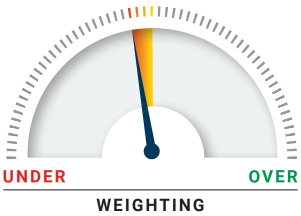
PIMCO

Late Cycle vs. End Cycle Investing

INSIGHTS FOR AN AGING EXPANSION

As the economic expansion aged and volatility increased throughout 2018, consensus shifted from viewing the U.S. expansion as likely to continue for the foreseeable future to believing that we are in the late stages. We believe we are late cycle, not end cycle, and our key view is that one should continue to be invested, but judiciously prefer securities that are higher in quality and liquidity across asset classes.

Here is how we are positioning asset allocation portfolios in light of our outlook for the global economy and markets.

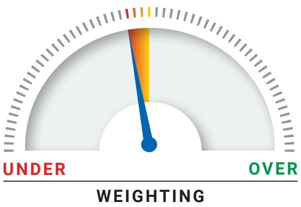


OVERALL RISK

Given broadly slowing growth, lower levels of monetary policy support and generally higher levels of volatility, we are maintaining overall risk close to our benchmark, but building liquidity to take advantage of tactical buying opportunities.

POSITIONING

OPPORTUNITIES



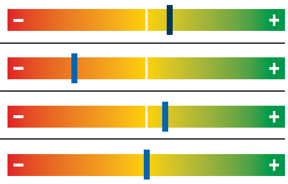
EQUITIES

U.S.

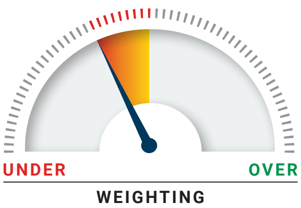
Europe

Japan

Emerging markets



We expect volatility and slowing profit growth to continue to impact investor appetite for equities in 2019. Therefore, we have a modest underweight to equities with an emphasis on liquidity and high quality, defensive sectors. We favor large caps over small caps, U.S. equities over European equities and are modestly overweight Japanese equities given positive earnings, low leverage and still supportive Bank of Japan.



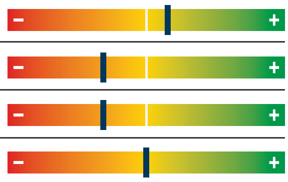
RATES

U.S.

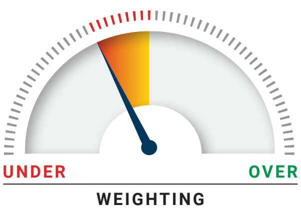
Europe

Japan

Emerging markets



We prefer high quality duration as we move toward the later part of the cycle as we still believe that fixed income offers an attractive diversifier for risk in portfolios. However, we are selective in our exposures. We find U.S. rates the most attractive in developed markets. Beyond the U.S., we find UK gilts and Japanese government bonds rich, and we believe valuations of eurozone peripheral bonds are suspect without continued ECB support.



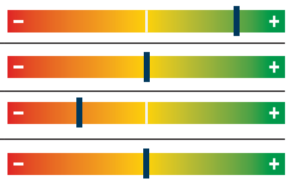
CREDIT

Securitized

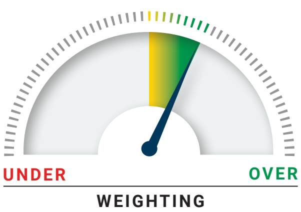
Investment grade

High yield

Emerging markets



Given our late-cycle view, we expect corporate credit will underperform over the coming year. Within corporate credit, we prefer shorter-dated bonds from high quality issuers, especially in defensive and noncyclical sectors, which is in keeping with our quality and liquidity theme. The high yield underweight reflects in particular the glut of low quality leveraged loan issuance. We continue to favor non-agency mortgage-backed securities (MBS) as they remain a relatively stable high quality alternative to corporate credit. We are also keeping dry powder in order to pursue targeted opportunities which we think offer attractive risk/reward characteristics.



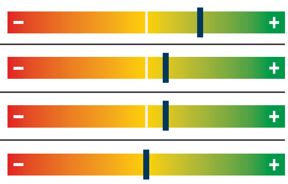
REAL ASSETS

Inflation-linked bonds

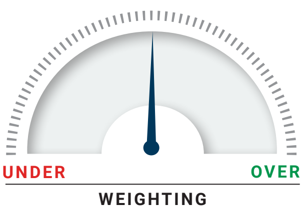
Commodities

MLPs

Gold



Historically, real assets tend to perform well in late-cycle environments; however, that relationship has become less stable in recent periods. That said, we still view real assets as an effective tail risk hedge against rising inflation as well as a portfolio diversifier, and we therefore maintain a modest allocation to what we feel are attractively valued opportunities, including TIPS and MLPs which should benefit from U.S. production growth.



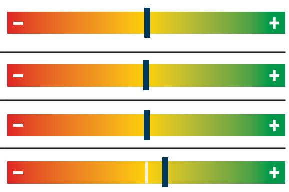
CURRENCIES

USD

Euro

Yen

Emerging markets



We have a nuanced view on currencies, and expect more significant alpha opportunities to emerge outside of the majors. We are currently close to neutral in U.S. dollars (USD) versus the other majors, and will pursue idiosyncratic opportunities in emerging markets as they unfold. We expect downward pressures on the Chinese yuan (CNY) to persist, and therefore also maintain Asian currency shorts versus the USD.

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