LORD ABBETT

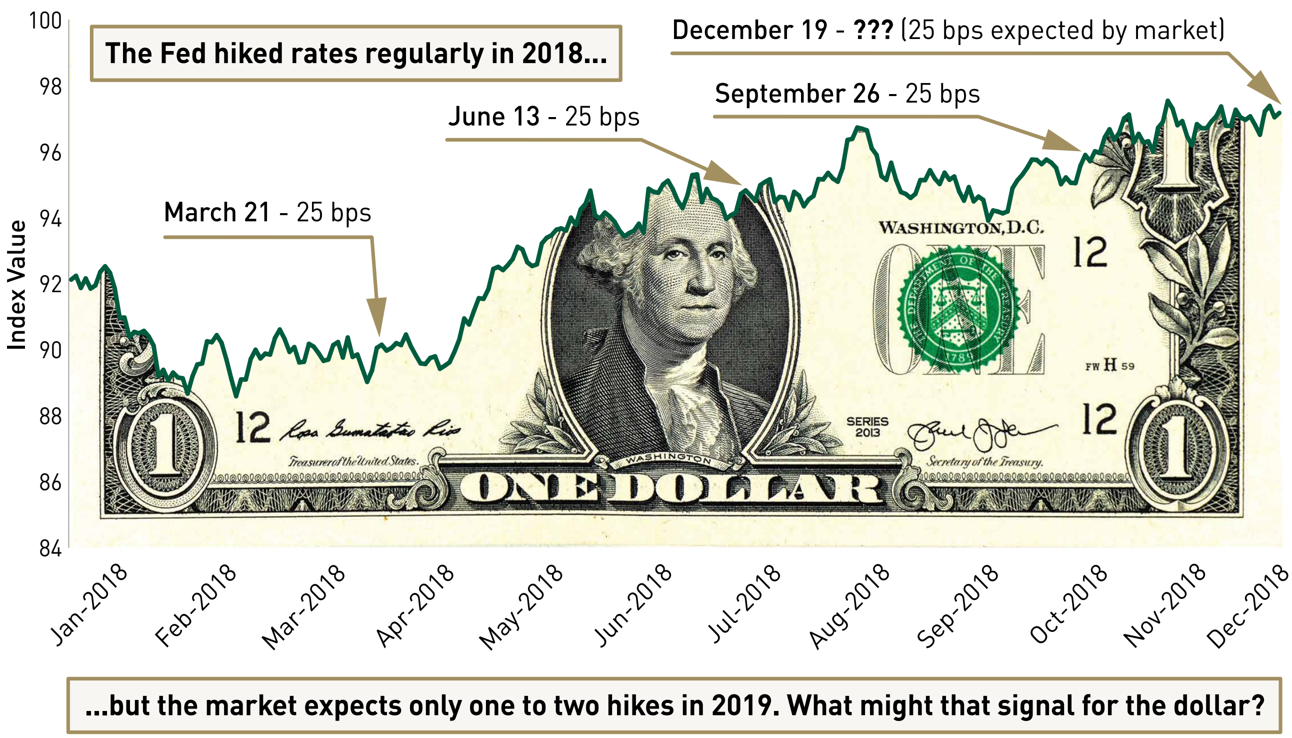
MARKET VIEW

2019 INVESTMENT OUTLOOK: OPPORTUNITIES IN THE NEW YEAR

In the third and final part of the series, Lord Abbett experts offer their views on prospects for fixed income and equity investments in the coming year.

CHART 1. IN 2018, AN ACTIVE FED LED TO U.S. DOLLAR STRENGTH. 2019 MAY BE A DIFFERENT STORY

U.S. DOLLAR INDEX (DXY), JANUARY 1, 2018–DECEMBER 13, 2018



Source: Bloomberg. "Fed" refers to the U.S. Federal Reserve. Market expectations of rate hikes are based on fed funds futures data.

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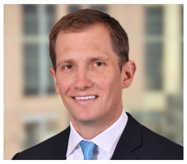
IN BRIEF

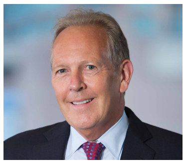
- In the previous *Market View*, we outlined the macroeconomic factors that may influence markets in 2019.
- Here, we conclude our roundtable with Lord Abbett investment leaders—representing a range of investment disciplines—with a discussion of prospects for key asset classes in 2019.
- Our experts gave their outlook for U.S. taxable fixed income, U.S. equities, emerging market investments, and municipal bonds.

FEATURED INVESTMENT LEADERS

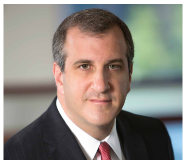


Joseph Graham
Investment Strategist

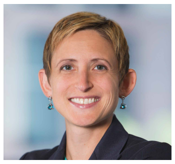
Giulio Martini
Partner, Director of Strategic Asset Allocation



Thomas O'Halloran
Partner, Portfolio Manager for Growth Strategies



Daniel Solender
Partner, Director of Tax-Free Fixed Income



Leah Traub
Partner, Portfolio Manager for Taxable Fixed Income

Kewjin Yuoh
Partner, Portfolio Manager for Taxable Fixed Income

How should investors be thinking about key asset classes in the New Year? In this, the final installment of a special three-part *Market View*, we collect the thoughts of Lord Abbett experts representing a range of investment disciplines. (In the first part, we examined the factors that influenced market performance in 2018, and in the second, we looked at how the macroeconomic environment may evolve in 2019.)

In late November, we gathered a panel featuring Lord Abbett partners Giulio Martini, director of global asset allocation; Thomas O'Halloran, portfolio manager for micro-, small-, and large-cap growth strategies; Daniel Solender, director of tax-free fixed income; Leah Traub, portfolio manager for taxable fixed income; and Kewjin Yuoh, portfolio manager for taxable fixed income. The discussion was moderated by Joseph Graham, head of the firm's investment strategy group.

Graham started the third and final segment of the roundtable discussion by asking the panelists for their thoughts on the 2019 outlook for major investment categories.

U.S. Taxable Fixed Income

Addressing the bond market, Martini said that yield spreads on U.S. high yield bonds versus U.S. Treasuries of comparable maturity had contracted in 2018 before widening out again late in the year. "In a benign economic environment, you could not only pick up the yield advantage in high yield," which was around 6%, based on the representative Bloomberg Barclays U.S. High Yield Index, compared to U.S. Treasury yields around 3%. Also, said Martini, prices of high yield bonds could recover based on the potential for the yield spread to narrow in 2019.

Martini noted that yield spreads on investment-grade debt had also "widened out quite a bit" in the late-year volatility. "So in an environment where inflation stays close to 2%, where the economy just grows somewhere around 2% to 2.5%"—which, he said, "looks quite reasonable"—he thinks U.S. assets are "actually priced attractively" as the calendar turns to 2019.

Yuoh added that his investment team "feels good about taking opportunities within risk sectors" going into 2019. But he sounded one cautionary note: "One scenario that we're thinking about is the return of inflation. We'll be keeping an eye on that."

U.S. Equities

After the late-year selloff, Martini believes that U.S. equities are also attractively priced. Corporate earnings growth in the United States was at 25%, year over year, in 2018, he noted. The forward price-to-earnings multiple, a widely followed valuation measure based on analysts' earnings expectations, peaked at about 18.2 in September, and had moved under 16 by late November—below its long-term average of 16.2.

"So we're in a situation where if we just get the mid-to-single digit earnings growth that's priced in for next year, the market actually could do pretty well," with the potential to offer percentage returns "in the high single digits."

O'Halloran noted that growth equities entered "a corrective phase" late in the year, as a breakout to new highs in leading technology names was quickly undone. But, he expects that "growth will do well in 2019." While he doesn't expect U.S. economic growth to accelerate, he believes advances in technology will enable "a lot of great innovation" in the consumer and health care sectors, and in the technology industry. "So, I see a lot of companies that are going to grow at double-digit rates" or better, he added.

Emerging Markets

What about markets outside the United States? Our experts agreed that the wild card for non-U.S. markets in 2019 is the U.S. dollar, particularly for emerging markets. "I think the emerging markets are going to be at the whim of the dollar in some respects," said Traub, as the U.S. currency likely will be influenced by the Fed's policy path in 2019. "So I think volatility is definitely here to stay." But Traub believes valuations have moved to reflect that volatility, so there may be chances for some recovery in emerging-market asset prices.

Martini sounded a similar note. If the Fed adopts a less aggressive tightening path, the dollar should not "rise much more than it already has, says Martini. (See Chart 1.) "And that, I think, would clear the way for a better environment for emerging market asset spreads as well as equities."

Municipal Bonds

Solender noted that retail investors, who make up the majority of the muni-bond market, remain "very concerned" about rising rates. This has reduced their demand for longer-dated munis and spurred buying in the shorter end of the market. To the surprise of many, Solender added, the muni yield curve steepened in 2018 even as the Treasury curve flattened, reflecting supply and demand dynamics across the spectrum of muni-bond owners.

What will his investment team look at in 2019? They will be eying the impact of the 2017 tax bill, as the residents of high-tax states will be filing their first full-year federal returns following the imposition of the $10,000 cap on state and local taxes. "It will be fascinating to see the impact on people's investment decisions"—especially demand for tax-advantaged instruments like municipal bonds— "as they see their tax bills." Changes in party control of state governorships and legislatures following the 2018 U.S. midterm elections likely will also have an impact on spending, and thus, muni-bond issuance, he says. Long-delayed infrastructure projects may eventually have to be funded with additional muni-bond issuance, according to Solender.

With yields much higher on many maturities within the muni-bond sector, Solender figures that "investors are eventually going to realize" the potential advantages of the asset class, especially when factoring in tax-equivalent yields. Solender expects that "eventually there will be some comfort level" for investors if interest rates stabilize in 2019, lending further appeal to muni bonds.

Looking Ahead

As a reminder, visitors to the 2019 Investment Outlook page can access a full range of content from the panel discussion. *Market View* will return on January 7 with a closer look at prospects for U.S. equities. ■

Want to learn more about our investment strategies?

Contact Lord Abbett at 888-522-2388 or visit us at www.lordabbett.com.

IMPORTANT INFORMATION

A Note about Risk: The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. Fixed-income investments are subject to various other risks including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Lower-rated securities are subject to greater credit risk, default risk, and liquidity risk. Credit risk is the risk that debt issuers will become unable to make timely interest payments, and at worst will fail to repay the principal amount. The municipal market can be affected by adverse tax, legislative, or political changes, and by the financial condition of the issuers of municipal securities. Income from municipal bonds may be subject to the alternative minimum tax. Federal, state and local taxes may apply. Investments in Puerto Rico and other U.S. territories, commonwealths, and possessions may be affected by local, state, and regional factors. These may include, for example, economic or political developments, erosion of the tax base, and the possibility of credit problems. 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 long-term, especially during periods of downturn in the market. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. 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 long-term, especially during periods of downturn in the market.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. All investments involve risks, including the loss of principal invested.

Federal funds rate (fed funds rate) is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight. Fed funds futures are financial contracts that represent market opinion of where the daily official fed funds rate will be at the time of the contract expiry.

Forward Price-to-Earnings Ratio: Stock analysts calculate a forward price-to-earnings (P/E) ratio by dividing a stock's current price by estimated future earnings per share. Some forward P/Es are calculated based on estimated earnings for the next four quarters, while others use actual earnings from the past two quarters with estimated earnings for the next two. A forward P/E may help you evaluate the current price of a stock in relation to what you can reasonably expect to happen in the near future. In contrast, a trailing P/E is based exclusively on past performance.

Yield is the annual interest received from a bond and is typically expressed as a percentage of the bond's market price.

Tax-equivalent yield is the pretax yield that a taxable bond needs to possess for its yield to be equal to that of a tax-free municipal bond. This calculation can be used to fairly compare the yield of a tax-free bond to that of a taxable bond in order to see which bond has a higher applicable yield.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. One such comparison involves the two-year and 10-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

The **Bloomberg Barclays U.S. High Yield Index** covers the universe of fixed rate, non-investment grade debt.

The **U.S. Dollar Index** is a measure of the value of the U.S. dollar relative to the value of a basket of currencies of the majority of the most significant trading partners of the United States.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

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