PIMCO

Rich Clarida
March 2017

The Global Economy, the Fed, and US Fiscal Policy

For institutional investor use only

Disclosures

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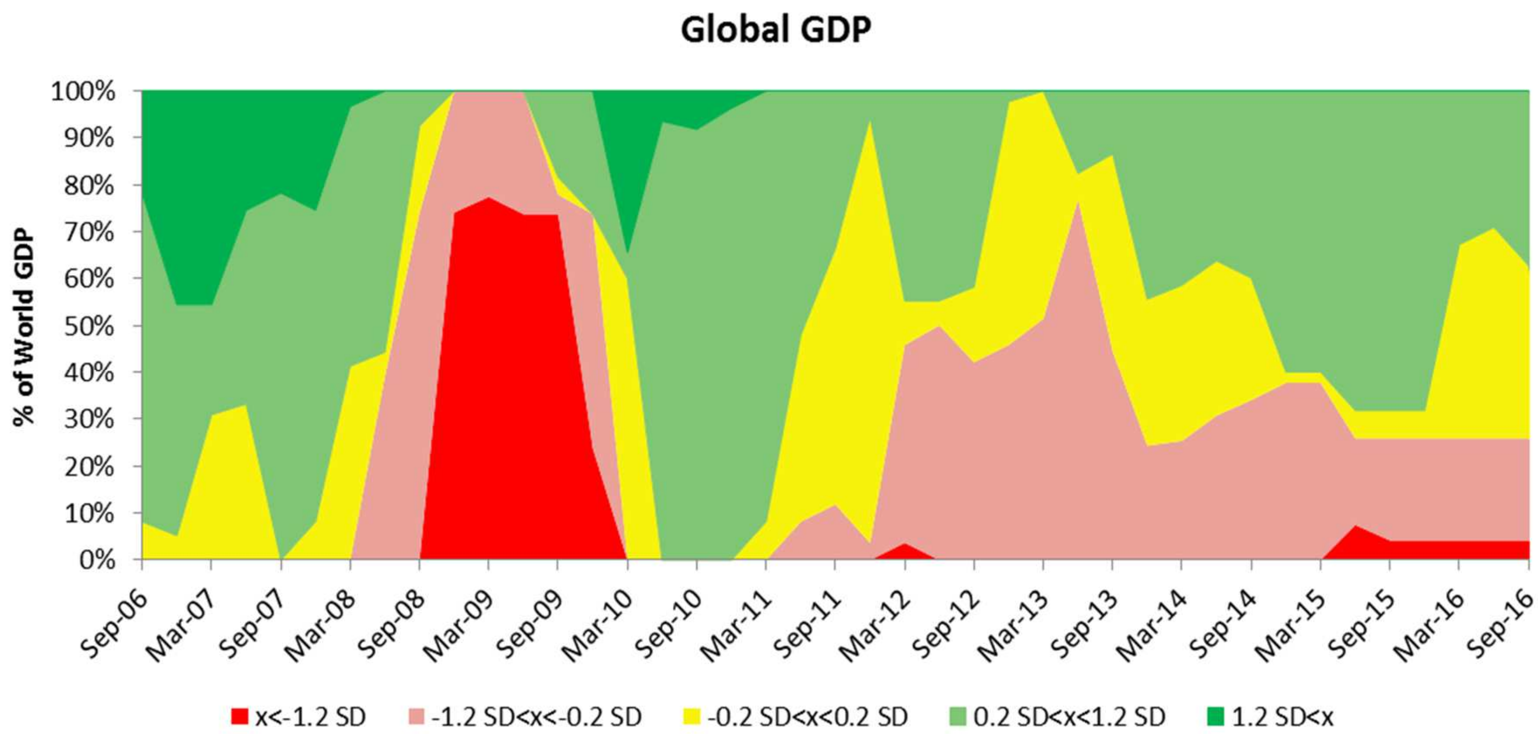
Biographical information

Richard Clarida, Ph.D

Dr. Clarida is a managing director in the New York office and PIMCO's global strategic advisor. In this capacity he leads PIMCO's annual Secular Forum process and works closely with the Investment Committee to assess and analyze global monetary and fiscal policy trends. Since joining the firm in 2006, he has worked extensively with and served as a trusted adviser to the firm's many central bank and sovereign wealth fund clients. Prior to joining PIMCO, he gained extensive experience in Washington as assistant Treasury secretary, in academia as chairman of the economics department at Columbia University, and in the financial markets at Credit Suisse and Grossman Asset Management. He has 18 years of investment experience and holds a Ph.D. in economics from Harvard University. He received his undergraduate degree with Bronze Tablet Honors from the University of Illinois.

Time Series of Major Economies' GDP Growth Rates relative to historical average

(Nominal GDP weighted)

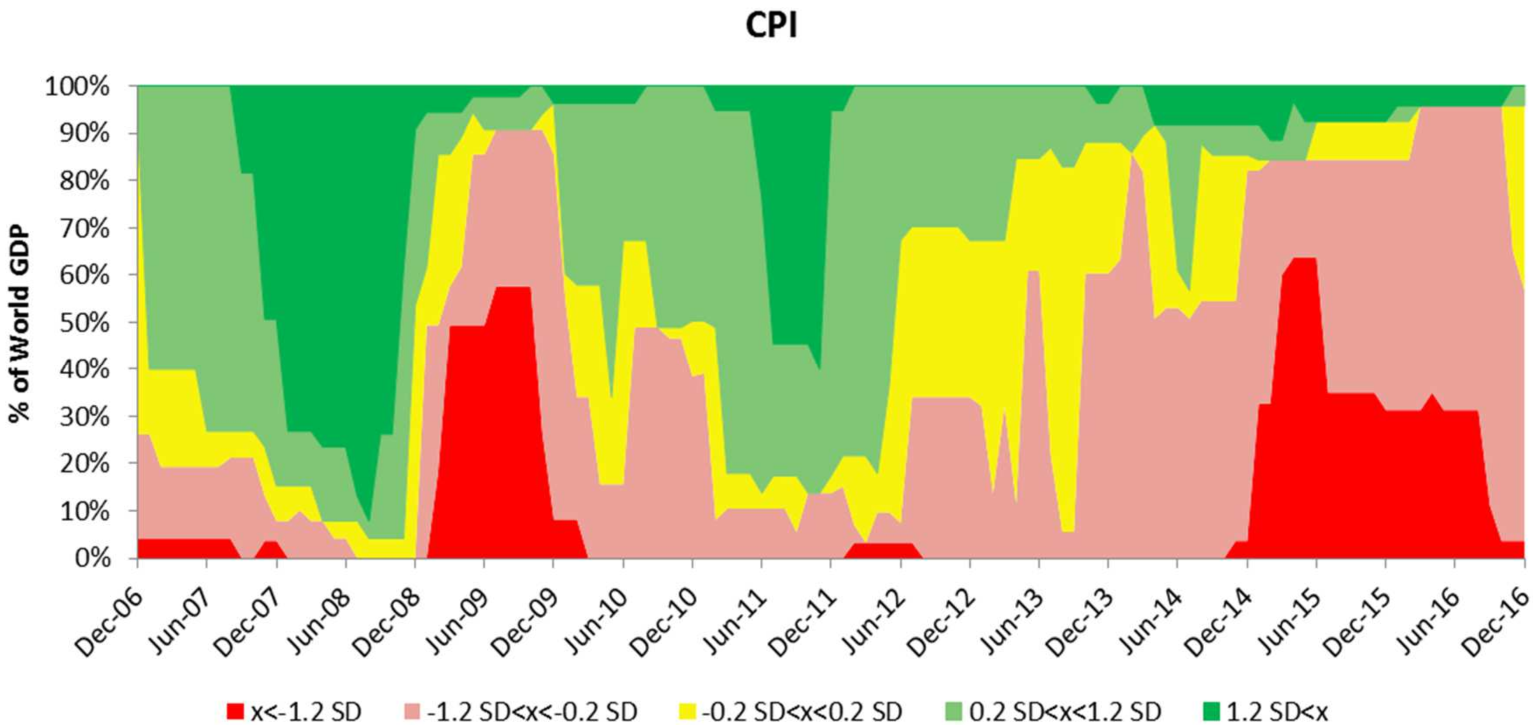


SOURCE: Bloomberg, Haver

*Colors represent how many standard deviations away from the 10 year historical average the current reading is.

Time Series of Major Economies' CPI Inflation relative to historical average

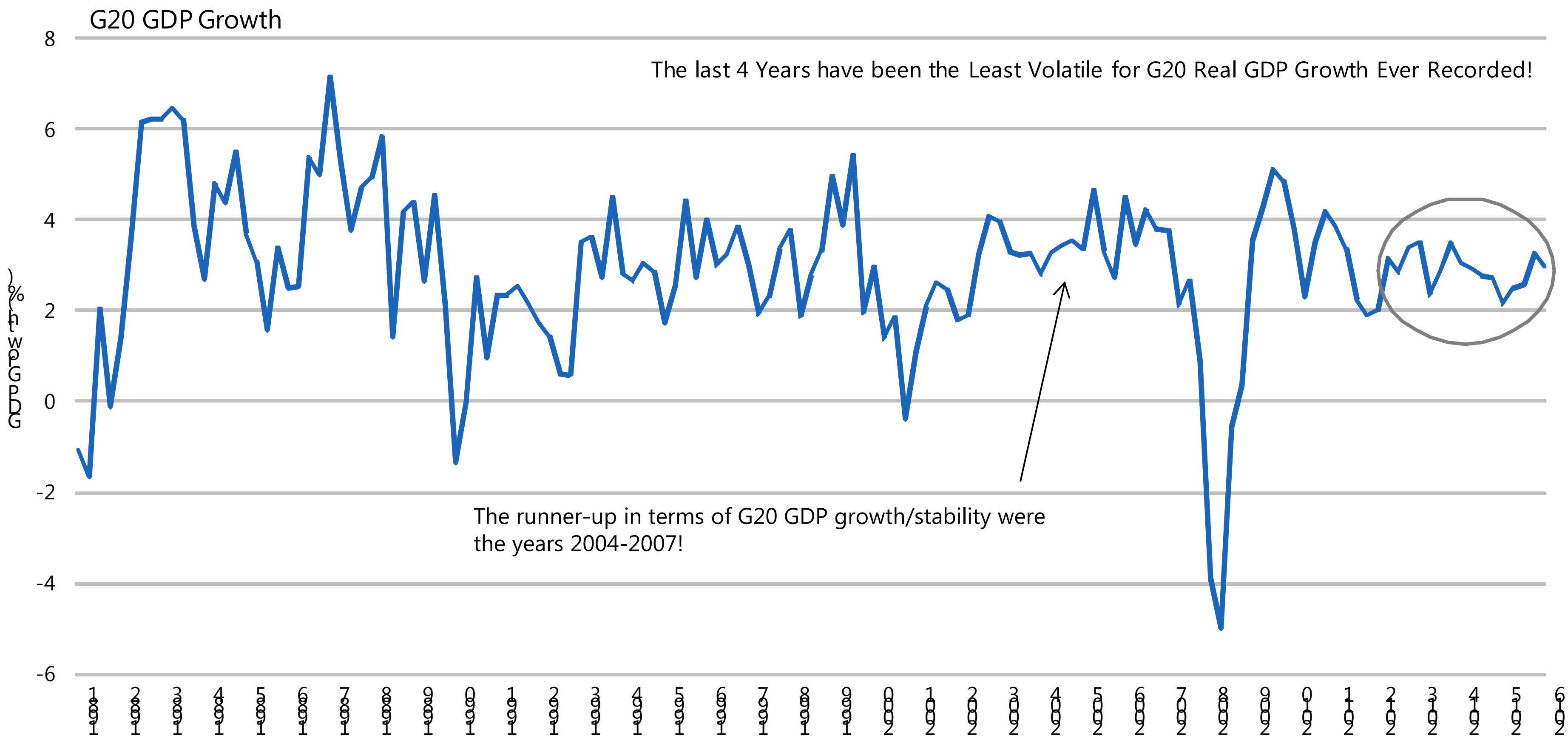
(Nominal GDP weighted)



SOURCE: Bloomberg, Haver

*Colors represent how many standard deviations away from the 10 year historical average the current reading is.

Global economy appears to be stable…



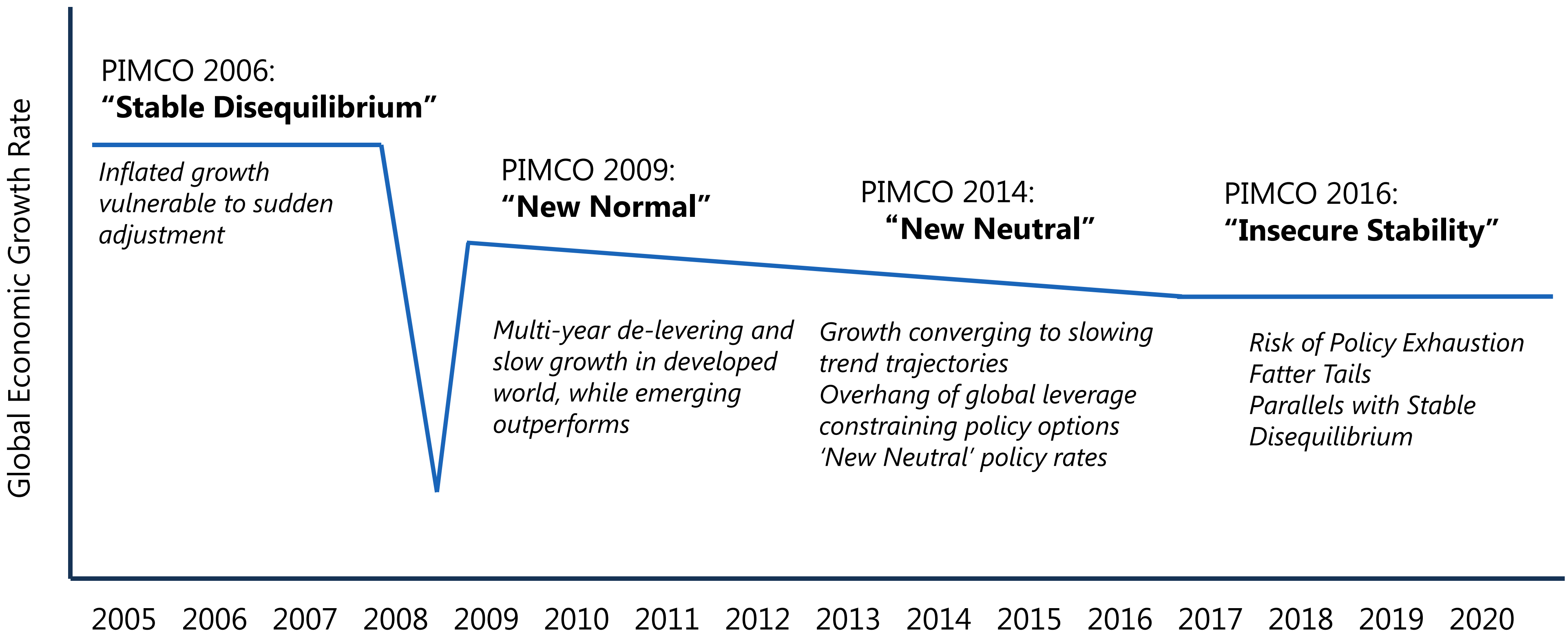
As of 31 December 2016
SOURCE: Bloomberg
Refer to Appendix for additional outlook information.

…but it is not secure

As of 31 May 2016
SOURCE: PIMCO
Refer to Appendix for additional investment strategy, outlook, and risk information.

Evolution of PIMCO's secular themes

"PIMCO Sees 'Insecure Stability' Era Marked by Escalating Risks"
John Gittlesohn, Bloomberg News
June 1, 2016



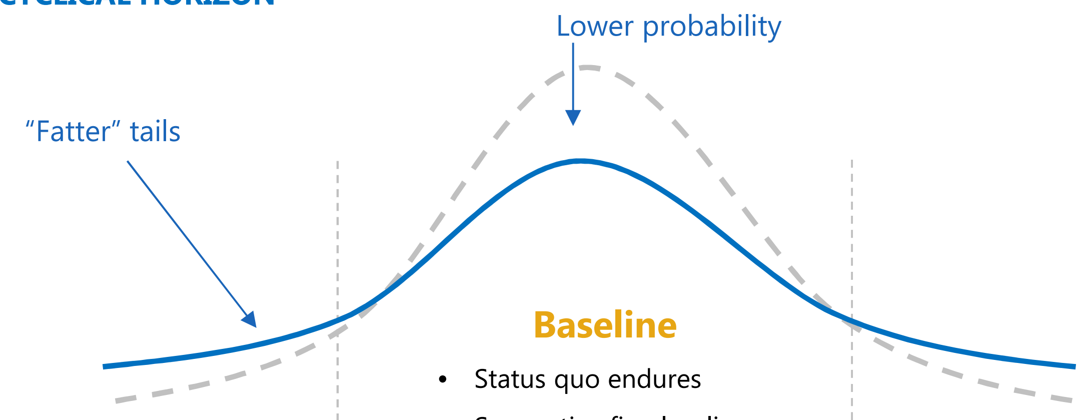
As of 31 May 2016
SOURCE: PIMCO
Refer to Appendix for additional investment strategy, outlook, and risk information

PIMCO's Cyclical Outlook
Into the Unknown

GUIDING PRINCIPLES

- Blurring of secular (3-5yr) and cyclical (6-12mons) outlooks
- "New Paradigm" vs. "New Normal/New Neutral"
- Cyclical over- and under-shoots
- "Radical Uncertainty" – Mervyn King
- 3 Difficult Transitions:
  - Monetary → fiscal policy
  - Globalization → de-globalization
  - China's currency regime transition

MACRO OUTCOMES OVER THE CYCLICAL HORIZON



Left-Tail

- Global recovery disrupted by:
  - Debt overhang in major economies
  - Monetary policy exhaustion
  - Transition to de-globalization powered by populism

Baseline

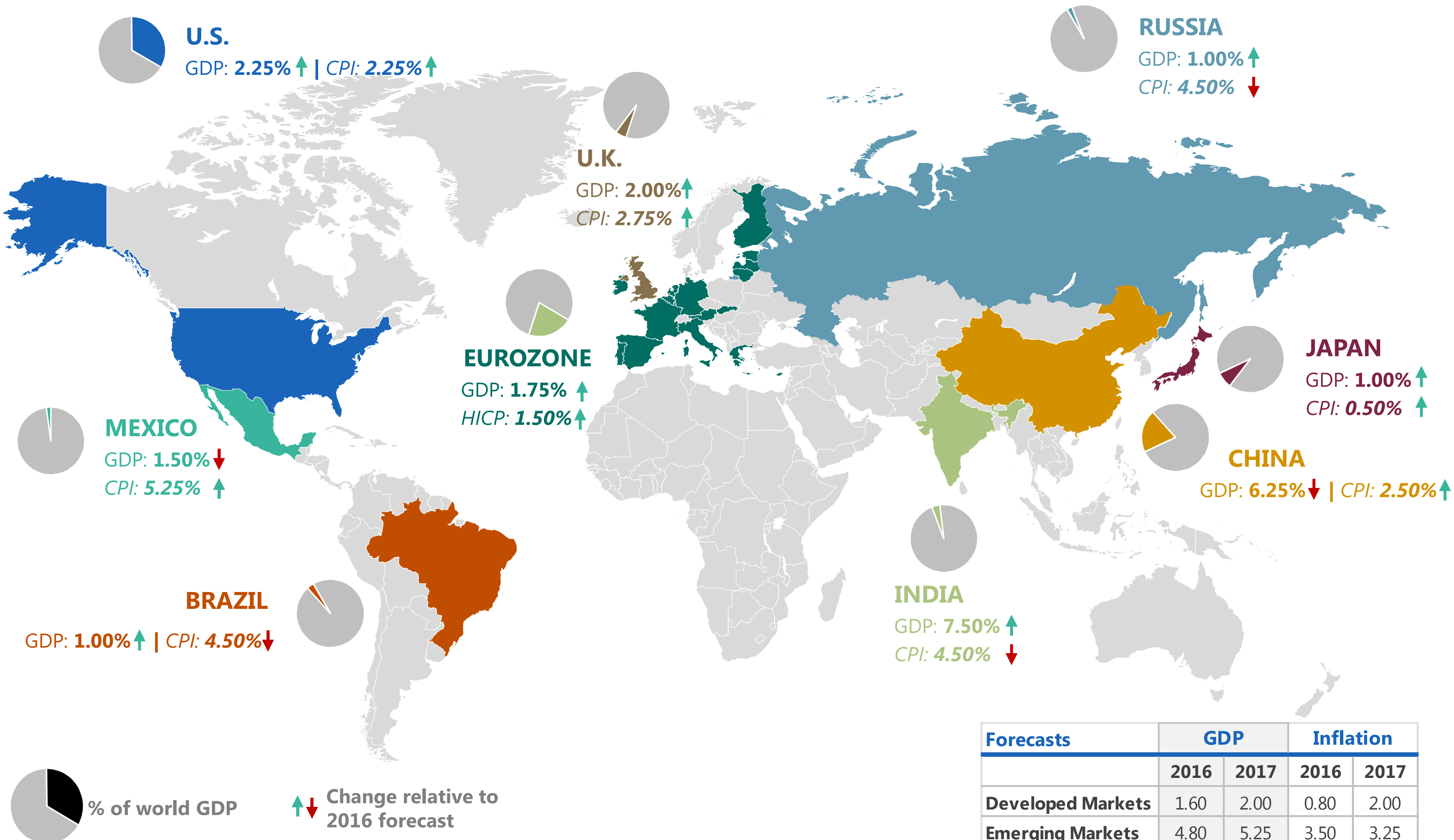
- Status quo endures
- Supportive fiscal policy, a gradual reduction in central bank support, and limited protectionist policies
- Headline inflation accelerates in DM while ebbing in EM

Right-Tail

- Better growth outcomes resulting from:
  - De-regulation
  - Awakening animal spirits
  - Accelerated transition from monetary to growth-enhancing fiscal policy

As of December 2016
SOURCE: PIMCO

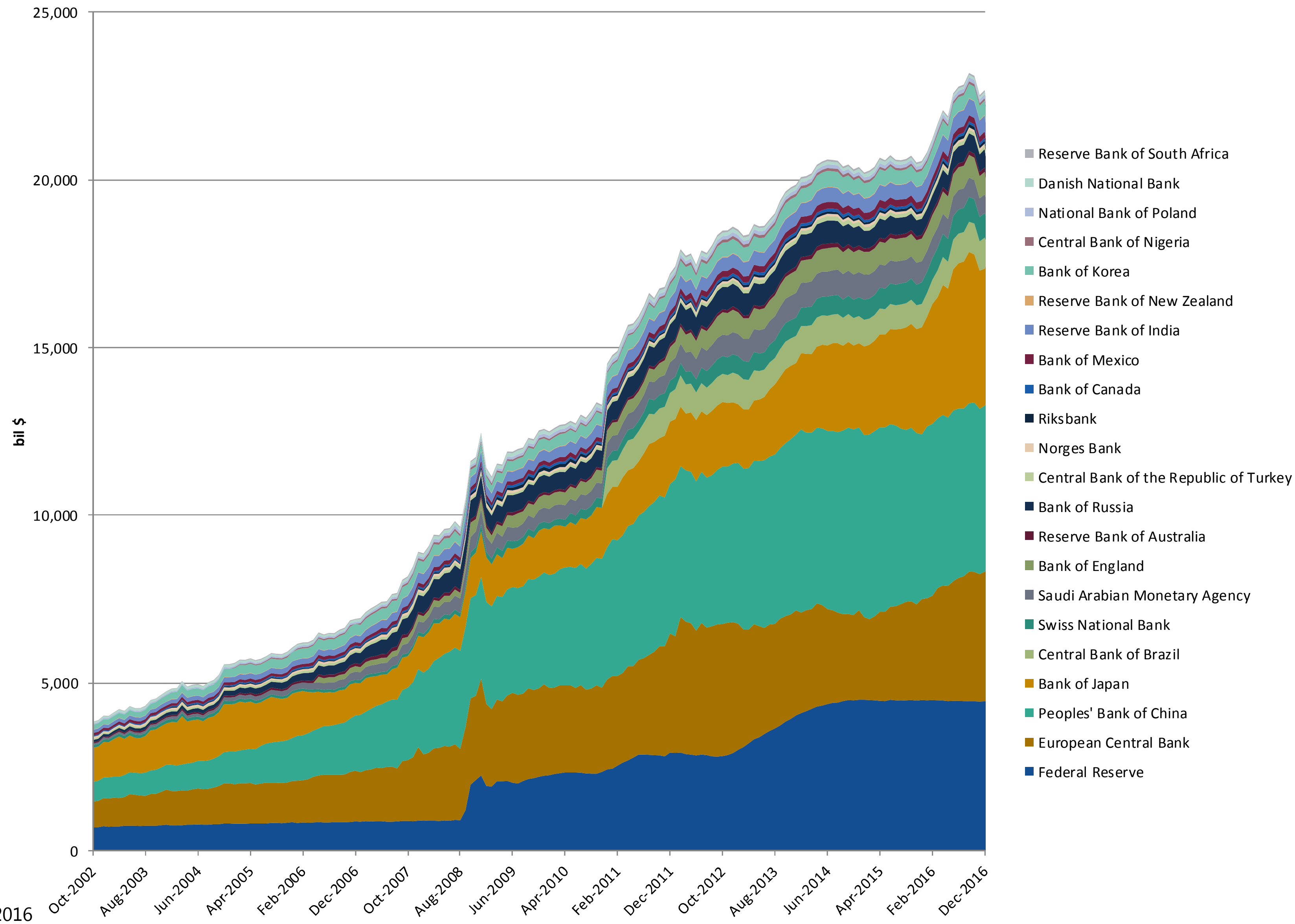
PIMCO's 2017 cyclical outlook



Forecasts	GDP		Inflation	
	2016	2017	2016	2017
Developed Markets	1.60	2.00	0.80	2.00
Emerging Markets	4.80	5.25	3.50	3.25
World	2.60	3.00	1.70	2.50

PIMCO forecast ranges as of March 2017.
Real GDP and inflation projections reflect the midpoints of PIMCO's forecast ranges for 2017.

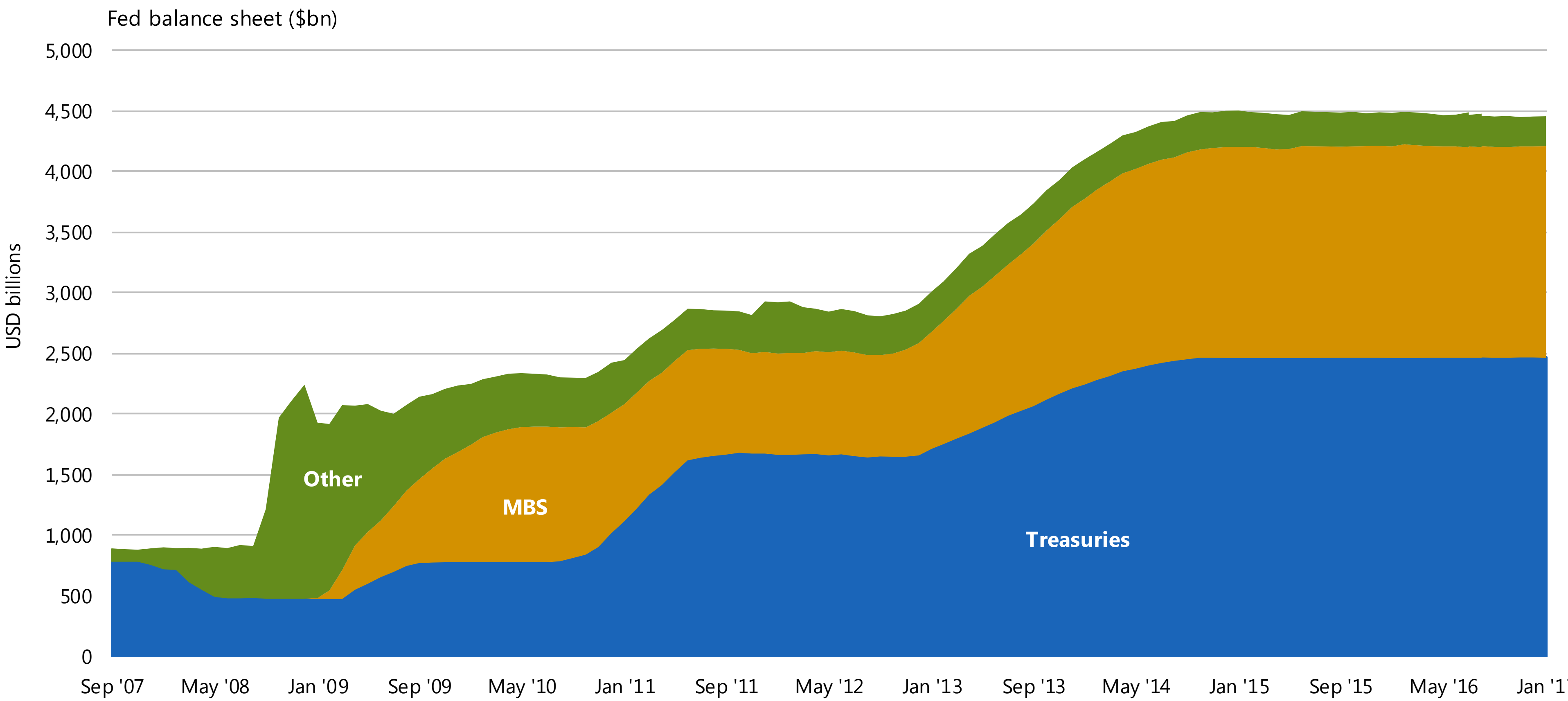
Size of Global Central Bank Balance Sheets



As of 31 December 2016
SOURCE: Haver Analytics, Bloomberg

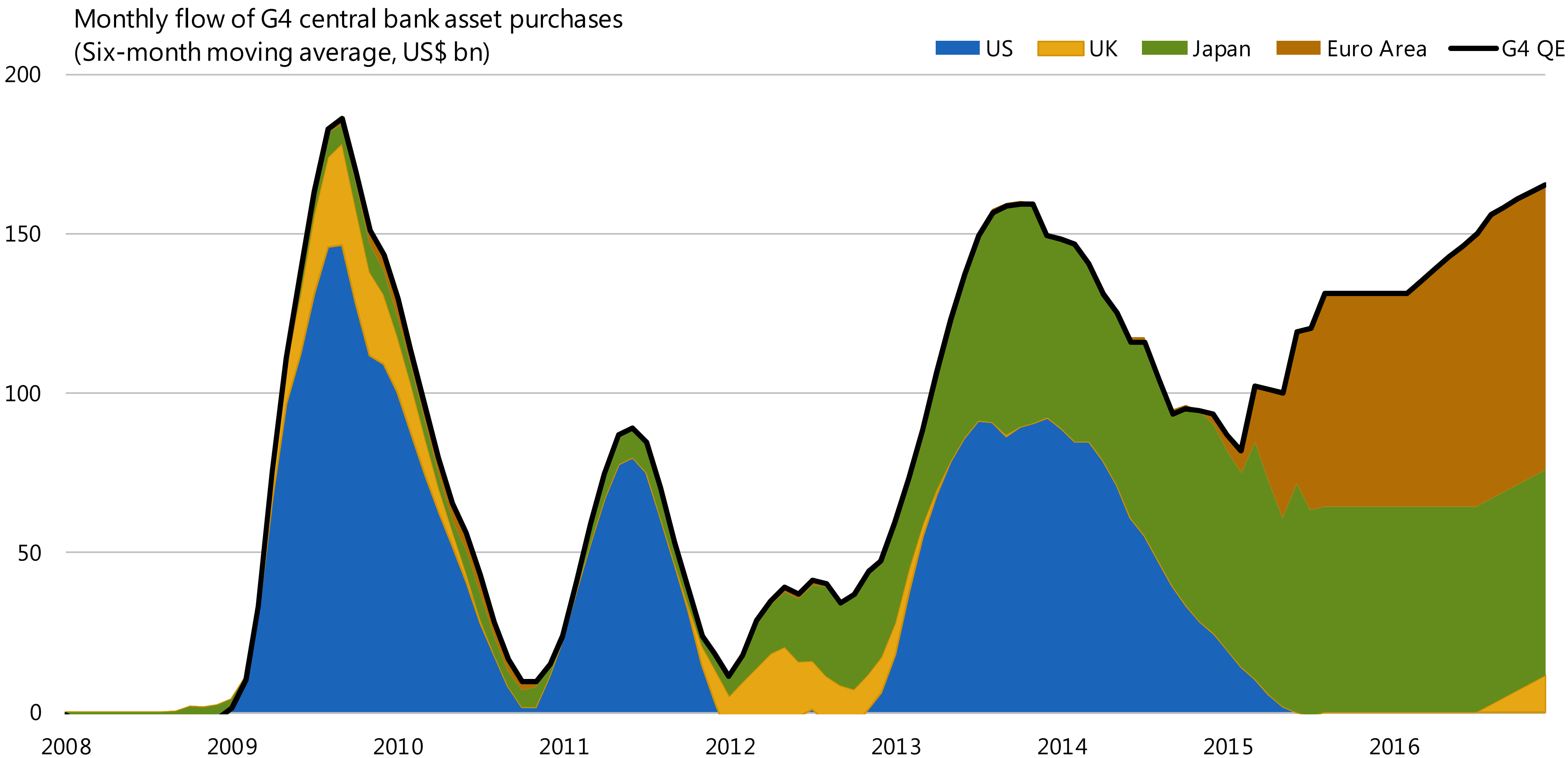
Fed balance sheet

- Balance sheet stands at about $4.5 trillion



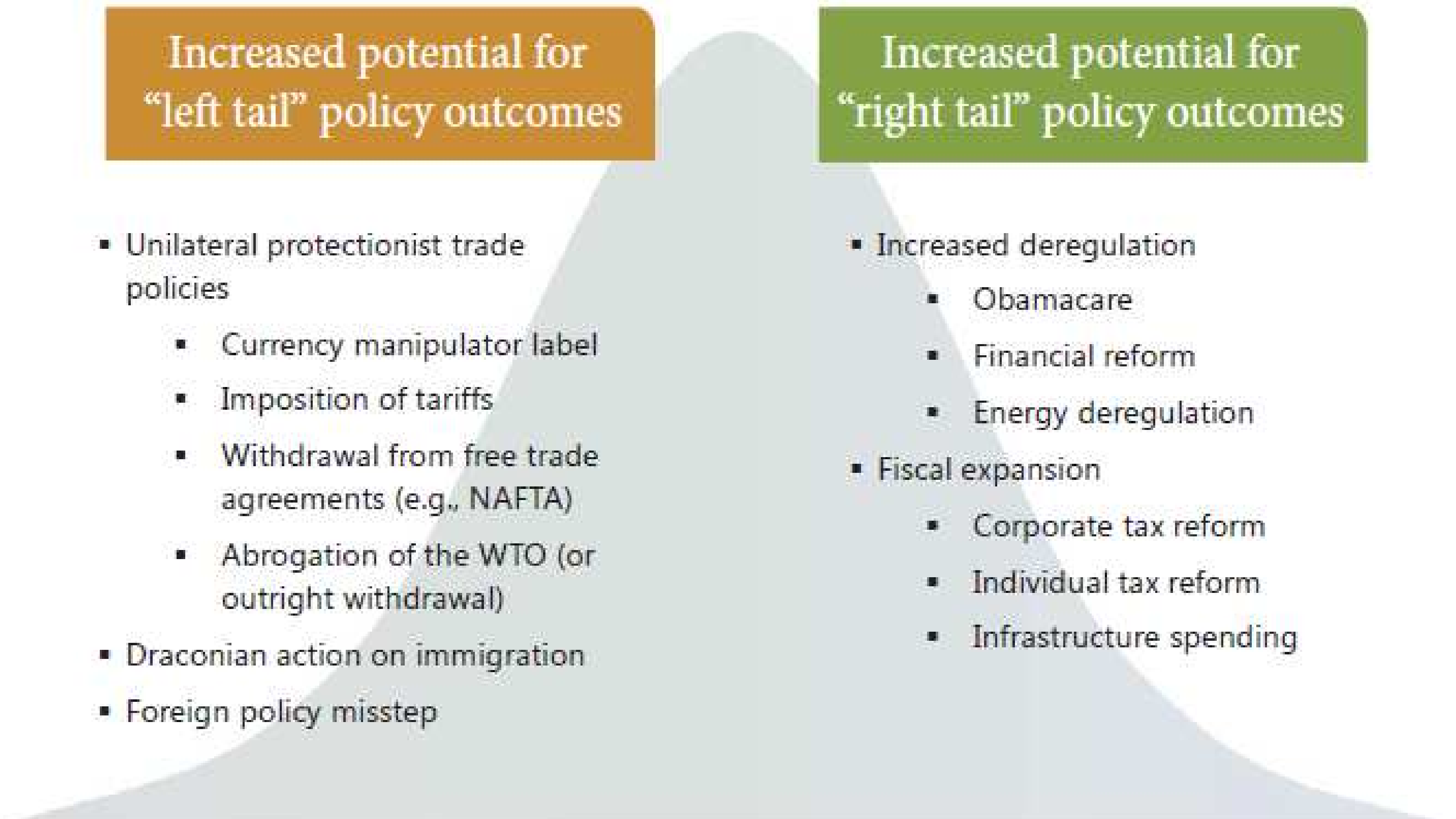
As of 31 January 2017
SOURCE: Federal Reserve.

Global Monetary Policy: the Fed is on the QE sidelines, the ECB, BoJ, and BoE are still providing enormous liquidity to global sovereign markets



As of December 2016
SOURCE: Federal Reserve, Bank of Japan, Bank of England, European Central Bank
Refer to Appendix for additional forecast information.

A Trump White House represents a widening of the distribution of outcomes: More possibility for "right tail" policy outcomes, but also for "left tail" missteps



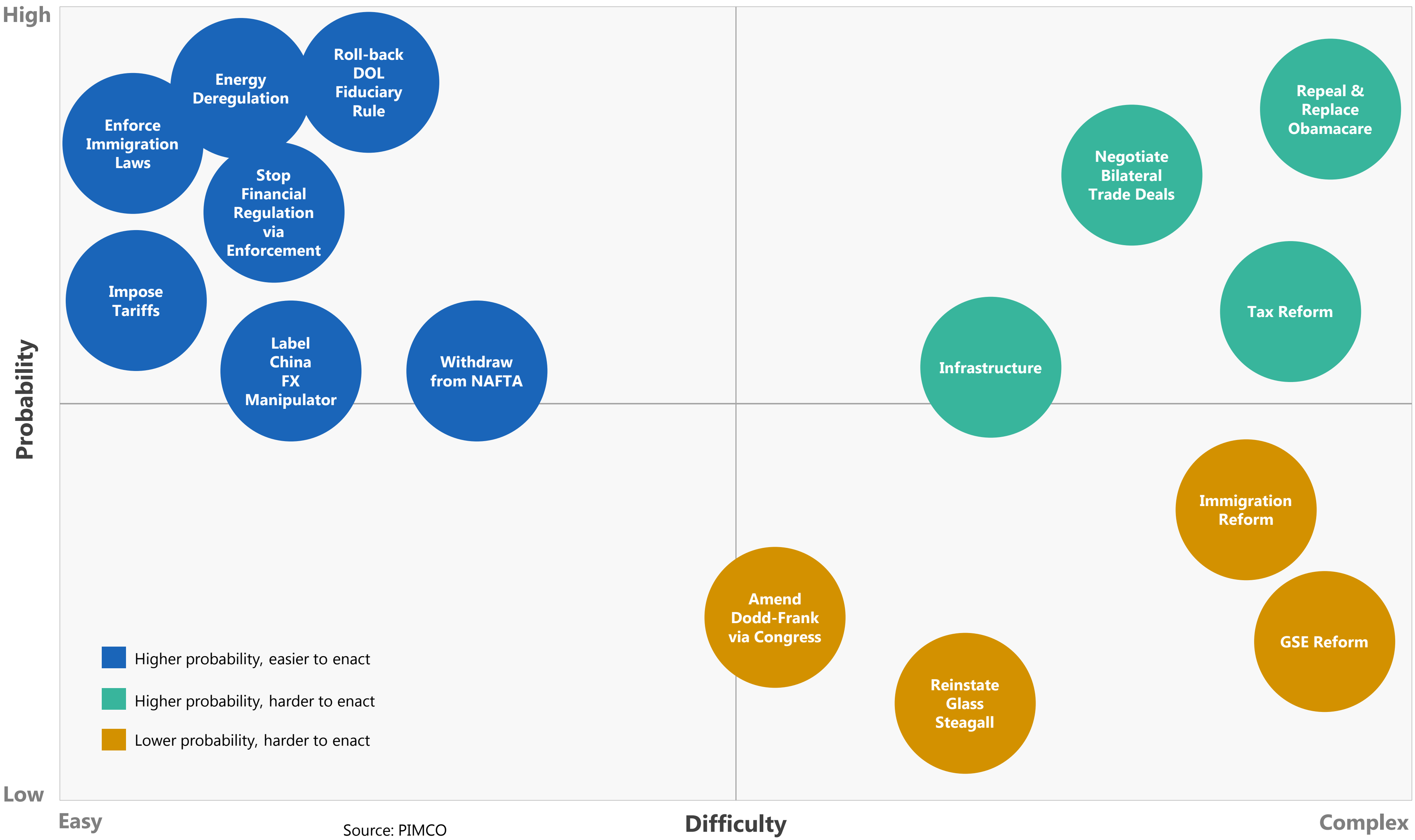
As of December 2016. SOURCE: PIMCO

President Trump’s Agenda
What is likely in the first18 months?

Proposal	Growth Impact	Inflation Impact	Fiscal Impact*	Timing	Additional Comments	Requires Congress?	Probability
Repeal and Replace of Obamacare	**TBD**	**TBD**	**TBD**	**2017**	• Partial repeal expected via reconciliation (required only 50 Senate votes); no consensus (yet) on replacement • Healthcare overhaul will be difficult and time-consuming	✓	**High**
Tax Reform (Corporate + Individual)	**+**	**+**	**$2T (Ryan)-$5T (Trump)**	**4Q 2017/ 2018**	• Final bill will likely be smaller than either proposal • Obamacare has to go first; border adjustment tax could complicate passage; Senate version of bill?	✓	**Moderate to High**
Infrastructure Spending	**+**	**+**	**$1T**	**4Q 2017/ 2018**	• Trump’s private/public plan from campaign faces obstacles; may not target maintenance or mission critical projects; Republicans still ambivalent • Direct funding of infrastructure may be easier; smaller deal is likely (if any deal)	✓	**Moderate**
Financial Deregulation	**+**	**+**	**TBD**	**2017/ 2018**	• Financial Choice Act is a likely blueprint for reform but faces headwinds, especially in the Senate • Trump can (and has) moved unilaterally (e.g. DOL)	**Both**	**Low (legislation) to High (executive order)**
Trade	**-**	**+**	**TBD**	**2017**	• Withdrawal from TPP (occurred) and renegotiation of NAFTA (high) • Labeling China a currency manipulator and imposing tariffs (moderate)	**X**	**Moderate to High**
Immigration	**-**	**+**	**TBD**	**2017**	• Focus on enforcement; improvements to e-verify; reinforce border fence; deport undocumented workers with criminal history (high) • More draconian measures (moderate)	**X**	**Moderate to High**

Source: CBO, Tax Foundation, Tax Policy Center, DonaldJTrump.com, PIMCO
* As currently proposed; all scores over ten year period

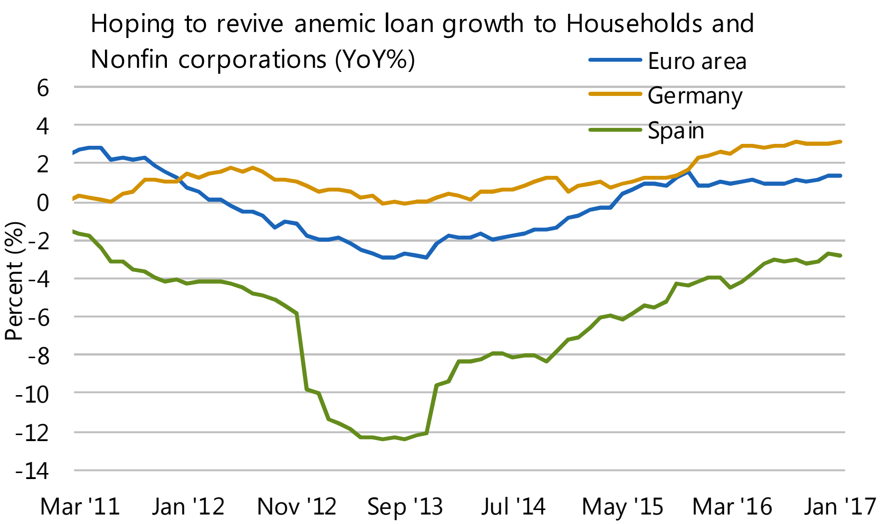
President Trump's Agenda
Separating reality from rhetoric

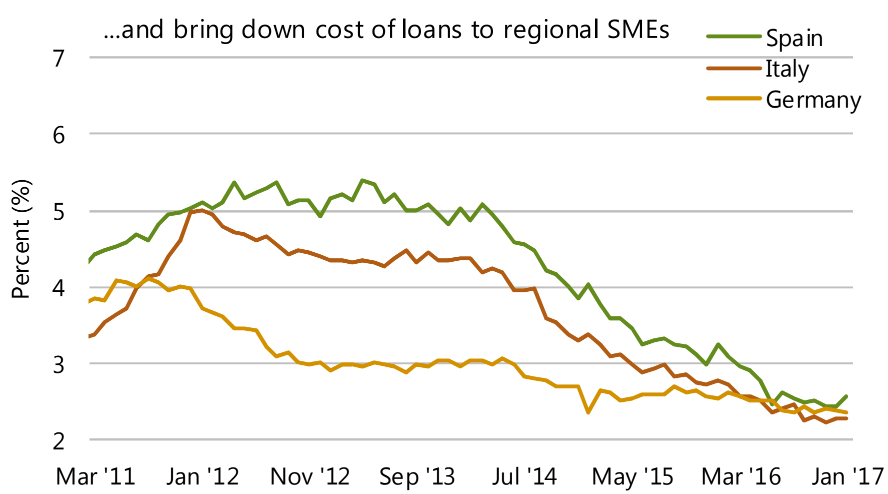


Source: PIMCO

ECB policy as of January 2017

- **Asset Purchase Program:** Total size of the program is **€80bn/month** (increased from €60bn/month in March 2016) until April 2017. Then the purchases revert to **€60bn/month** carried out until the end of December 2017 and “in any case until the Governing Council sees a sustained adjustment in the path of inflation that is consistent with its aim of achieving inflation rates below but close to 2% over the medium term”.
  – The expanded asset purchase program includes: third covered bond purchase program (CBPP3), asset-backed securities purchase program (ABSPP), public sector purchase program (PPSP), and **corporate sector purchase program (CSPP)**
  – **Corporate Sector Purchase Program:** At the March 2016 meeting, the ECB announced it would expand its quantitative easing program to include corporate bonds and began purchases on June 8. Similar to CBPP3 and ABSPP, no specific figures for amounts will be purchased but it is included in the €80bn/month. Data on actual holdings will be published ex post on a weekly basis.
- **Negative Rates:** Deposit facility rate is -0.4% (first went negative in September 2014), marginal lending facility rate: 0.25% and main refinancing operations at 0.0%.
- **Adapting to Bund Scarcity:** As the ECB extends their quantitative easing program the demand for Bunds will exceed the eligible stock of Bunds outstanding. There are three options available: 1) allow purchases below the deposit facility rate, 2) allow purchases above the 33% issuer limit, of 3) relax capital key. At the December 2016 meeting the ECB announced that they will allow purchases below the deposit rate facility and reduced the lower bound of the maturity range for purchases from two years to one.





Charts as of 31 January 2017
SOURCE: Wall Street Journal, PIMCO SME: small to medium enterprise
Refer to Appendix for additional outlook and risk information.

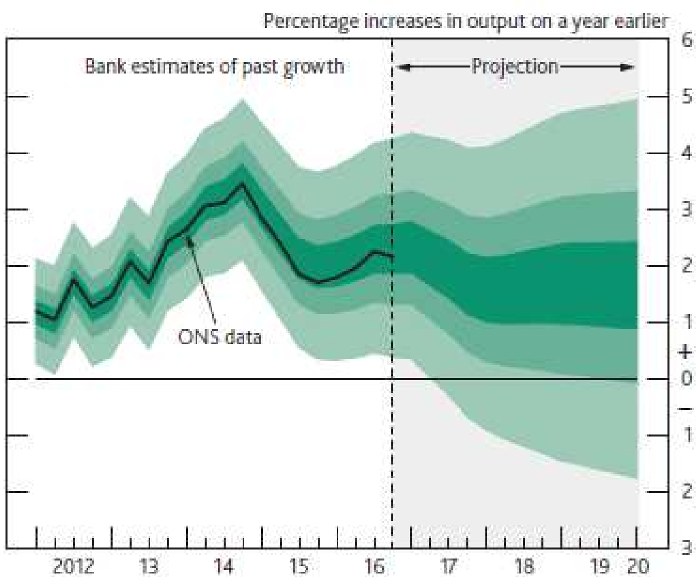
BoE Policy as of February 2017
After Brexit the Bank of England over delivers

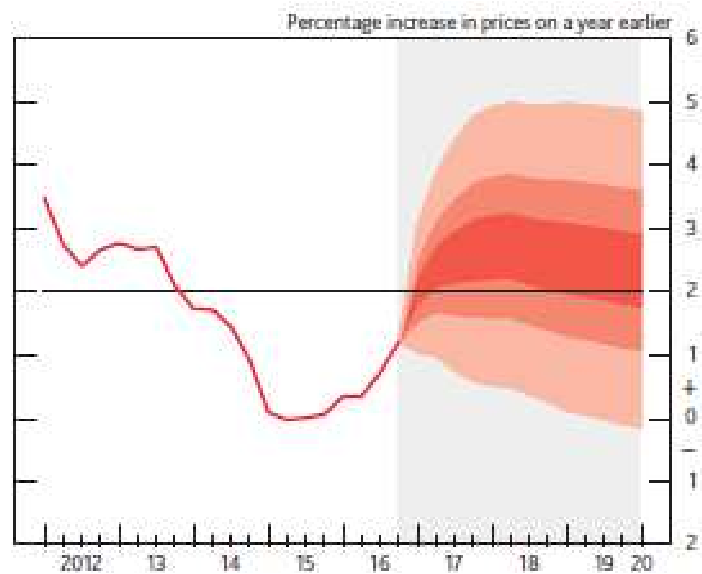
At the February 2017 the BoE's Monetary Policy Committee (MPC) left policy unchanged with the Bank Rate at 0.25%, continued with the program of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, totaling up to £10 billion and to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

At their August 2016 meeting, the MPC voted on a stimulus package that included the following:

- **Rate Cut**: a 25 basis point cut in the Bank rate to 0.25%, notably with no intention to go into negative territory
- **Expansion of the Asset Purchase Program:** The BoE will purchase UK government bonds in the total amount of £60bn over 6 months.
- **Corporate Bond Purchase Program:** The BoE will purchase up to £10bn of UK corporate bonds over 18 months.
- **Term Funding Scheme** (formerly Funding for Lending Scheme) to reinforce the pass-through of the Bank Rate cut
  - Banks are able to borrow bank reserves at close to the bank rate for four years, with initial allowance of up to 5% of their stock outstanding lending to UK corporates and households. Range of collateral is very wide from gilts to eligible whole loans.
  - Initial drawdown period will last 18 months
  - The proposed cost of the TFS (base rate +0 to +25bp max) compares very favorably to the current all-in bank funding costs of 100bp

GDP and Inflation Forecasts from the BoE – Base Case No Recession!





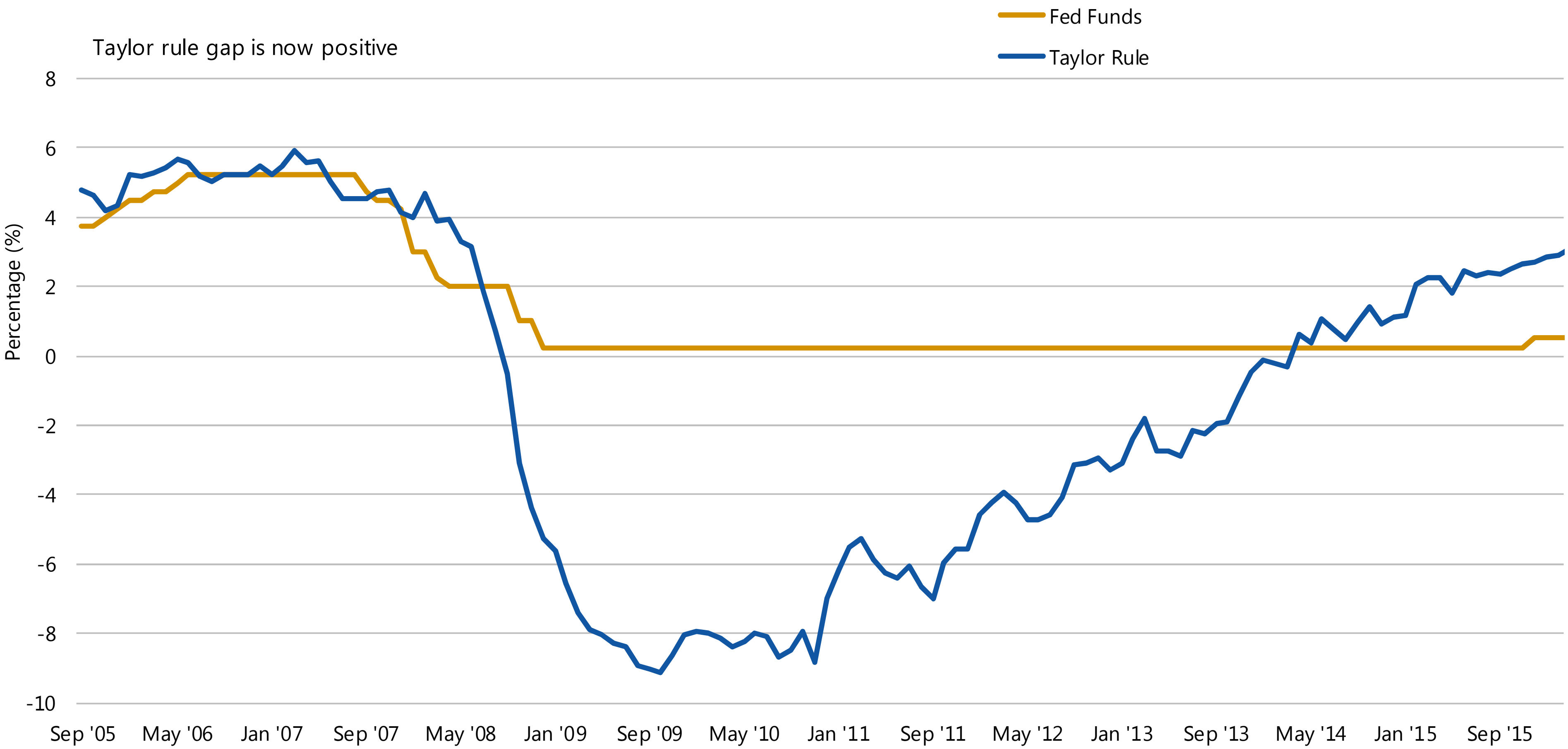
As of 2 February 2017
SOURCE: Bank of England
Refer to Appendix for additional outlook and risk information.

BoJ policy as of March 2017
Shift to Yield Curve Control from QE makes monetary policy more sustainable

	Previous: QQE with negative rates	New: Yield curve control with QQE
Rates	IOER -0.10%	Yield curve control Target: IOER -0.10%, 10 year rates around 0%
Quantity	Monetary base expansion Target: Increase by JPY 80trn/yr	Base money no longer a target Commitment to inflation-overshooting
Quality	• JGB average maturity 7-12 years • Buy Equity ETF/ J-REIT • Buy corporate bonds • Lending USD/ funding support	• JGB average maturity is removed • Buy Equity ETF/ J-REIT • Buy corporate bonds • Lending USD/ funding support

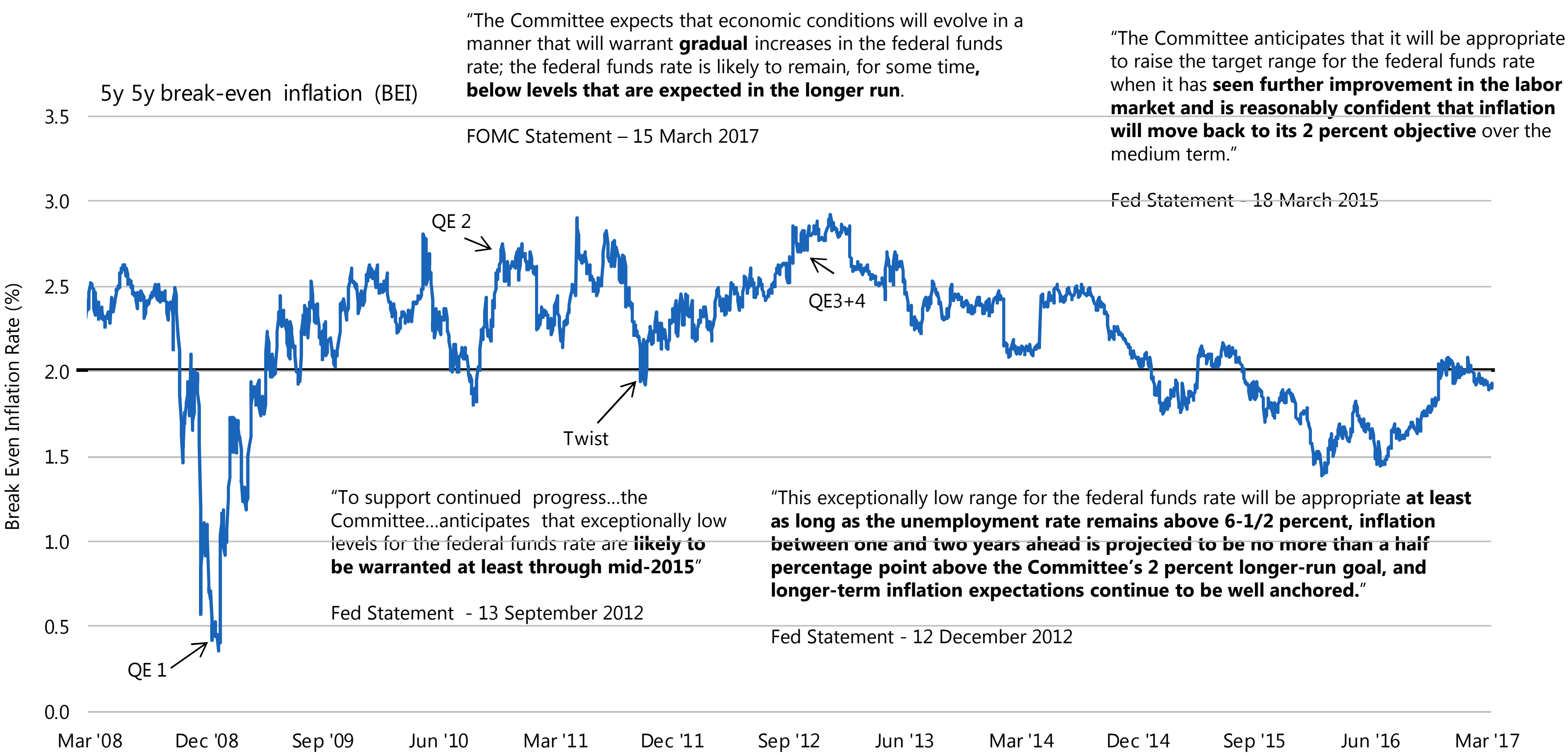
As of March 2017. SOURCE: PIMCO

The Fed: a "gradual" liftoff



As of 28 February 2017
SOURCE: Bloomberg
*Uses 5y5y Tips yield as proxy for expected real interest rate at full employment, uses 5y breakeven inflation as proxy for expected inflation, uses Taylor (1999) weight of 1 on unemployment gap, assumes Okun of 2.5, assumes NAIRU of 5.75% post crisis and 4.75% pre crisis. Spliced in March 2012 with a Taylor rule using inputs from Fed SEP published four times a year for neutral policy rate.
Refer to Appendix for additional outlook information.

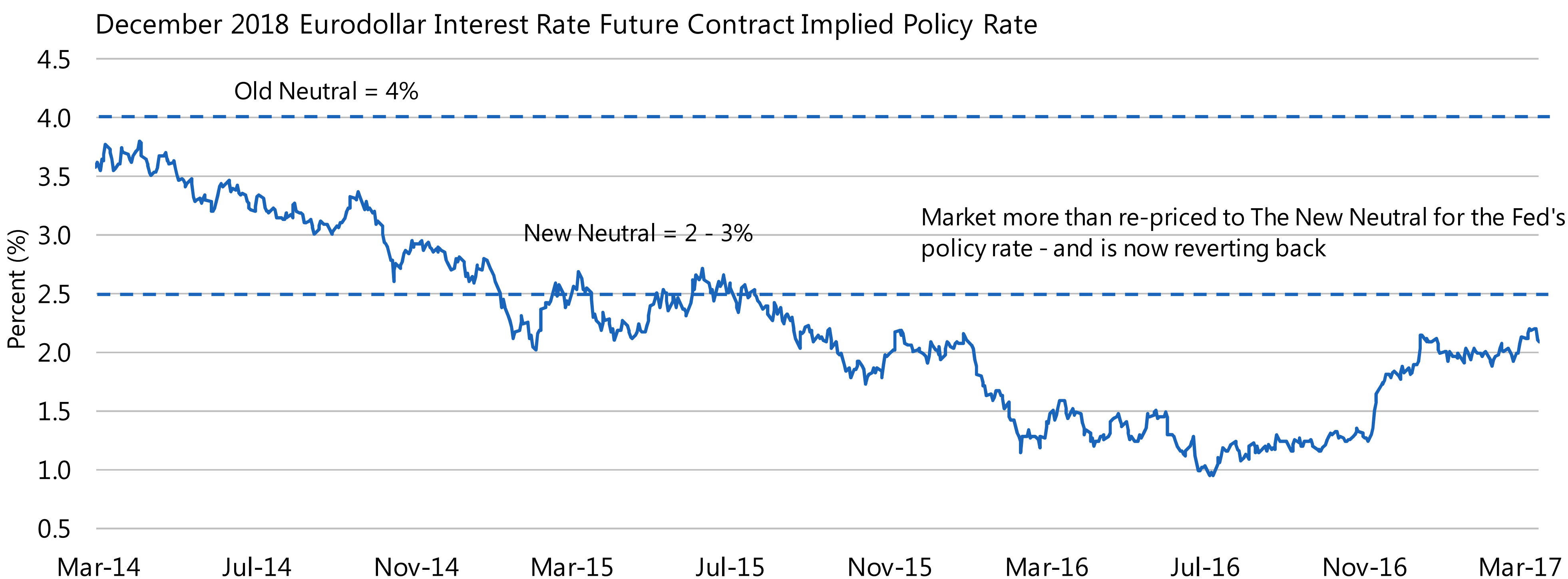
Fed is trying to normalize policy gradually (at least for now)



As of 15 March 2017
SOURCE: Bloomberg, Federal Reserve
Refer to Appendix for additional outlook information.

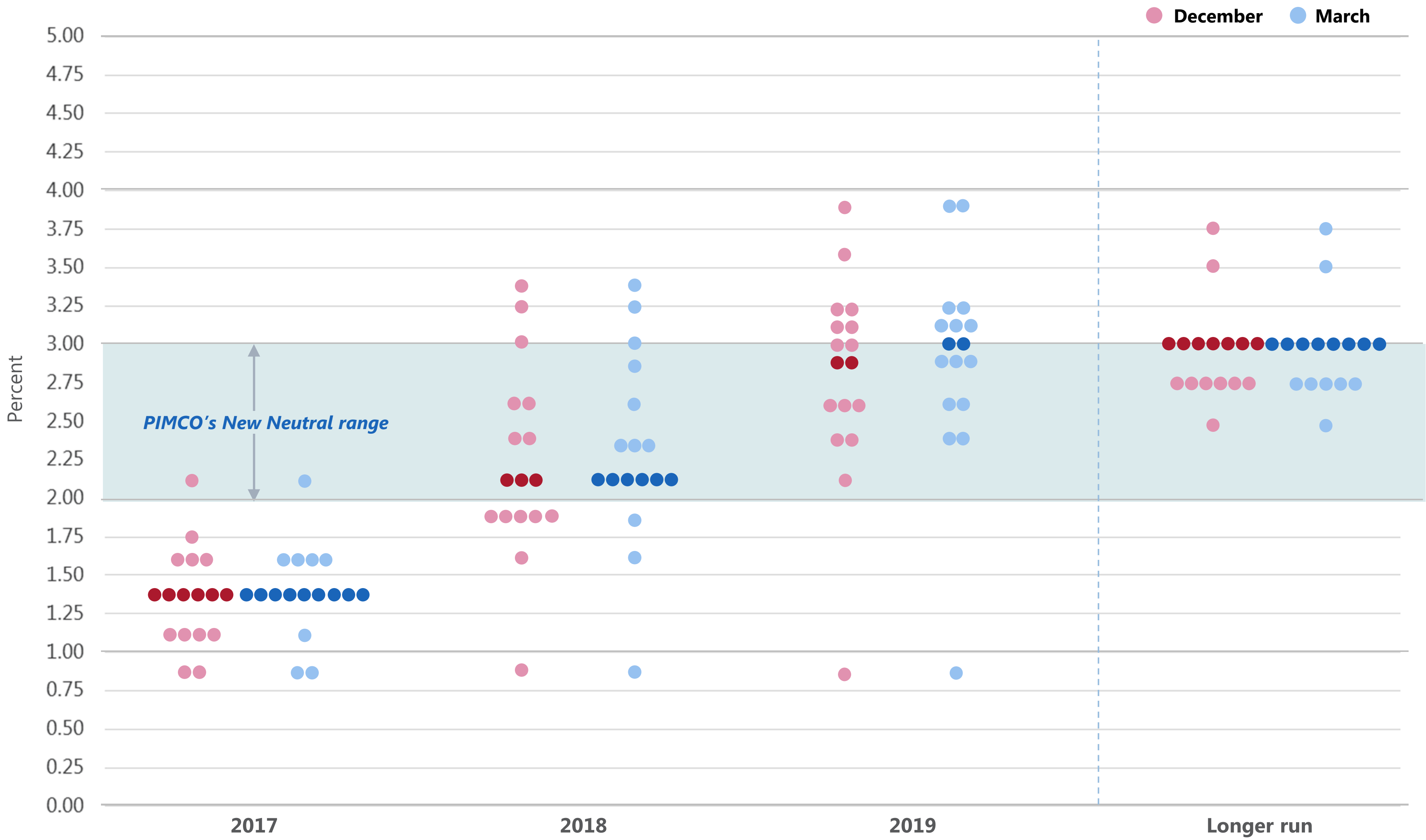
Yellen and EDZ8* agree – There is a New Neutral and it is priced into markets…

> The neutral nominal federal funds rate – defined as the value of the federal funds rate that would be neither expansionary nor contractionary if the economy were operating near potential – is currently low by historical standards and is likely to rise only gradually over time.
>
> -Janet Yellen, December 16, 2015



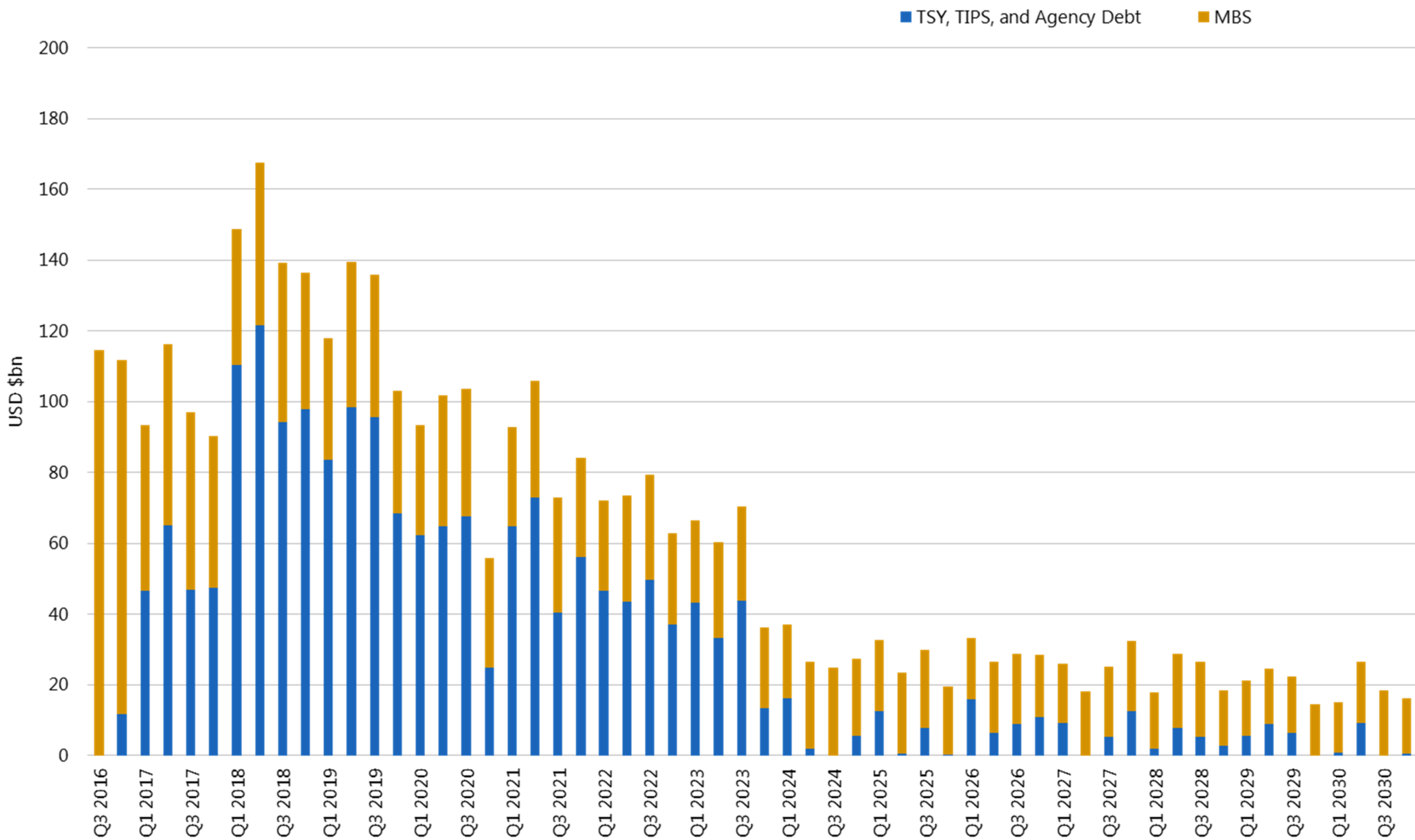
As of 15 March 2017
SOURCE: Bloomberg
* EDZ8 = December 2018 Eurodollar contract
Refer to Appendix for additional outlook information.

December vs. March "dots"



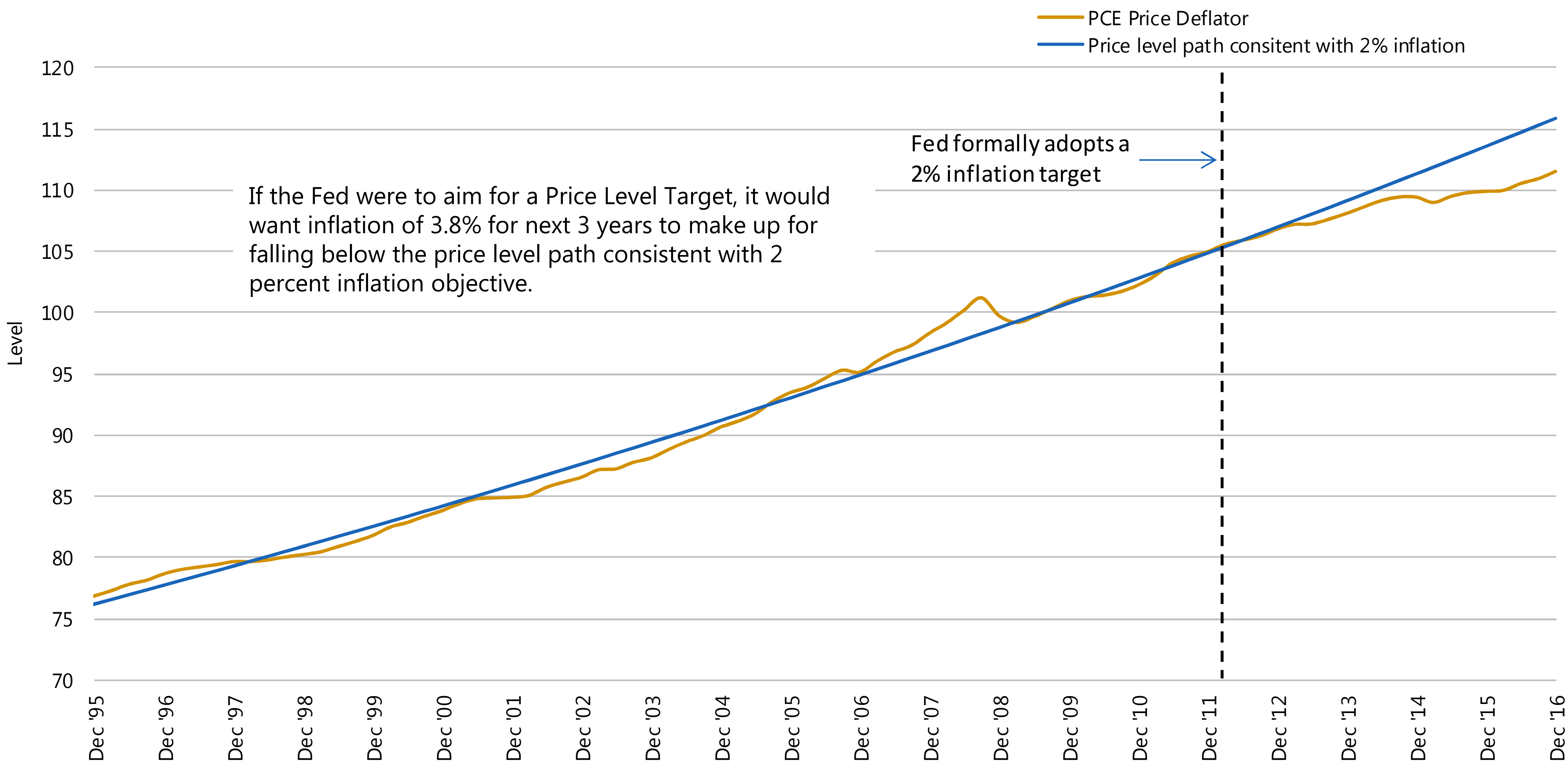
As of 15 March 2017
SOURCE: Federal Reserve, PIMCO
Note: Darker dots indicate median values.

Maturity profile of the Fed's balance sheet through 2030



As of 28 December 2016
SOURCE: Federal Reserve Bank of New York, PIMCO
MBS "maturities" are estimated by modeling prepayments on MBS currently held on the Fed's balance sheet
Refer to Appendix for additional outlook information.

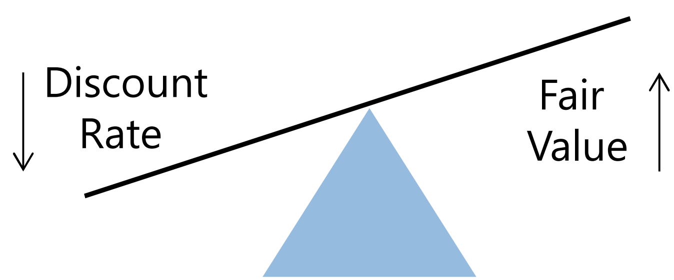
US price level since 1992



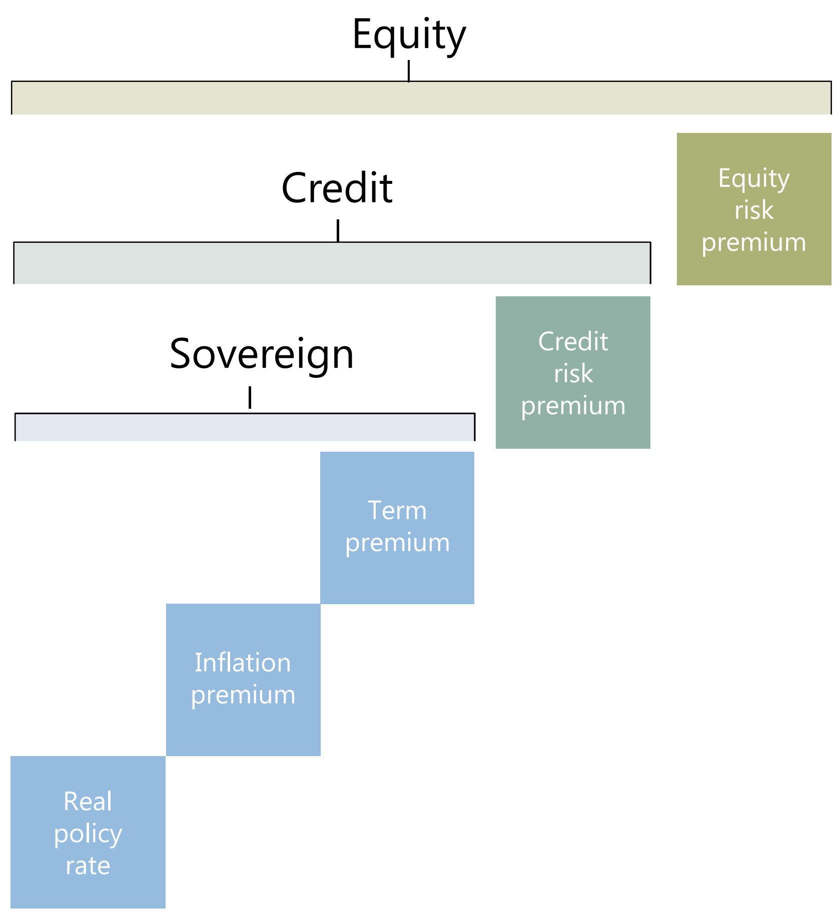
As of 31 December 2016
SOURCE: PIMCO, Haver Analytics

Lower discount rates fueled asset returns and support higher valuations…but the discount rate boost is about to plateau

Lower discount rates led to higher valuations…



…across all major asset classes



For Illustrative Purposes Only
SOURCE: PIMCO

Key questions in a stable but not secure world

Outlook

Is last year's secular baseline this year's secular right tail? If so, what does the left tail look like? What will be the impact of "Trumponomics"?

Monetary Policy

Do unconventional monetary policies still have positive (but diminishing) returns or have they reached a dead end? Is so, what is the end game?

China

How will the economic policy regime evolve and will it be capable of navigating the middle income transition and capital account liberalization? If not, what is a "crash landing"?

Political Populism

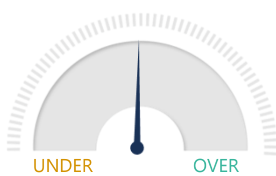
Do recent political events like Brexit and the rise of populist politics in the US election signal a new secular reality? If so, what are the implications?

Asset class relative value views

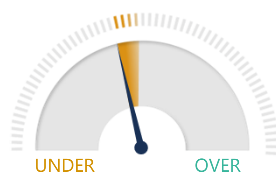
OVERALL RISK

- We are moderately underweight equities with a focus on country and sector selection, which remain critical
- We favor EM and Japanese equities over U.S. given relative valuations and global monetary policies as a backdrop

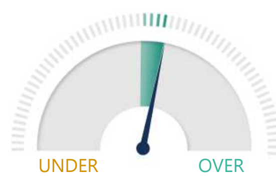
EQUITIES



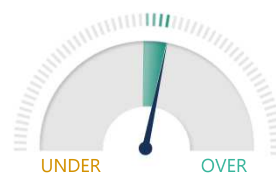
RATES



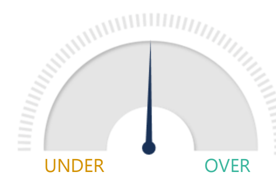
CREDIT



REAL ASSETS



CURRENCIES

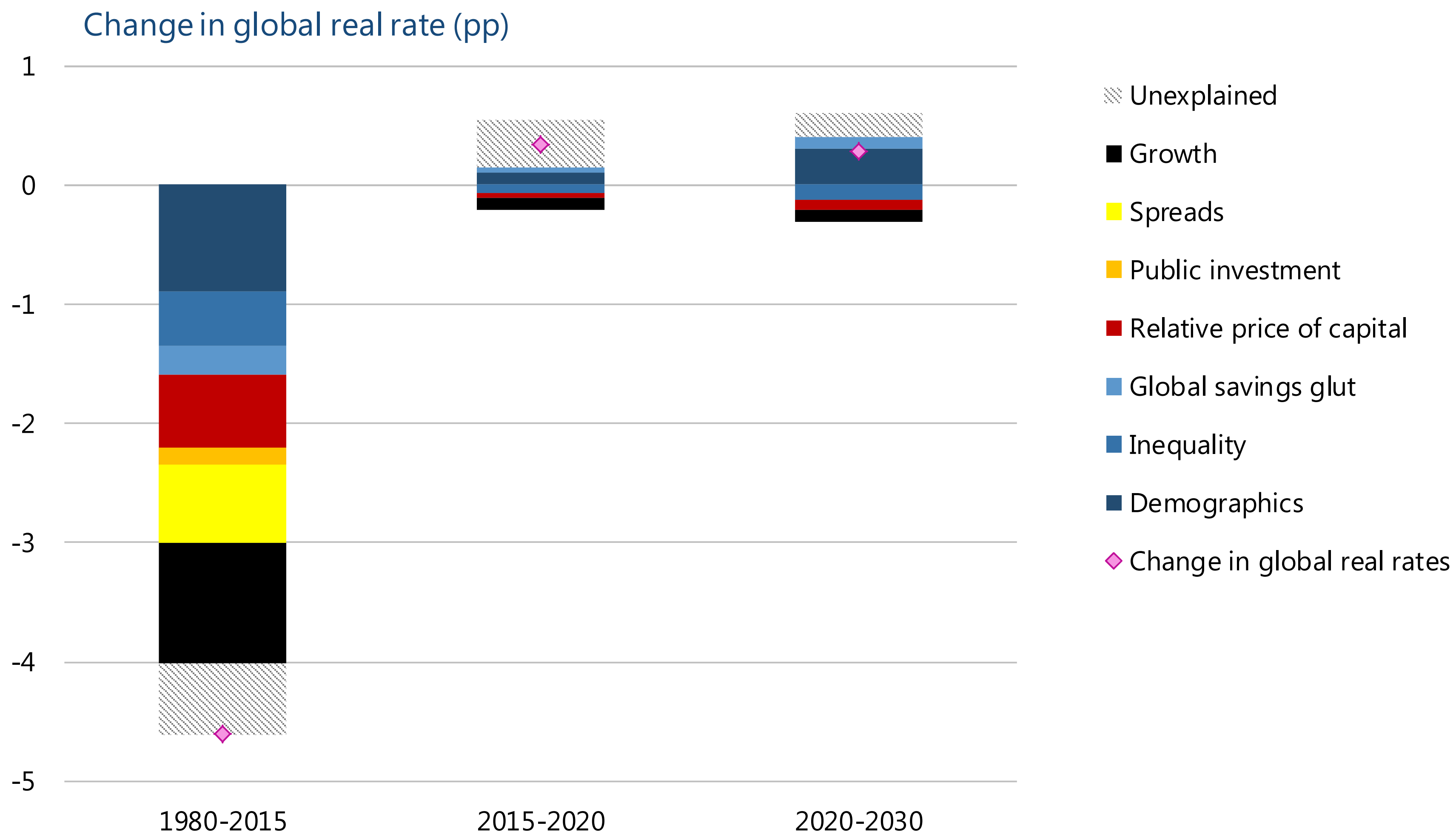


- We continue to favor equity-like risk higher up in the capital structure as we believe in risk-adjusted returns on select credit sectors are more attractive
- We believe U.S. TIPS are an attractive substitute for defensive high quality nominals given the broader markets' low inflation expectations
- We are increasing exposure to structural alpha (otherwise known as alternative risk premia) strategies that can act as enhanced diversifiers by delivering potential returns uncorrelated to traditional assets

As of 31 December 2016; SOURCE: PIMCO
Refer to Appendix for additional investment strategy and risk information.

Estimates and forecasts of drivers of world real interest rates

Secular drivers of global real interest rates BoE staff paper 571, December 2015



SOURCE: Bank of England

Investment Implications

Active management in a world of negative policy rates, full valuations, and asymmetric risks

Capital preservation in a world in which prospects for debt write downs will be increasing

Bottom up security selection versus hugging an index

Global opportunity set to find attractive valuation

Inflation protection for a world in which helicopter money will tempt and perhaps seduce policymakers

Refer to Appendix for additional investment strategy and risk information.

Appendix

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

FORECAST
Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument.

INVESTMENT STRATEGY
There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate their ability to invest for a long-term especially during periods of downturn in the market. Investors should consult their investment professional prior to making an investment decision.

OUTLOOK
Statements concerning financial market trends or portfolio strategies are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

Appendix

RISK

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. **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. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. 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. **Diversification** does not ensure against loss.

It is not possible to invest directly in an unmanaged index.