committed to a wind-down of their bond purchase programs. In December, the Fed announced an acceleration of its tapering of U.S. Treasury and mortgage purchases, and those purchases should cease by March. The ECB announced a similar policy: Its pandemic purchase program (PEPP) will also end in March, although the ECB will continue purchasing assets under its more general asset purchase program.

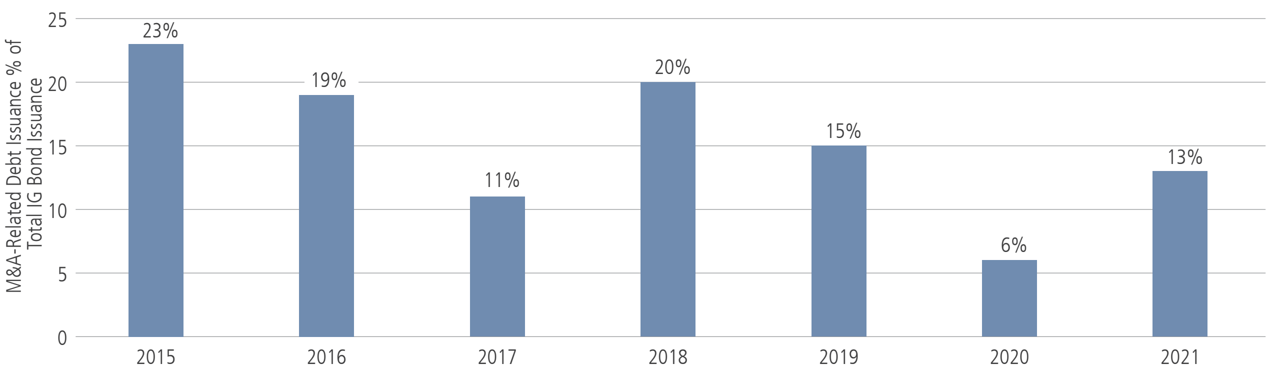
While the Fed's transition from "on hold" to tightening policy has been well telegraphed, more complicated policy decisions are being made by the ECB and People's Bank of China (PBoC), and markets will likely have rising sensitivity to these two central banks in particular.

For the ECB, the key reason we expect unchanged policy relates to the durability of economic trends in Europe. We expect the central bank to be hesitant to forecast inflation higher than its 2% target (and thus signal tighter policy) unless and until it sees lower unemployment rates and higher wage increases. For the markets, we expect increased focus on specific factors that could influence the timing of further policy changes: consumption momentum as economies reopen, whether next-generation funds support higher domestic growth, and how trends in inflation (excluding base effects) develop, having affected German inflation rates in particular.

Likewise, the PBoC faces increased challenges in 2022. Unlike other developed banks, the PBoC will likely still be biased toward easier policy, with an emphasis on supporting growth and not asset speculation. In practice, we believe the PBoC will cut the rate on its medium-term lending facility by 10 basis points to 2.85%, and will further cut the

MORE M&A COULD PRESSURE SPREADS

M&A issuance was 13% of total investment grade issuance in 2021, which was a lower percentage than most recent pre-COVID years.



Source: Bloomberg, company reports, JPMorgan.

reserve ratio requirement by 50 bps to 11%. In addition, the central bank is likely to lean heavily on its relending facility in 2022 to more directly promote lending toward its desired sectors, and has announced a CNY1 trillion relending quota for green financing.

More broadly, China is aiming for higher growth this year, against a backdrop of continued rebalancing of growth drivers. The Central Economic Work Conference (CEWC), which concluded in December, refocused policy priority toward growth, and suggested a more supportive policy environment for 2022. We think the government will set a growth target of 5% or above for 2022. The pace and intensity of regulatory tightening are likely to be adjusted to prevent systemic risks. Fiscal policy could do the heavy lifting in the first half of 2022 with the CEWC directing spending to be ramped up and frontloaded. The government will likely announce a 6% fiscal deficit for 2022, slightly higher than the estimated fiscal deficit of 5 – 5.5% in 2021.

While inflation rates and how they may impact central bank policy will likely be the two largest drivers of volatility this year, a few other developments should be highlighted as well.

One trend we are monitoring is the potential for merger and acquisition activity within the investment grade credit market. Over the past two years, these transactions—which often involve higher leverage—have been relatively muted. As the display above highlights, the last couple of years have been relatively unusual and a return to more typical levels of M&A activity would likely create some modest headwinds for investment grade spreads.

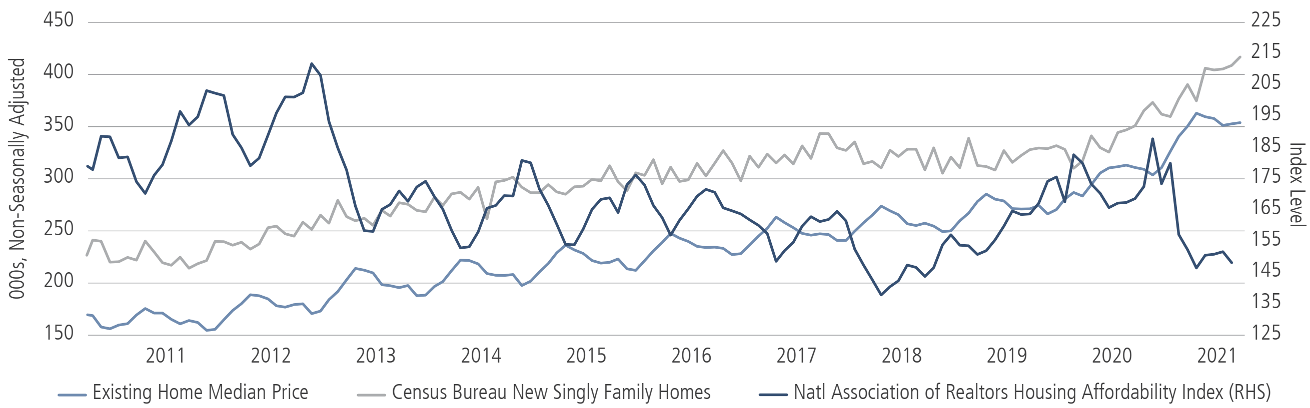
Second, housing price appreciation has helped support a range of securitized assets. As shown on page 6, house prices and affordability levels in the U.S. have seen significant movement in the past three years. While a support for seasoned securities, new issuance in these markets in 2022 is starting from more elevated valuations. Given our expectation for more modest housing appreciation in the coming years, divergences in these markets are likely only increasing.

Finally, the importance of environmental, social and governance factors in the credit market continues to increase. Whether climate change, equity inclusion and diversity, or general corporate governance, we expect more regulatory clarity on these issues (particularly in Europe) in 2022, which could further accelerate the trend toward leading-edge issuers. At the same time, we expect the energy sector to continue to be volatile in 2022. A strong performer in 2021, these markets should continue to be supported by strong commodity prices while facing headwinds given ESG concerns.

In terms of how to position fixed income portfolios this year, we are focused on four key ideas:

- **Maintain defensive positioning to interest rates, in the U.S. in particular.** We expect the bond market to reprice the Fed's terminal rate as growth and inflation exceed the Fed's targets. We believe a repricing toward a 2.25% terminal funds rate (from 1.75% currently) is a reasonable expectation. This would likely imply a 10-year Treasury note target of approximately 1.85 – 2.00%. Given that the ECB will be on hold in 2022, we believe defensive positioning in U.S. rates will likely be appropriate in the near term.

AS HOME PRICES HAVE MOVED UP, AFFORDABILITY HAS MOVED DOWN



Source: Bloomberg.

- **Overweight credit markets, less so than in 2021, and be prepared to buy on dips.** Similar to the past few years, fundamental credit risk remains limited. For example, we expect sub-1% default rates in high yield markets, which speaks to the strength of corporate balance sheets and the growth environment. If macro risks disrupt credit markets, investors should be prepared to add exposure. Within credit markets, we prefer high yield to investment grade, while European credit markets offer slightly more value than U.S. markets. Particularly in non-investment grade, we believe investments in telecommunications and technology sectors offer the most relative value. In investment grade, we continue to like BBB companies with spread advantages. This includes telecom, cable/media and technology. We continue to think U.S. banks provide attractive valuations. Corporate hybrids continue to provide attractive yield advantages, but the spread compression opportunities are currently limited. Energy is not attractive at these current valuations, in our view, even at elevated oil prices. Finally, taxable municipals should be an area of focus given spreads to investment grade credit.

- **Increase allocations to emerging markets hard currency debt.** After relative underperformance to other credit markets in 2021, we expect that EM will do better in 2022. There are two main reasons. The first is valuations: EM is trading at one of the cheapest levels to corporate credit in the U.S. and Europe that we've seen over the past five years. The second relates to the cycle: EM is further advanced in the tightening and fiscal adjustment cycles than developed markets. Within EM, we see opportunities in the high yield hard currency space, select opportunities in the investment grade hard currency space, and Chinese securities.

- **Maintain inflation protections in portfolio.** At current valuations, we prefer cash and floating-rate securities in the ABS, CLO, bank loan and corporate credit markets as a way to maintain flexibility toward higher inflation rates. A repricing of TIPS and/or other inflation markets will offer a direct way to position for enduring inflation, but at current valuations, we prefer emphasizing other assets to achieve this goal.

Sector Commentary

Investment Grade Corporate Credit: Strong Fundamentals, Full Valuations

Investment grade credit was characterized by relatively low levels of spread volatility in 2021 as fundamentals improved significantly due to the economic recovery. Strong fundamentals, supportive monetary policy and continued positive fiscal action resulted in relatively tight and range-bound spreads throughout the year even in the wake of supply chain issues, monetary policy transitions and new variants from the original COVID-19. Entering 2022, we expect spreads to remain range-bound, but with more volatility than experienced in 2021. in our view, the main source of potential spread weakness would likely be the continued tightening of monetary policy in response to inflation. Ultimately, continued strong fundamentals for credit globally should result in buying interest at wider levels.

On the fundamental side, supply chain and inflation issues (both in terms of costs and pricing power) were important topics in global credit, but were generally offset by significantly improving cash flows for global investment grade corporations. In 2022, we expect these strong cash flows to continue, but also anticipate an increase in event risk. M&A activity, increased share buyback activity and perhaps even some leveraged buyouts have potential to introduce more idiosyncratic risk into credit markets. While this should not result in systemic weakness to spreads, credit selection will be important to generating returns this year.

Global demand for investment grade credit has continued to be strong as yield remains important for investors in the generally low-interest-rate environment. Demand for U.S. credit, in particular, has been consistent and benefitted from the Fed's maintaining interest rates at zero. This has resulted in generally favorable hedging costs for foreign investors to purchase dollar credit. Assuming short interest rates increase in the U.S. in 2022 at a faster pace than other developed markets, the result would be that hedging costs become less attractive for offshore investors. This will be an important dynamic to watch for throughout the year.

Putting it all together, we enter 2022 with moderated risk views compared to what was carried throughout much of 2021. This is not due to concern about deteriorating fundamentals, but is instead a reflection of expected volatility due to monetary transitions around the world. Having flexibility to increase risk and capitalize on adding risk during bouts of volatility will be critical to adding value in investment grade credit in 2022.

Global Non-Investment Grade: Fundamentals and Technicals Remain Supportive

Similar to investment grade markets, non-investment grade credit fundamentals and technicals remain highly supportive of valuations, and we have a constructive outlook for high yield, loans and CLOs. While the managements at high yield and loan issuers have been highlighting inflation, supply and labor constraints as concerns in their recent earnings reports, many continue to benefit from an ability to raise prices, and they continue to see strong end demand from consumers and businesses as a result of above-trend global real GDP growth, strong balance sheets and solid income growth. Above-trend growth, higher-trend inflation and central banks acknowledging a need for the removal of massive stimulus create a highly constructive backdrop for non-IG credit investor demand and for issuer fundamentals.

In our view, valuations in high yield and loans reflect the very benign default outlook with default rates at or near all-time lows (less than 1%), which is a function of solid free-cash-flow growth and issuers' ability to refinance at lower rates. High yield aggregate net leverage continues to decline with historically well-above-average interest coverage. Loan issuers' EBITDA growth is also firmly positive, and balance sheets overall are in very good shape. Credit conditions and where we are in the credit cycle are generally supportive of the tighter credit spreads and, in high yield, the share of BBs is near an all-time high of 54% of total outstanding. Technicals should also be very supportive of both high yield and loans as investors continue to seek attractive yields with lower interest rate risk as we move into a period where central banks are more likely to raise rates as a result of elevated inflation. Moreover, in high yield, the effect of rising stars and a moderation of new issuance should create incremental support for valuations. Also, the loan market continues to see strong demand from both retail investors and CLO production, which has been setting records.

While absolute yield levels in global high yield markets are still relatively low compared to history, the increased share of higher-quality credits in high yield, and the fact that we are still in the earlier phase of the credit cycle, are important to keep in mind when thinking about spreads and yield levels. It is not atypical for spreads in high yield and loans to remain in a narrow-but-low range at this part of an economic expansion. Further, the potential for spread compression remains as investor demand for lower duration yield persists. Also, yields on the leveraged loan market remain attractive, especially given its minimal duration and floating rate nature in an environment of central banks beginning to be more aggressively addressing the higher-than-expected inflation.

Emerging Markets: Opportunities Given Attractive Valuations

Our base case is for emerging markets growth to stay above-potential in the coming year, though not yet fully recovering all output lost during the pandemic. In the process, the excess of growth over developed markets remains very slim as the U.S. and Europe have fiscal drivers that their counterparts in EM lack. Furthermore, emerging markets are already front-loading tightening monetary policies significantly, reducing demand in the process. Political risks and unorthodox policymaking, or the risk thereof, will keep uncertainty elevated in Latin America especially, leading to low growth expectations, with bellwether Brazil, for example, expected to grow little if at all. Vaccinations across EM countries should increase, but the ability to cope with renewed waves is more constrained than in developed economies in most cases, although this is offset to a fair to large degree by resilience in EM on the back of younger populations, but also out of sheer necessity; new variants are expected to have progressively less impact on economic life and mobility. While tighter financial conditions may create bumps in the road and cap the pace of the rebound, the market has already increased its expectation for tightening meaningfully, and EM has preempted the tightening significantly, creating some buffers for the time ahead.

For China, due to the enforced deleveraging in the property sector, but also the regulatory clamp-down on various other sectors, we believe the scope for a resumption of growth in the first quarter is limited at the very least. Tightness in liquidity is spreading to other sectors as well. We foresee low growth, also given our expectation that policymakers will not meaningfully deviate from the structural path set out by the common prosperity policies, even if policies will be incrementally eased further on the credit, policy-rate and local government financing via bond markets, for example. While banks are easing policies toward the property sector, this is only feeding through selectively via stronger, better-positioned credits. The takeover of property projects that are stalled by state-owned entities will take more time than many of the maturing bonds would require, causing more distress and default outcomes.

With regard to valuations broadly, given that hard currency spread levels are near the wides of the last five years (excluding the peak pandemic period of late Q1 and Q2 2020), they discount the aforementioned risks to a more-than-proportionate degree, we believe. As such, we see room for spread compression in our central scenario, especially within pockets of the high yield universe of sovereigns, where we identify compelling value given the scope of underperformance over the last two years, offsetting the negative return-drag effect of rising U.S. rates. EM corporates are likely to be supported in the near term by robust standalone fundamentals, with decreasing leverage trends, resilience against sovereigns and their relatively low duration. The main 2021 headwind was from the China high-yield property sector, which we believe will stabilize and potentially contribute positively in 2022. A turn toward more supportive policies for the property sector in China should reduce the tail risk of a hard landing in the country and offer select opportunities for revaluation in this sector, which saw unprecedented spread-widening in 2021. We do think that the future landscape of the property sector in China will also be populated more heavily by state-owned enterprises. For 2022, we expect defaults to be above the historical average at 5%, mainly driven by China and to a lesser extent by Argentina, with very limited risk elsewhere. If we exclude China, the full-year default expectation for 2022 is 2.3%. However, default adjustments mean that only part of the spread compression contributes to returns.

On the local currency side, we are selective in local duration, favoring a number of high yielders with steep curves and where meaningful rate hikes have been largely priced in markets, such as Russia and Mexico, for example, while maintaining underweights across low yielders where the risk/reward is less attractive. While the risk of high inflation persisting for longer is meaningful, we believe the current levels have already created room for outperformance going into 2022. Meanwhile, we maintain a moderate risk stance on EM currencies given their higher sensitivity to the highlighted near-term headwinds for EM, even though relatively healthy external positions across EM, multiyear low valuations in some cases, and improving carry limit the downside risks for EM FX. During 2022, as the scope for rate hikes in the U.S. is increasingly discounted or realized, combined with some slowdown in developed markets with the effects of the pandemic easing, it could set the stage for a recovery in EM currencies.

Securitized Products: Slower House Price Appreciation, Reduced Fed Support for MBS

We believe securitized credit fundamentals should continue to support performance in the sector. Consumers are coming off a record year in 2021 of robust income growth, healthy household balance sheets and record house price appreciation. Household financial strength was reflected in broad consumer credit performance with sectors such as credit cards, auto loans, consumer loans and student loans approaching or setting new lows for serious delinquencies. Housing continues to be an asset with robust and widespread demand countered with modest supply. Commercial real estate credit continues to mend, led by rebounding travel activity and fading impact from government-imposed lockdowns. That said, the pandemic's path will likely continue to dominate outcomes for specific property types—most notably retail, lodging and office sectors as the near-term disruption in travel, leisure and shopping patterns could weigh on loan performance and long-term changes to workplace practices and business travel have yet to be fully realized.

While we retain a positive outlook for consumer financial health into this year, we expect to see modest deterioration in securitized credit performance as one-off tailwinds that prevailed in 2021 fade. The benefits from the liquidity infusion provided by successive fiscal stimulus packages are unlikely to be repeated. House price appreciation was a significant contributor to growing household net worth and will likely slow due to higher interest rates and declining affordability. Additionally, federal forbearance programs for mortgages have not been renewed and households benefitting from relief will be required to resume payments. For spreads, we expect to see greater market volatility as the dispersion of potential paths for inflation, employment and growth overlap with a Fed policy reaction function for which there is no prior precedent.

Regarding the agency MBS markets, the Fed ended up announcing that it would be reducing its net MBS purchases down to zero by sometime in Q1 2022. Spreads were minimally impacted and remained range-bound during the fourth quarter. Looking forward, we expect the agency MBS market to grapple with two main questions: First, how much supply will the market need to absorb as the Fed reduces its purchases? And second, if interest rates do rise as we expect, how much will that reduce house price appreciation and refinancing activity? Overall, similar to other markets, we expect more volatility in 2022 as the markets wrestle with these issues.

Municipals: Supportive Trends Should Spill Over Into 2022

In absolute and relative terms, the municipal bond market delivered very competitive returns in 2021. Absolute returns were positive across IG tax-exempt, high yield and taxable munis despite a rising rate environment. High-yield municipals delivered the best results, with the Bloomberg Barclays Municipal High Yield index returning more than 7%. The overall muni market was lifted by several factors in 2021. First, the credit backdrop improved significantly as the economy continued its recovery from COVID-19 and large sums of federal stimulus were directed to the major municipal sectors. As a result, upgrades outpaced downgrades in 2021. Second, the technical backdrop was also quite favorable as 2021 broke the record for inflows into muni bond mutual funds. Third, although 2021 will be a record for headline supply, the composition of that supply was quite manageable. Taxable muni supply continues to be well above historical averages due to the tax law changes in 2017. However, that shift to taxable municipals has still not been enough to satiate overseas demand for a high-quality long duration fixed income with spread. In addition, this uptick in taxable muni supply has pulled issuance out of the tax-exempt market, which has, in turn, created a supply/demand imbalance for domestic U.S. investors. Finally, although it’s hard to quantify the total impact, U.S. investors were bombarded all year with the prospect of higher federal taxes, which probably led to more interest in the muni market’s ability to shelter income from taxes.

As we look to 2022, we think it is reasonable for investors to have lower return expectations for municipal bonds. We entered 2021 with a high degree of confidence that the Fed would be very accommodative for much of the year. With the economy continuing to recover and inflation proving to be more than “transitory,” the Fed has already started tapering its bond-buying program and signaling multiple rate increases in 2022. We expect volatility to increase as the Fed tightens monetary policy. With high-grade municipal valuations relative to Treasuries at very tight levels, it makes sense that prices could soften. Given that rates will continue to be low by historical standards, demand for spread should remain robust, but further tightening of spreads in taxable and high-yield munis is unlikely given current valuations.

In our view, an uptick in volatility will be a welcome development for the muni market given how narrow trading ranges were for much of 2021. We may see bonds become less tightly held, which should increase the ability to add value through security selection. As we enter 2022, we think it makes sense to be cautious on duration given current valuations and the likelihood that rates will drift higher. High-yield municipals should continue to outperform the IG muni market given the additional carry they generate, but the relative value calls on lower-rated munis will need to be more discerning. If high-grade valuations soften, they may offer more relative value when compared to certain lower-rated bonds that have already rallied so much. While not a huge part of the overall muni market, floating rate munis in our view could be a compelling opportunity as the Fed begins to raise rates. Despite some potential headwinds, an allocation to actively managed municipal bonds should continue to dampen overall portfolio volatility while delivering tax-efficient income for U.S. taxpayers. Rising rates, particularly at the short end of the curve, should inject some much-needed yield into muni bond portfolios.

Market Views
Next 12 Months

	UNDER −−	−	NEUTRAL ◇	+	OVER ++	CHANGE NOTES
GOVERNMENT BOND MARKETS						
United States	○	●	○	○	○	
United Kingdom	○	●	○	○	○	
Germany	○	●	○	○	○	
France	○	●	○	○	○	
Italy	○	○	●	○	○	
Spain	○	○	●	○	○	
Japan	○	●	○	○	○	
Canada	○	●	○	○	○	The BOC's likely rate hikes for 2022 offer little chance of appreciation, with opportunities coming on a tactical basis.
New Zealand	○	○	●	○	○	
Australia	○	●		○	○	Low yields amid global tightening limit return potential despite, in our view, the RBA's potential pause on rates in 2022.
U.S. TIPS	○	○	●	○	○	
INVESTMENT GRADE SECTOR						
U.S. Agencies	○	○	●	○	○	
U.S. Agency MBS	○	○	●	○	○	Despite consumer strength, reduced liquidity infusion and slowing housing price appreciation could limit tailwinds.
U.S. CMBS	○	○	●	○	○	
U.S. ABS	○	○	●	○	○	
U.S. Mortgage Credit	○	○	●	○	○	
U.S. Credit	○	○	●	○	○	
Europe Credit	○	○	●	○	○	
U.K. Credit	○	○	●	○	○	
Hybrid Financial Capital	○	○	○	●	○	
Municipals	○	○	●	○	○	

	UNDER −−	−	NEUTRAL ◇	+	OVER ++	CHANGE NOTES
HIGH YIELD & EMERGING MARKETS						
U.S. Full-Market High Yield	○	○	○	●	○	
U.S. Short-Duration High Yield	○	○	○	●	○	
Pan-Euro High Yield	○	○	○	●	○	
Floating-Rate Loans	○	○	○	●	○	
U.S. CLO	○	○	○	○	●	
EM Hard-Currency Sovereigns	○	○	○	●	○	
EM Hard-Currency Corporates	○	○	●	○	○	
EM Hard-Currency Short Duration	○	○	○	●	○	
EM Local-Currency Sovereigns	○	○	○ →	●	○	Low valuations have created opportunity, especially in some high-yielding countries where investors have priced in meaningful rate increases.
CURRENCY*						
U.S. Dollar	○	●	○	○	○	
Euro	○	○	●	○	○	
Pound	○	○	●	○	○	
Yen	○	○	○	●	○	
Swiss Franc	○	●	○	○	○	
Australian Dollar	○	○	●	○	○	
Swedish Krona	○	○	●	○	○	
Norwegian Krone	○	○	○	●	○	
Canadian Dollar	○	●	○	○	○	
Mexican Peso	○	○	●	○	○	
Brazilian Real	○	○	●	○	○	
Chinese Yuan	○	○ →	●	○	○	Growth recovery will take time while financial conditions remain tight, but policy support should reduce tail risk in the property sector.
Russian Ruble	○	○	○	●	○	
Turkish Lira	○	●	○	○	○	

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*Currency views are based on spot rates, including carry.

ABOUT THE

FIXED INCOME INVESTMENT STRATEGY COMMITTEE

The Neuberger Berman Fixed Income Investment Strategy Committee consists of 16 of our most senior investment professionals who meet monthly to share views on their respective sectors to inform the asset allocation decisions made for our multisector strategies. The group covers the full range of fixed income, combining deep investment knowledge with an average of 29 years of experience.

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