

P I M C O

SECULAR OUTLOOK

May 2018

Rude Awakenings

We expect a more difficult market environment will surprise many investors as the post-crisis era ends. It's time to position for the opportunities ahead.




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Ten years after the financial crisis, the global economy and financial markets could be entering a new era of potentially radical change that will make the next decade look very different from the last. Investors who assume that the future will resemble the post-crisis past could be in for a series of rude awakenings. Rather, we want to be prepared for the challenges ahead and to be in a position to play offense when these awakenings eventually occur.

The post-crisis global environment has been characterized by financial repression (via regulation and dominant central banks), mostly passive or restrictive fiscal policies, weak growth in productivity and real wages, subdued inflation, largely uninhibited trade and capital flows, and low macro and market volatility. Meanwhile, aggregate global debt levels have continued to rise.

Over the secular horizon, we expect a very different macro landscape to emerge, for better or worse. Important shifts are already underway: The monetary-fiscal policy mix is changing as central banks retreat and fiscal policy becomes more expansionary, the regulatory discussion is moving from the financial to the tech sector, and economic nationalism and protectionism are on the rise.

One way the real economy could break out from the post-crisis lull on a sustainable basis is through a significant pickup in productivity growth as the diffusion of new technologies finally accelerates via stronger business investment. However, stronger potential growth would likely also produce higher real interest rates.

Another scenario that could come to pass in (or after) the next recession, which we expect to occur at some point over the next three to five years, is a more extreme populist backlash than seen thus far. This could come in different flavors: radical income and wealth redistribution, more aggressive protectionism, nationalization of key companies or even industries, or attacks on central bank independence.



A FORUM FOR THE LONG VIEW

Earlier in May we held PIMCO's annual Secular Forum, and as always our focus was to identify the key economic and political forces that will shape the global economy and financial markets over the next three to five years.

To guard against groupthink and broaden our horizon, we welcomed six distinguished invited speakers, listened to fresh ideas from our newest class of MBAs and PhDs, and engaged in active debate with our Global Advisory Board and among our investment professionals from around the globe. One key absence this year was Richard Clarida, our global strategic advisor who has been leading our Secular Forum process over the past five years and also prepared the agenda for this year's forum; he was nominated recently to serve as Vice Chair of the Board of Governors of the U.S. Federal Reserve.

To set the stage, we briefly reviewed our conclusions from the May 2017 Secular Forum. Back then, we prognosticated that over the longer-term horizon, the global economy would undergo five significant pivots in the direction and scope of monetary, fiscal, trade, geopolitical and exchange rate policies. In a world of Insecure Stability (which was the theme of our 2016 Secular Forum), these five policy Pivot Points would test markets and could lead to a repricing of risk.

In fact, looking back over the past year since the May 2017 forum, we have already seen important gyrations on all five fronts:

- The Fed started to run down its balance sheet, the European Central Bank inched closer to the exit from its asset purchase program, the Bank of Japan reduced its sovereign bond purchases and various other central banks hiked rates.
- The U.S. embarked on a major fiscal expansion via tax cuts and higher federal spending planned over the next several years.
- A serious trade tussle between the world's largest trading nations raised the specter of a full-blown trade war.
- The geopolitical situation in the Middle East and on the Korean Peninsula dominated headlines.
- A larger-than-expected depreciation of the U.S. dollar unfolded during 2017.

More recently – and partly in response to these policy pivots – rising rates in the U.S., a reversal of the U.S. dollar, and a range of country-specific factors are putting pressure on emerging market (EM) assets. That said, the longer-term environment should remain generally supportive for many investments in EM.

2018 SECULAR FORUM GUEST SPEAKERS

Erik Brynjolfsson

Director of the MIT Initiative on the Digital Economy, Schussel Family Professor at the MIT Sloan School, Research Associate at the National Bureau of Economic Research

Stanley Fischer

Former Vice Chair of the Board of Governors of the Federal Reserve System, former Governor of the Bank of Israel

Timothy Geithner

President of Warburg Pincus, former Secretary of the U.S. Treasury, former President of the Federal Reserve Bank of New York

Dina Powell

Executive Office at Goldman Sachs, former U.S. Deputy National Security Advisor for Strategy, former U.S. Under Secretary of State for Public Diplomacy

Eswar Prasad

Tolani Senior Professor of Trade Policy and Professor of Economics at Cornell University, Senior Fellow at the Brookings Institution, Research Associate at the National Bureau of Economic Research, former head of the IMF's China Division

Andres Velasco

Professor of Professional Practice in International Development at Columbia University, former Finance Minister of Chile, former Sumitomo-FASID Professor of International Finance and Development at the Harvard Kennedy School of Government

PIMCO GLOBAL ADVISORY BOARD

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Former Federal Reserve Chairman and Distinguished Fellow at the Brookings Institution

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Gordon Brown

Former U.K. Prime Minister and former Chancellor of the Exchequer

Ng Kok Song

Former Group Chief Investment Officer of the Government of Singapore Investment Corporation (GIC)

Anne-Marie Slaughter

President and CEO of New America, Bert G. Kerstetter '66 University Professor Emerita of Politics and International Affairs at Princeton University, and former Director of Policy Planning for the U.S. State Department

Jean-Claude Trichet

Former President of the European Central Bank and present Chairman of the European group of the Trilateral Commission

REGULAR PARTICIPANTS

Robert Arnott

Founder and Chairman, Research Affiliates

Gene Sperling

President, Sperling Economic Strategies; previously Director of the National Economic Council and Assistant to the President for Economic Policy under both President Clinton and President Obama

In short, we felt that our 2016 and 2017 secular themes have started to play out but have further room to run in the next few years. Also, economic, policy, geopolitical and financial market developments over the past year provided plenty of food for thought and raised important new questions about the secular and supersecular outlook.

OUR SECULAR BASELINE INCLUDES A RECESSION

For starters, we re-examined our existing baseline view that a recession in the U.S. over the next three to five years is more likely than not, and that large parts of the rest of the world would not be immune to it. To be sure, we discussed and acknowledged that a possible pickup in productivity growth and a potentially very low fiscal multiplier might keep inflationary pressures at bay and prevent a significant tightening of monetary policy, resulting in a moderate expansion continuing throughout the next five years. However, the road toward such a benign outcome is narrow and curvy for several reasons:

First, assuming no additional stimulus in 2020, the fading of the U.S. fiscal sugar-rush after 2018–2019 could lead to withdrawal symptoms that could exacerbate a cyclical slowdown.

Second, the fiscal stimulus is arriving at a time when the unemployment rate is already

below 4%, which raises cyclical overheating risks. Moreover, depending on the outcome of the November 2018 U.S. midterm elections and in the run-up to the 2020 presidential election, there is a possibility of additional fiscal easing, either in the form of a public infrastructure program or by making the tax cuts permanent, or both. While this is not our base case, if this came to pass it would add fuel to the flames.

Third, a fiscal-policy-induced overheating might force the Fed, which seems unwilling to tolerate a prolonged overshoot of its inflation target by more than a couple of tenths of a percentage point, into pushing policy rates significantly above neutral. This has usually not ended well in past cycles.

Fourth, while not our baseline, there is a distinct possibility that the current trade tussle between the U.S. and much of the rest of the world turns into a full-blown trade war, hitting consumer confidence and corporate animal spirits. As one participant mentioned at our forum, the current trade tensions may be akin to professional wrestling: a spectacle that's more bluster than real action, but still an inherently risky activity where people can get hurt.



A SHALLOWER BUT LONGER AND RISKIER RECESSION

To be fair, a poll we conducted among sell-side economists and strategists ahead of our forum suggests that a U.S. recession over the next three to five years has now become consensus – even though markets do not seem to be pricing in this risk, judging by risk spreads and volatility. Thus, a more interesting question we considered at the forum is how deep and how long the next recession might be, and what policy responses it might entail. While all of this is highly speculative, we lean toward forecasting a shallower and longer, call it wok- or saucer-shaped, recession rather than a deeper but shorter V-shaped recession:

- **Shallower**, because there are so far no signs of corporate or housing overinvestment or overconsumption in the U.S. economy, and the global financial sector looks steadier than in the past few cycles. The main risk to this view is elevated levels of non-financial corporate leverage, which raises the risk of a major default cycle even in an initially shallow recession.

- **Longer**, because relatively low interest rates, bloated central bank balance sheets and (in the U.S.) larger fiscal deficits limit the policy space to fight a global recession. Moreover, given the widespread trend toward economic nationalism and protectionism, a recession could fuel trade deglobalization and currency wars, thus shrinking the pie further.
- In addition, the next recession could be **riskier** than a standard postwar recession, for a few reasons: Inflation expectations are very low at the outset almost everywhere, the structural weaknesses in the eurozone could be exposed, and a recession would raise the risk of populism aimed at wealth redistribution and confiscation.

A MORE DIFFICULT ENVIRONMENT AHEAD

While the evolution of the economic cycle over the next several years – overheating or not, recession or not, what type of recession and where – is important, we concluded that there are much broader issues with far-reaching implications to consider.

Since the crisis, the global economy has been characterized by financial repression (via regulation and extraordinary central bank activity), generally passive or restrictive fiscal policies, weak growth in

productivity and real wages, low inflation, largely uninhibited trade and capital flows, and limited volatility. Meanwhile, aggregate global debt levels have continued to rise.

Over the secular horizon, we expect a very different macro landscape to emerge, for good or ill. Many changes are underway already: Many central banks have begun dialing back post-crisis monetary policy actions even as fiscal policy becomes more expansionary, the regulatory discussion is moving from the financial to the tech sector, and right-wing economic nationalism and protectionism are gaining strength in many regions.

Among the many potential drivers of significant change over our secular horizon, at our forum we zoomed in on productivity, fiscal policy and more extreme incarnations of economic nationalism and populism than we're currently seeing.

First, regarding *productivity*, some forum participants argued for a mean reversion after a disappointing stretch of several years, partly helped by cyclical factors such as on-the-job learning in an almost fully employed U.S. economy. Others expected technology-driven efficiency advances to lift productivity and potential output growth on a more sustained basis, thus lifting natural real interest rates over



time. However, as we discussed at the forum, such productivity gains may be slow in coming and more likely to become meaningful on the supersecular horizon rather than in the next three to five years, as we still seem to be in the early stages of the diffusion of artificial intelligence and machine learning into the broader economy. To become more optimistic on productivity over the long term, we would first need to see a significant pickup in investment spending in the coming years.

Second, a global *fiscal expansion*/ public dis-saving that is large enough to offset some or all of the global excess of desired saving over desired investment in the private sector would challenge the status quo of low inflation and low interest rates. So far, the U.S. is the only major economy that has embarked on meaningful fiscal stimulus, which will take effect over the next few years. While this is unlikely to be enough to absorb the global savings glut, there is a possibility that even more expansionary policies may be adopted ahead of the 2020 U.S. presidential elections, and other countries might join in.

Third, and relatedly, over the secular horizon there is a significant risk of a *populist backlash*, especially if and when we hit another recession. This could come in different flavors: income and wealth redistribution from the

winners to the losers of the games of globalization and digitalization, more aggressive protectionism, nationalization of major firms or even industries, or attacks on central bank independence, to name just a few. Think wealth taxes, more progressive income taxes and universal basic income, potentially financed by money-printing. If left-wing populism were to take hold in the U.S., U.K. or Europe, weaker growth and higher inflation would likely result. Note, however, that there is also a potential (if not very likely) upside for the economy if sensible redistribution policies support real incomes and provide training and jobs for those left behind by digitalization and globalization.

CHINA, THE U.S. AND THE THUCYDIDES TRAP

Geopolitics could be another source of rude awakenings. With the help of our [Global Advisory Board](#), we discussed the geopolitical implications of an assertive China under a strong authoritative leader with a clear long-term vision to reach developed country income levels by 2035 and “fully developed” status by 2049, the 100th anniversary of the People’s Republic. Many observers discuss a potential “Thucydides trap” – which results in conflict when a rising power (such as Athens at the end of the 5th century B.C., Germany at the end of the 19th

century and now China) challenges a ruling power (such as Sparta, Great Britain and now the U.S.). The Thucydides trap is not inevitable. However, the likely tensions caused by China becoming a global economic and military superpower while the U.S. tries to more assertively defend its status in the areas of trade, intellectual property and defense create uncertainty and could be another source of accidents over our secular horizon.

On a more positive note, we acknowledged that a united and strong Chinese leadership that regained centralized control of state-owned enterprises and suppressed capital flows could make China a less likely source of systemic shocks for the rest of the world. Also, with China’s leadership having a long-term orientation while the Trump administration is more short-term-focused given the presidential election cycle, there is a good chance of a “fairer and freer trade deal” that includes better protection of intellectual property rights and satisfies the U.S.’s short-term goal but allows China to keep pursuing its longer-term goals. That said, there remains an elevated element of unpredictability in U.S. policy, while a Chinese leader who is internally unrivalled and fully in control may still make unintended policy mistakes.



Secular investment implications

The Secular Forum is a central and longstanding part of our investment process, helping to tilt our strategy toward a long-term orientation, encourage contrarian thinking and establish investment guardrails. As we look out over the next three to five years, we do not assume a continuation of the post-2008-crisis past. We will prepare for a more difficult environment and look to be positioned to play offense when expected rude awakenings present themselves.

To be sure, a benign path for the next three to five years is possible. But it would be a difficult path, with stretched valuations and the range of potential potholes and accidents leaving little room for maneuvering. The current recovery has led to a shift toward less central bank support and outright tightening in a number of cases, led by the U.S. Less predictable and perhaps less market-friendly central banks could lead to higher volatility over time. A rise in inflation pressures after decades of wage quiescence would make the challenge all the more difficult.

Since the 2008 crisis, bad news for the economy has typically been interpreted as good news for financial assets, as policymakers have been quick to respond. But this “buy the dip” mentality may not endure. Financial assets have significantly outperformed the real economy over the past decade but, over the next decade, the opposite may very well be the case.

Over the secular horizon, good and bad news for the economy may affect markets in unpredictable ways. There are upside risks from a breakout in productivity growth, for example. But productivity improvement in the real economy could lead to higher real rates, hurting many investors in fixed income assets and in equities alike (though as we’ve often discussed, a rising rate environment, while potentially painful in the short run, is not necessarily something long-term bond investors need fear).

At the same time, a U.S. recession is part of our baseline outlook for the next three to five years, and we would expect significant global economic and market spillovers in that event. Economic nationalist and populist pressures could be amplified. Central banks may come to the rescue

again, but there may also be new threats to central bank independence in such an environment, with unpredictable consequences.

No one has a crystal ball on the economy, markets or politics, and the risks arising from populist movements are harder to quantify. But we can guard against placing too many eggs in one basket, which could happen if we attach too high a probability to a benign baseline path. And we can focus on maintaining portfolio flexibility to respond in the face of both downside and upside risks or surprises. This may mean giving up some portfolio yield potential in exchange for this flexibility, for example by holding more highly liquid short-term investments.

While we expect to be cautious in our positioning, we will remain focused as always on our clients’ objectives, such as the need for income, across our range of different strategies. We will look to find and exploit the best tactical and structural ideas, and to generate income from as broad an opportunity set as possible without excessive reliance on corporate credit.

FLEXIBILITY

Given less attractive valuations and increased volatility in many markets, our broad and flexible mandates are likely to provide considerable advantages over the secular horizon – they have access to our best ideas from the full global opportunity set and can diversify across a broad range of sovereign and spread sectors. Global policy and political uncertainties also mean that strong global research capabilities will be important in pinpointing the most attractive opportunities to deliver returns while managing risk.

As we get closer to a possible end to the current expansion, it becomes harder to distinguish between cyclical overshoots and long-term shifts in the underlying macro and market dynamics. There is ample potential for cyclical overshoots in the face of relatively small changes in the data, and as a consequence of market valuations that leave little room for error. These cyclical overshoots and data “head fakes” may provide trading opportunities across different sectors of the market.

SUSTAINABLE INVESTING

We will continue to deepen the integration of environmental, social and governance (ESG) factors as a core part of our active investment process. ESG factors are a crucial component of our assessment of corporate, securitized asset and sovereign risk. We have launched dedicated U.S. and global core ESG strategies and plan to expand our ESG strategies further. ESG is an area where we will continue to invest in our capabilities in analysis and issuer engagement – both to meet client objectives and to strengthen our overall investment process.

DURATION, VOLATILITY, CURVE

Continuing the discussion from the March 2018 Cyclical Forum, while interest rates have moved higher, likely driven in large part by the prospect of wider fiscal deficits and increased supply in the U.S., we continue to expect The New Neutral framework of low equilibrium policy rates anchoring global fixed income markets to be a useful guide.

Demographics, high existing debt levels, low productivity and the global savings glut would work against significantly higher real and nominal interest rates. At the same time, we view productivity growth, fiscal policy and more extreme incarnations of economic nationalism and populism as significant sources of disruption. Thus, in our portfolios we expect to maintain durations that are close to benchmark, given our forecast for fairly range-bound global fixed income markets and what we see as generally balanced upside and downside risks to the forward yield curves.

While in our baseline view the level of global yields looks broadly anchored, we believe the level of bond market volatility seems surprisingly low, considering the increased uncertainty in the outlook and our expectation of less central-bank-driven suppression in volatility. Indeed, we may see less predictable central bank activity in general, with the Fed well into its tightening cycle and many other major central banks at minimum dialing back their post-crisis support and some following the Fed lead. We anticipate a rise in volatility and, as a result, we expect to place less emphasis on volatility sales, which in a more normal volatility environment would be a key part of our portfolio construction. We may find targeted opportunities where buying volatility will present an attractive risk/reward trade-off.

We expect that higher volatility over time will lead to the re-establishment of higher term premia and risk spreads, leading to steeper yield curves. Higher inflation pressures, whether perceived or realized, could also lead to global curve steepening. As part of our focus on structural trades that seek to exploit market inefficiencies, we acknowledge the strong technical demand for the long end of the curve created by the regulatory environment for insurance companies and pension funds. The shorter end of the curve tends to offer better yield or income per unit of duration.

REAL RETURN

We view U.S. Treasury Inflation-Protected Securities (TIPS) as offering a reasonably priced portfolio hedge against the possibility of upside U.S. inflation risks. A significant breakout of higher inflation is not our base case for the secular horizon, but as labor markets tighten across much of the global economy, higher inflation certainly looks a bigger risk than it has been over the past decade. As well as TIPS, commodities and other hard assets also offer a reasonable inflation hedge.

CREDIT

We believe we should be much more selective on credit as we approach the end of the post-crisis secular recovery. Our overall caution is bolstered by the large flows we have seen into the asset class, the increase in corporate leverage, and the fact that many asset allocators who were pushed into credit by the low yields available in short-term, liquidity-focused markets in the last decade may find those short-term investments more enticing in the coming years.

We will continue to seek to limit our exposure to generic investment grade and high yield corporate bonds, emphasizing instead the best bottom-up ideas presented by our global team of credit portfolio managers and analysts. Overall we expect to continue to reduce corporate credit risk, emphasizing short-dated exposures and “bend but don’t break” positions in corporate debt and structured products with a low likelihood of default. We think that investments related to the U.S. housing market and offering structural seniority and hard asset coverage remain attractive. More generally, sectors that have seen a significant increase in regulation, including commercial real estate and the financial sector as well as housing, will likely demonstrate resilience in a more difficult market environment, while other segments of the corporate universe may be more volatile than current valuations appear to anticipate.

EUROZONE INVESTMENTS

With central banks more uncertain actors over the longer term, we will seek to focus on investments that offer robust risk/return profiles and that do not rely excessively on central bank support. In that context we expect to be careful in particular on eurozone peripheral risk, given the reliance on European Central Bank (ECB) support, uncertainty over the future direction of the ECB, and our expectation that in the next eurozone recession the underlying weaknesses of peripheral sovereign credit and of the eurozone itself will be exposed once again, given the lack of noticeable institutional reforms since the last eurozone crisis. The rise of populist parties is only the latest example of populist risk in the eurozone at a time of reasonable growth by eurozone standards; we would expect political risk to grow in the event of a sustained slowdown.

CURRENCIES

We have a broadly balanced view on the U.S. dollar versus other G-10 currencies, reflecting limited valuation anomalies across markets and, in the U.S., the balance between upward pressure on the dollar exerted by rates and growth differentials and the downward pressure exerted by the twin current account and fiscal deficits.

EMERGING MARKETS

We expect to find opportunities in emerging markets, across countries and sectors, guided by our EM specialist team. Idiosyncratic risk, as well as the path for U.S. policy rates, the U.S. dollar, cyclical uncertainty and a potential rise in developed market volatility will be important in navigating emerging market investments. But we also expect that over time the continuation of The New Neutral environment and overall low policy rates and developed market yields will be supportive for EM assets.

ACTIVE MANAGEMENT APPROACH

Starting valuations across sectors mean that we anticipate overall an environment of lower nominal returns compared with the post-2008 recovery period. While we anticipate a difficult investment environment, it is one where we expect to find good opportunities as active managers and where, owing to lower beta market returns, we anticipate that alpha resulting from strong, well-established investment processes and rigorous analysis will be an even more important component of total return.

PRIVATE INVESTMENTS

The ongoing attractiveness of liquidity premia and complexity premia will continue to provide compelling opportunities across many of our investment strategies, and especially in private vehicles with appropriate lockups that would allow us opportunity to harvest potential returns over longer periods of time, whatever the vagaries of the cycle, and to seek to exploit voids in the financial system as the result of ongoing shifts in the regulatory environment. Market segments that have faced the most post-crisis regulation will continue to provide some of the best opportunities for years to come, in our view. Higher volatility and political uncertainty may also lead to intriguing private investment opportunities in real estate and credit. Emerging markets will likely remain volatile, which should provide attractive diversification potential.

Across most investments but especially in the private sphere, we think it is wise to hold more cash-like investments as markets remain prone to overshoots based on increasingly uncertain fundamentals and a technical environment prone to sizable flow reversals as sentiment changes. We have built out our private credit capabilities and will continue to do so, with care. We see this as an area for nimbleness and caution, and again a source of attractive diversification that complements our traditional fixed income strategies.



ABOUT OUR FORUMS

PIMCO's investment process is anchored by our Secular and Cyclical Economic Forums. Four times a year, our investment professionals from around the world gather in Newport Beach to discuss and debate the state of the global markets and economy and identify the trends that we believe will have important investment implications. We believe a disciplined focus on long-term fundamentals provides an important macroeconomic backdrop against which we can identify opportunities and risks and implement long-term investment strategies.

At the Secular Forum, held annually, we focus on the outlook for the next three to five years, allowing us to position portfolios to benefit from structural changes and trends in the global economy. Every Secular Forum, we invite distinguished guest speakers – Nobel laureate economists, policymakers, investors, scientists and historians – who bring valuable, multi-dimensional perspectives to our discussions and help us evolve and enhance our process. We also welcome the active participation of the PIMCO Global Advisory Board, a team of world-renowned experts on economic and political issues.

At the Cyclical Forum, held three times a year, we focus on the outlook for the next six to 12 months, analyzing business cycle dynamics across major developed and emerging market economies with an eye toward identifying potential changes in monetary and fiscal policies, market risk premiums and relative valuations that drive portfolio positioning.

Past performance is not a guarantee or a reliable indicator of future results.

All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and the current low interest rate environment increases this risk. Current reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Corporate debt securities** are subject to the risk of the issuer's inability to meet principal and interest payments on the obligation and may also be subject to price volatility due to factors such as interest rate sensitivity, market perception of the creditworthiness of the issuer and general market liquidity. **Inflation-linked bonds (ILBs)** issued by a government are fixed income securities whose principal value is periodically adjusted according to the rate of inflation; ILBs decline in value when real interest rates rise. **Treasury Inflation-Protected Securities (TIPS)** are ILBs issued by the U.S. government. Investing in **foreign-denominated and/or domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in **emerging markets**. **Currency rates** may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. **High yield, lower-rated securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. **Commodities** contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors. The value of **real estate** and portfolios that invest in real estate may fluctuate due to: losses from casualty or condemnation, changes in local and general economic conditions, supply and demand, interest rates, property tax rates, regulatory limitations on rents, zoning laws, and operating expenses. **Private investments** involve a high degree of risk that each prospective investor must carefully consider prior to making such an investment. Prospective investors are advised that investment in the Funds are suitable only for persons of adequate financial means who have no need for liquidity with respect to their investment and who can bear the economic risk, including the possible complete loss, of their investment. **Socially responsible investing** is qualitative and subjective by nature, and there is no guarantee that the criteria utilized, or judgment exercised, by PIMCO will reflect the beliefs or values of any one particular investor. Information regarding responsible practices is obtained through voluntary or third-party reporting, which may not be accurate or complete, and PIMCO is dependent on such information to evaluate a company's commitment to, or implementation of, responsible practices. Socially responsible norms differ by region. There is no assurance that the socially responsible investing strategy and techniques employed will be successful. **Management risk** is the risk that the investment techniques and risk analyses applied by an investment manager will not produce the desired results, and that certain policies or developments may affect the investment techniques available to manager in connection with managing the strategy. **Diversification** does not ensure against loss.

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