**Transcript: Focus on Shorter-Duration Credit Exposure**

The Federal Reserve pivoted to a dovish stance in early 2019, acknowledging that economic and financial conditions have weakened both in the U.S. and abroad. Some analysts think that the central bank's next move will be an interest rate cut. While the central bank's shift has helped quell market volatility, we see the potential for more spikes in volatility given global growth concerns.

In order to implement relatively defensive portfolio positioning while still generating yield, we are focusing on certain areas of the market that have the potential to better withstand a resumption in volatility. We favor allocations to shorter-duration bonds in some sectors with credit risk with structurally attractive risk/return profiles. These include asset-backed securities and dollar-denominated emerging markets debt.

When analyzing sectors, we look at the amount of widening in credit spreads that would offset the extra income generated from those sectors over the course of one year—this is the break-even threshold. Then we compare the standard deviation of credit spreads to the break-even level to gauge the likelihood that they will exceed the break-even threshold.

For example, in short-term emerging market corporate debt, our analysis shows that the recent one-year standard deviation of spreads is 29 basis points. Because this is less than the break-even level, it implies the chance of realizing negative excess returns over the next year is low, assuming we experience a level of spread volatility consistent with that of the trailing 12 months. In contrast, for the broad U.S. investment-grade corporate sector, the standard deviation of spreads exceeds the break-even threshold.

We monitor break-even spreads and volatilities across a range of sectors. We are carefully watching for signals that could change our outlook. If the economy unexpectedly slides into a recession, the short duration of our positions will limit exposure to credit risk. On the other hand, if stronger-than-expected economic numbers push the Fed off the sidelines to raise rates, an additional advantage of exposure to shorter-duration credit sectors is their lower price sensitivity to interest rate increases.

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