

FX and Rates Sentiment Survey

Pandemic, what pandemic?

Key takeaways

- USD duration longs now eclipse the pandemic highs of April 2020 to reach the highest levels since at least 2004
- This is despite rising sticky inflation concerns, fading financial stability & banking system fears, and a debt ceiling deal
- In contrast USD FX shorts have been covered back sharply to the most constructive since Nov 22

US duration longs now eclipse pandemic extremes

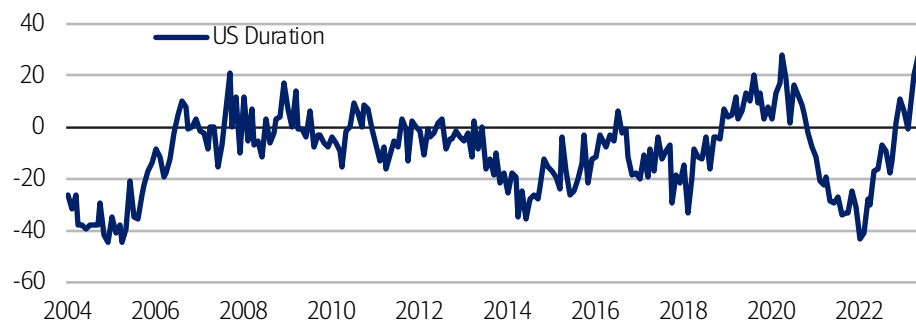
US duration overweights have reached an almost 20y record after another extension in June sees longs now exceed the April 2020 extremes (Exhibit 1).

Ironically, this goes against the detail revealed by most other questions in the survey: Respondents remain comfortable believing central banks will tolerate small inflation overshoots if it means avoiding recession (Exhibit 2). Concerns over sticky inflation are growing and financial stability fears fading (Exhibit 4). Inflation expectations are well in excess of market pricing (Exhibit 11). Fears of contagion out of the US banking system have receded (Exhibit 9). Investors see very limited implications from a TGA driven liquidity decline for risk assets (Exhibit 12). DM sovereigns lead over other asset classes as most likely outperformer collapsed (Exhibit 13). Finally, USD underweights in FX have been covered aggressively post debt ceiling resolution.

This raises concerns of a more meaningful positioning squeeze should other DM central banks be forced to follow the RBA and BoC into extending their hiking cycles.

Exhibit 1: UST duration overweights now exceed the April 2020 pandemic highs

US duration longs extend further in June versus May for a new post-2004 high



Source: BofA Global Research FX and Rates Sentiment Survey

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Trading ideas and investment strategies discussed herein may give rise to significant risk and are not suitable for all investors. Investors should have experience in relevant markets and the financial resources to absorb any losses arising from applying these ideas or strategies.

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Our survey was conducted on 2 – 7 June 2023. A total of 81 Fund Managers responded, with USD1196bn AUM. Responses came from the UK, Continental Europe, Asia & the US.

Invitation to join

If you are a benchmarked investor and would like to participate in this survey, please contact Ralf Preusser or your BofA sales representative.

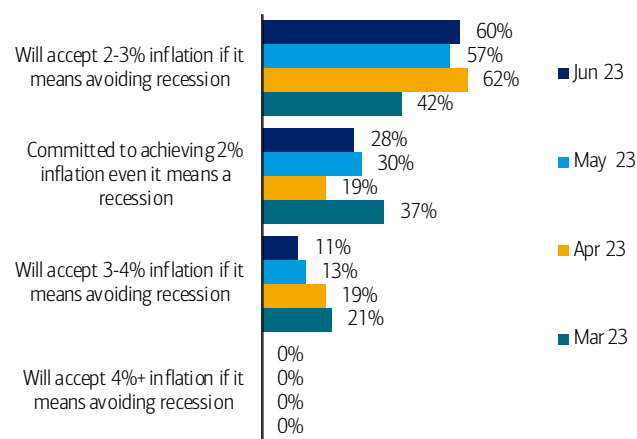
Participants in the survey will receive the full set of monthly results, but only for the relevant month in which they participate.

Central banks don't repeat but they can rhyme

While we are in the ballpark of terminal rates for most central banks, surprise rate hikes by the Reserve Bank of Australia and Bank of Canada are reminders of the commitment to achieving inflation targets, not to mention that pause \neq terminal. This is in contrast to the still prevalent view that central banks will tolerate small overshoots (Exhibit 2). Hawkish central banks may remain the pain trade over the coming week with the FOMC expected to hold, BoJ YCC adjustment forecasts pushed back to the fall (Exhibit 3) and the ECB contending with weaker-than-expected core inflation.

Exhibit 2: My view on central bank inflation targets:

2-3% still viewed as acceptable by central banks

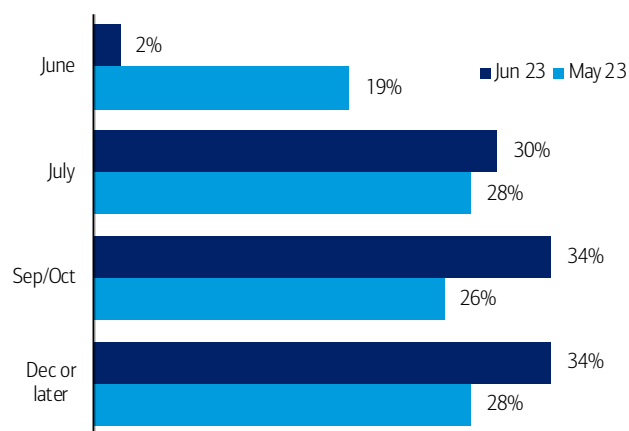


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 3: When do you think BoJ will tweak or remove YCC?

Base case has shifted to September or later



Source: BofA Global Research FX and Rates Sentiment Survey

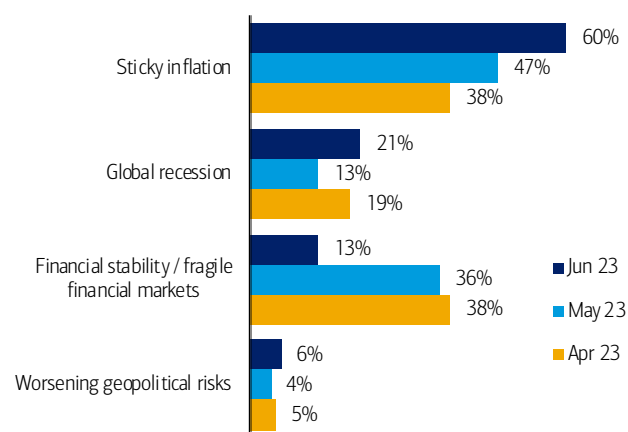
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Financial stability concerns recede

The US debt ceiling deal and improving sentiment on US regional banks has seen a meaningful drop in financial stability concerns. The widely anticipated Treasury bill supply surge is expected to tighten financial conditions at the margin but not weigh heavily on risky assets.

Exhibit 4: My biggest concern today is

Financial stability concerns have fallen

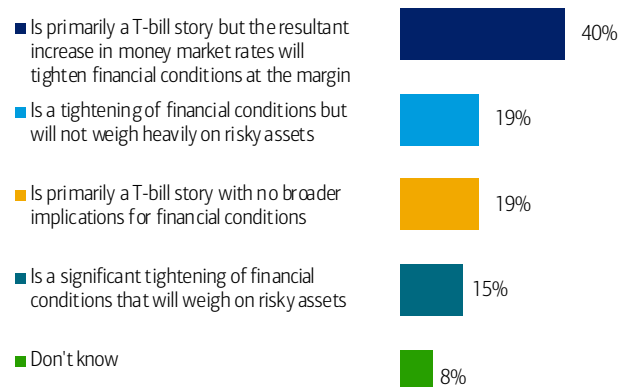


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 5: US Treasury's efforts to rebuild cash (TGA) balances post debt ceiling resolution

No major concern around broader risk market spillover



Source: BofA Global Research FX and Rates Sentiment Survey

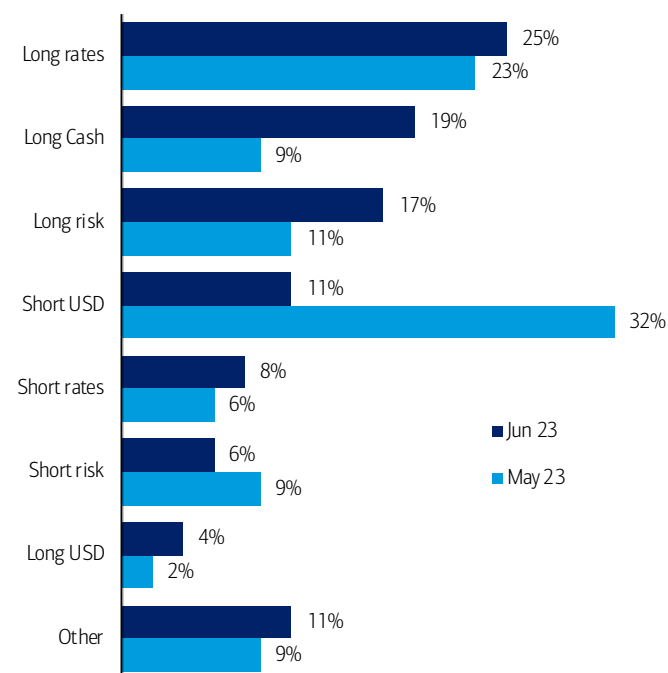
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Short USD positions have likely reduced meaningfully and no longer perceived as the most crowded trade. Long rates positions potentially vulnerable if central banks continue to surprise hawkishly.

Exhibit 6: Most crowded trade:

Long rates considered the most crowded trade



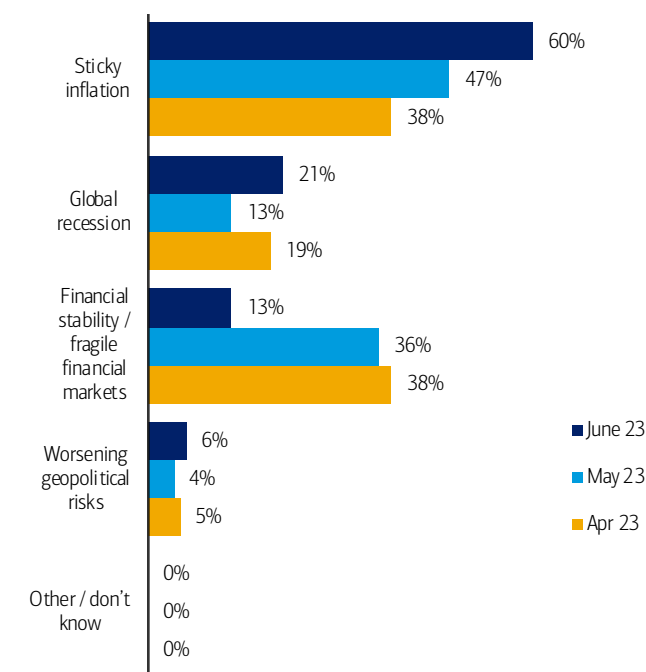
Source: BofA Global Research FX and Rates Sentiment Survey

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Sticky inflation most prevalent investor concern, while financial stability risks fall sharply reflecting better US regional bank sentiment and debt ceiling deal.

Exhibit 7: My biggest concern today is:

Sticky inflation concern escalates



Source: BofA Global Research FX and Rates Sentiment Survey

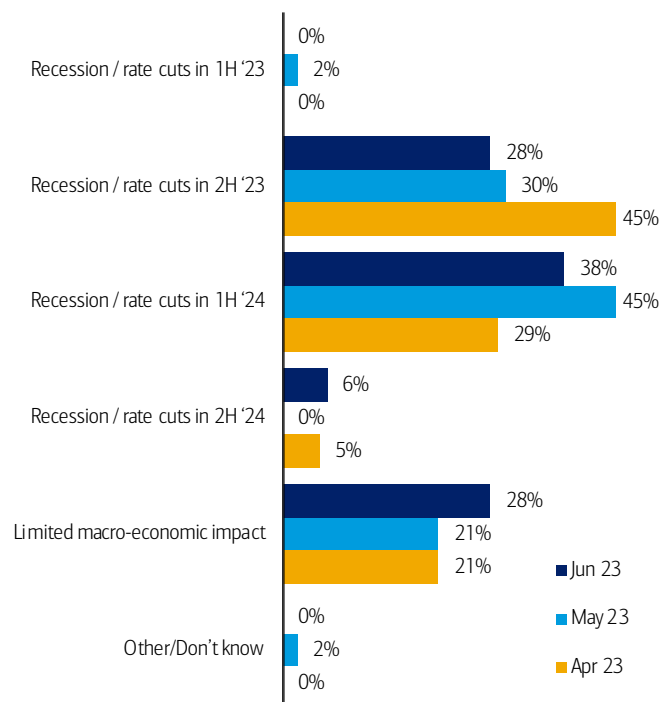
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That said, the base case remains recession and rate cuts by 1H 24, partly driven by tighter credit conditions following US bank stress.

Exhibit 8: Recent US bank stress will mean:

Despite a small rise, those expecting limited macro impact remain a minority



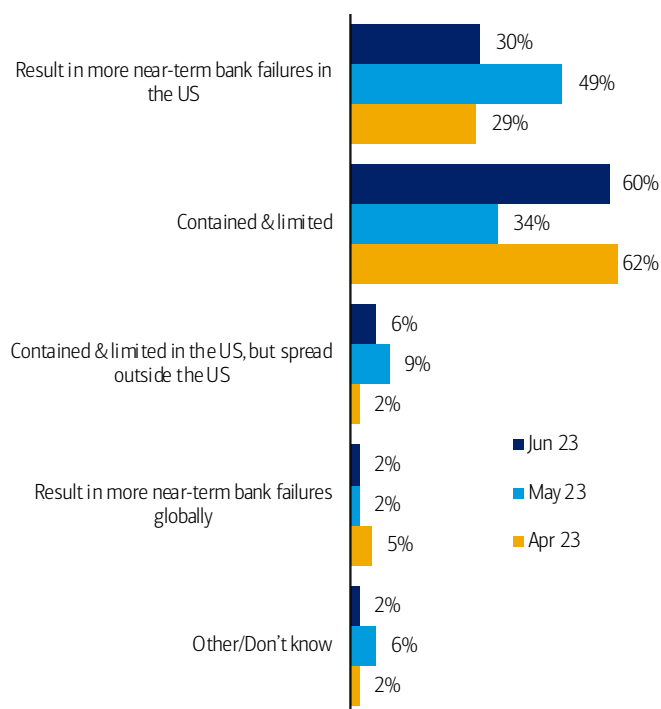
Source: BofA Global Research FX and Rates Sentiment Survey

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Respondents are less concerned about near-term bank failures in the US and expect very limited global impact.

Exhibit 9: Recent US bank stress will be:

Near term concerns have reduced



Source: BofA Global Research FX and Rates Sentiment Survey

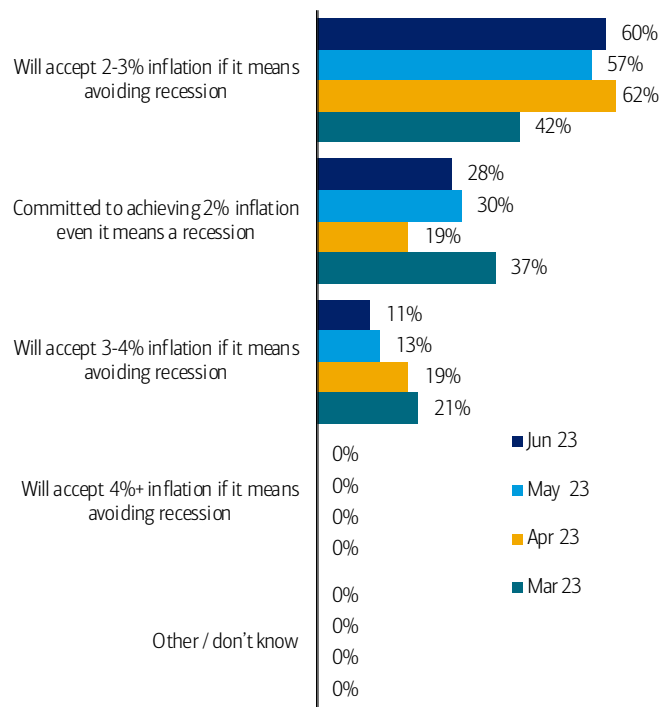
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Recent central bank actions (RBA and BoC) suggest greater tolerance for a slowdown/recession to achieve inflation targets although this is not yet reflected in the survey.

While the majority see US inflation at 2-3% by end-2024, the risks are skewed higher according to our survey. In contrast, market pricing is at the low end, close to 2%. We recommend going long 1y inflation swap.

Exhibit 10: My view on central bank inflation targets:

2-3% still viewed as acceptable by central banks

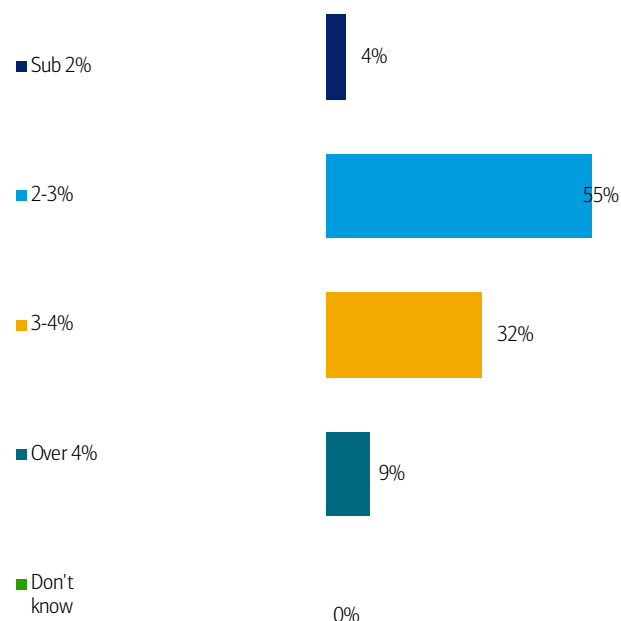


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 11: I expect US inflation at the end of 2024 to be

The majority see US inflation at 2-3% by the end of 2024



Source: BofA Global Research FX and Rates Sentiment Survey

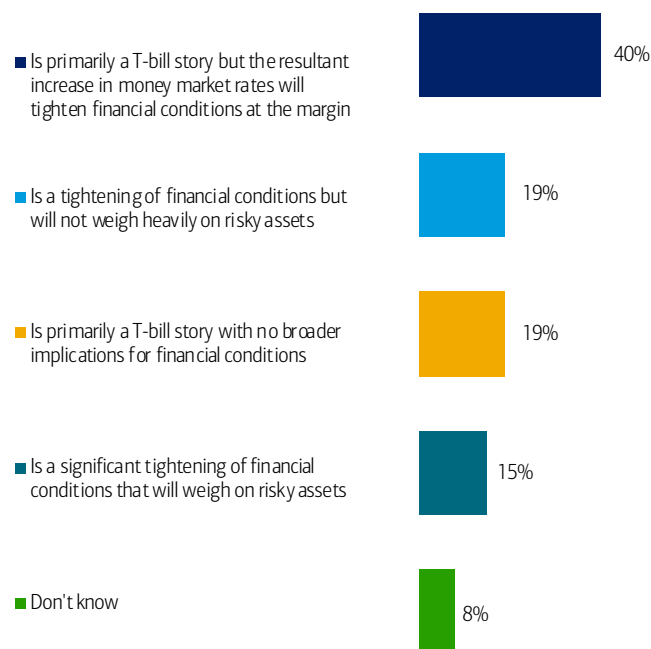
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The spillover from US Treasury bill issuance to replenish cash balances is expected to tighten financial conditions marginally but few expect negative spillover to risky assets.

Exhibit 12: US Treasury's efforts to rebuild cash (TGA) balances post debt ceiling resolution

No major concern around tighter USD funding for broader asset markets



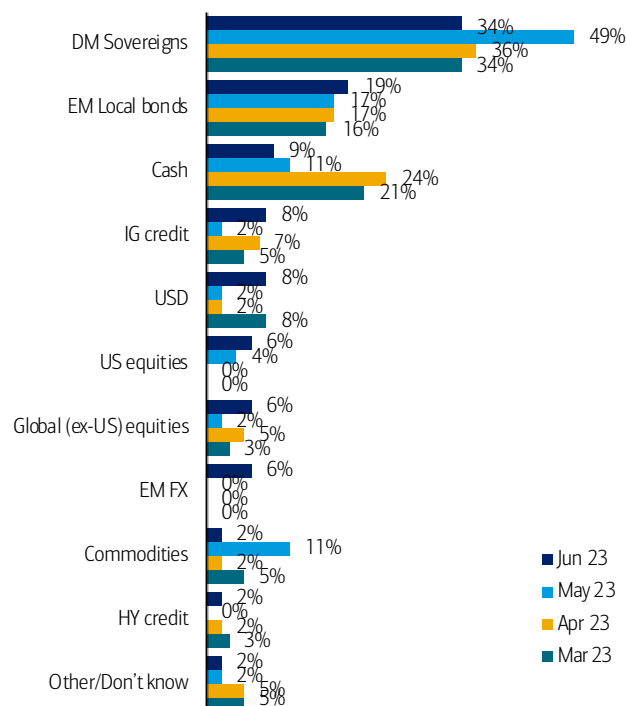
Source: BofA Global Research FX and Rates Sentiment Survey

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Confidence in DM sovereigns has taken a hit but over a third still saw it as their favourite asset class.

Exhibit 13: Which asset class will outperform over the next 3-6 months?

DM sovereigns pull back but remain the favourite asset class



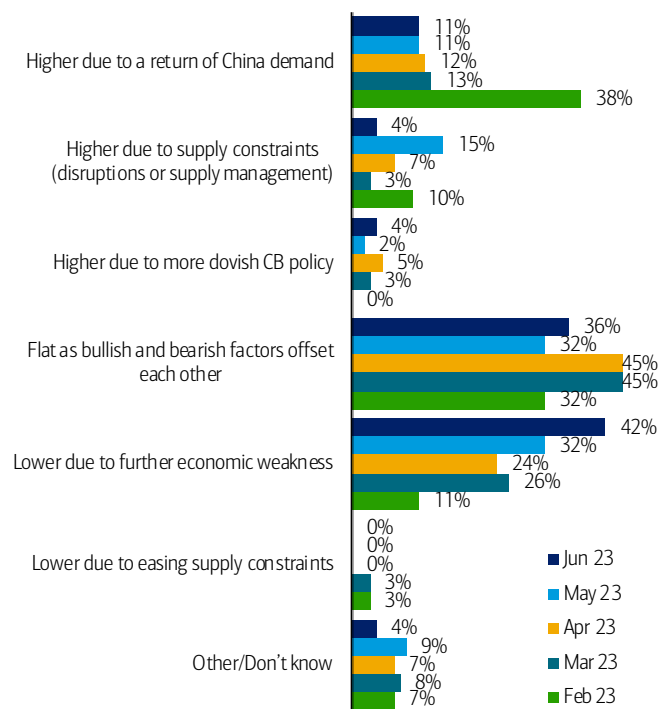
Source: BofA Global Research FX and Rates Sentiment Survey

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Respondents stay bearish commodities despite the Saudi output cut and potential property easing in China.

Exhibit 14: Over the next 6 months commodities will be:

Commodity bearishness continues to rise



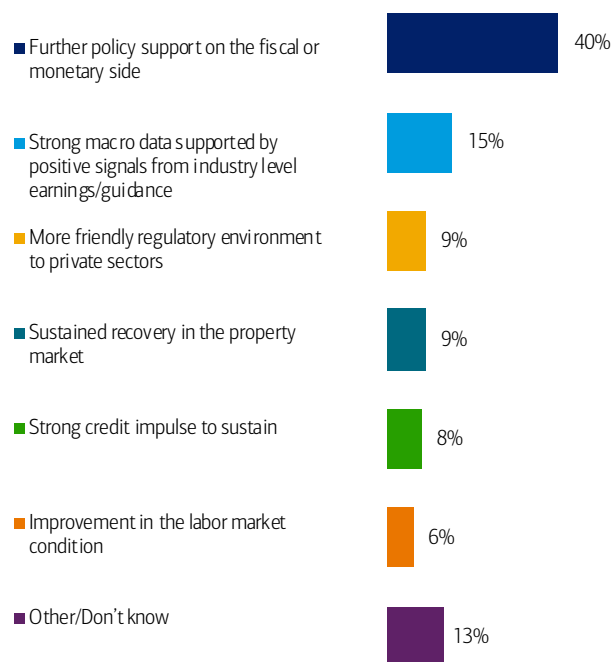
Source: BofA Global Research FX and Rates Sentiment Survey

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Disappointing economic data means policy stimulus is viewed as necessary for investors to reengage in the China trade.

Exhibit 15: What are the signs or catalysts that would make you more bullish on China?

Policy easing is necessary for a recovery in China sentiment



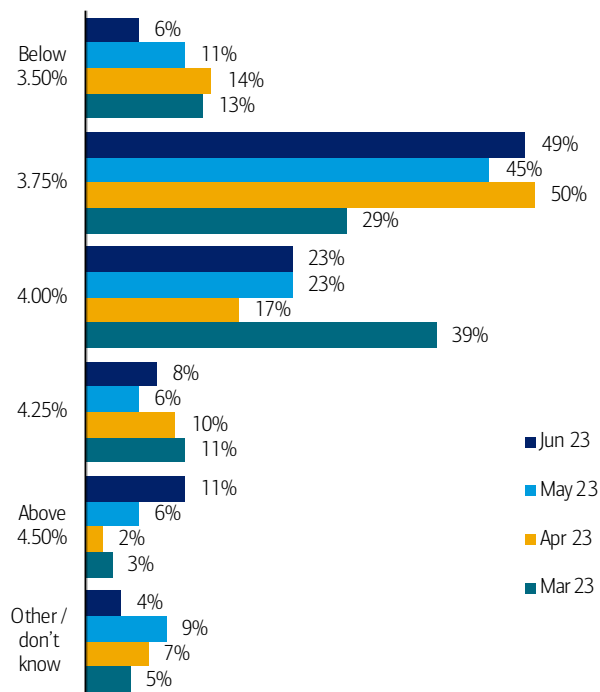
Source: BofA Global Research FX and Rates Sentiment Survey

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Despite lower-than-expected May inflation, there is little change in terminal rate expectations for the ECB...

Exhibit 16: I see the terminal ECB depo at:

3.75% still the base case



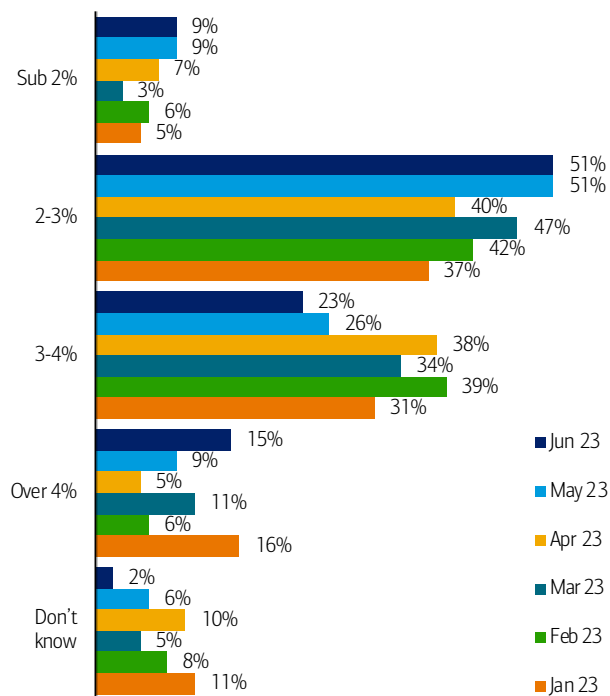
Source: BofA Global Research FX and Rates Sentiment Survey

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... while the perceived risk to Eurozone inflation staying above 3% by end-2024 has actually risen slightly.

Exhibit 17: I expect Eurozone inflation at the end of 2024 to be:

2-3% inflation at end 2024 remains the base case



Source: BofA Global Research FX and Rates Sentiment Survey

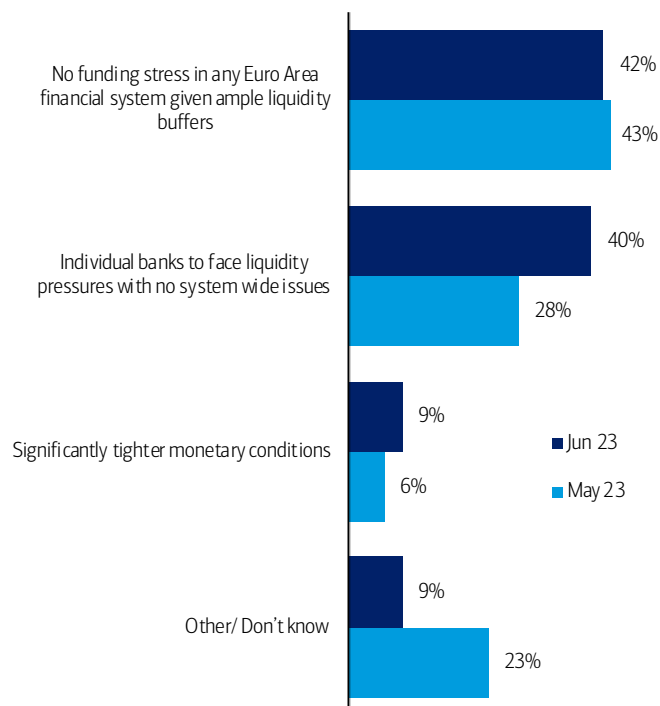
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TLTRO repayments are not expected to have a broad macro impact although some individual banks expected to face liquidity pressure.

A third of respondents see limited impact from quantitative tightening, with more confidence in wider spreads than a steeper curve.

Exhibit 18: Around the June TLTRO repayment date, I expect:

No systemic concern but some liquidity pressure anticipated

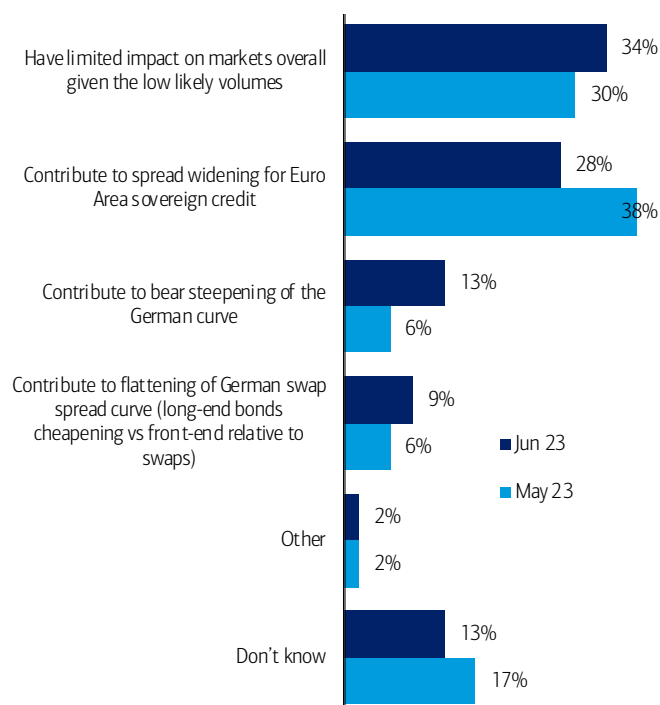


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 19: A possible acceleration of ECB QT (for the APP) will mainly:

QT to have limited impact, at best a spread trade



Source: BofA Global Research FX and Rates Sentiment Survey

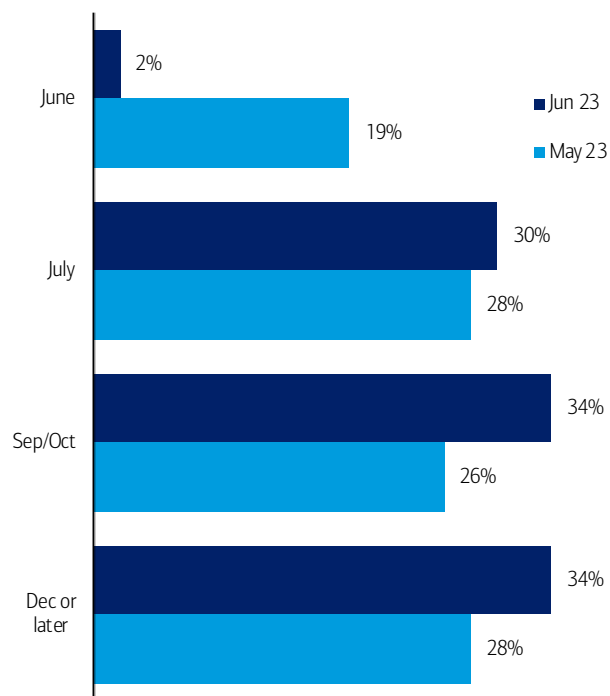
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Expectations for YCC adjustment have pushed back to September or later, although the July meeting remains very much live...

Exhibit 20: When do you think BoJ will tweak or remove YCC?

Base case has shifted to Sep or later



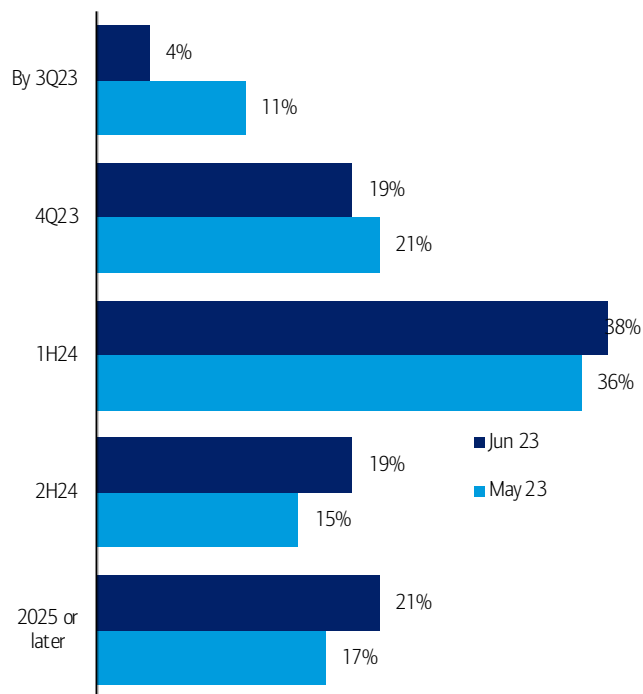
Source: BofA Global Research FX and Rates Sentiment Survey

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... while exit from negative rates remains likely to be a 2024 event

Exhibit 21: When do you think BoJ will remove NIRP?

NIRP abandonment expectations firm on 1H24



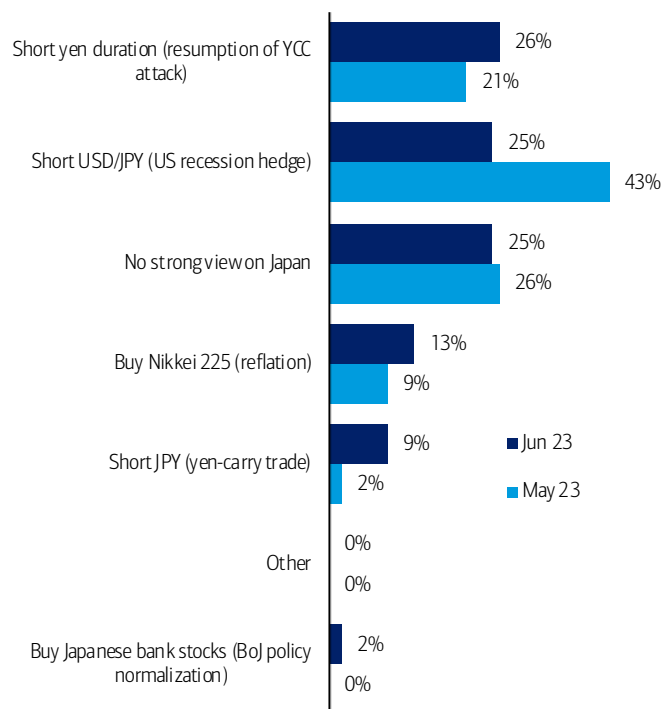
Source: BofA Global Research FX and Rates Sentiment Survey

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Short USD/JPY conviction has fallen sharply although investors still reluctant to engage in yen-funded carry trade.

Exhibit 22: What is the best Japan trade for 2023?

Short USD/JPY conviction falls sharply



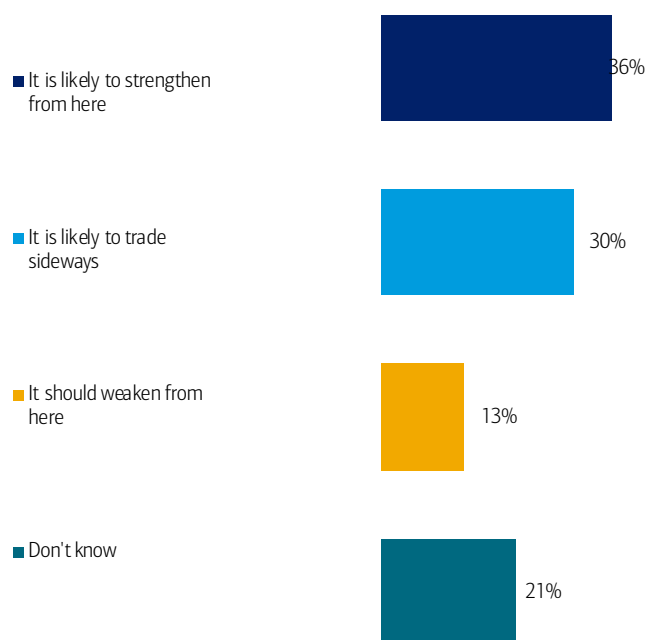
Source: BofA Global Research FX and Rates Sentiment Survey

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Respondents are constructive EM FX although strong USD and weak China mean many expect range bound conditions.

Exhibit 23: My view on EMFX in the 3 months is:

Constructive view on EM FX



Source: BofA Global Research FX and Rates Sentiment Survey

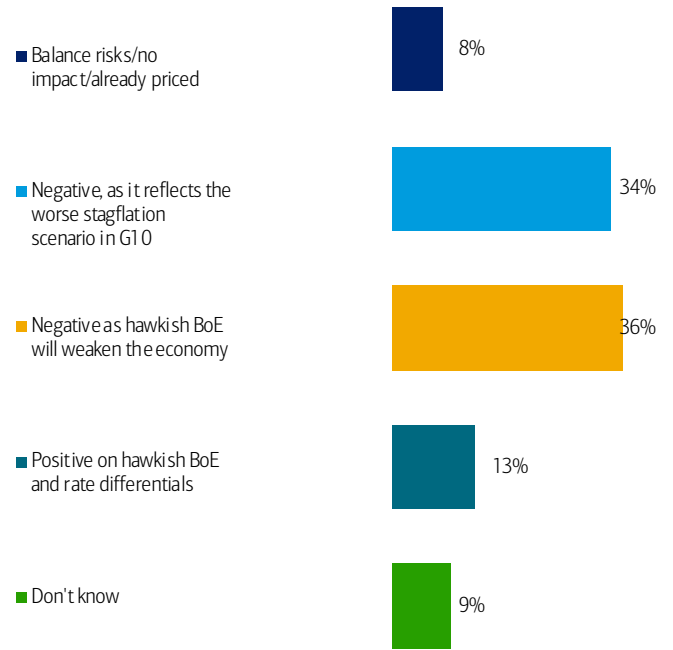
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Stagflation concerns rising – investors wary of GBP FX resilience despite higher rates.

Exhibit 24: The impact of the renewed surge in UK core inflation on GBP is:

Stagflation is bad for GBP



Source: BofA Global Research FX and Rates Sentiment Survey

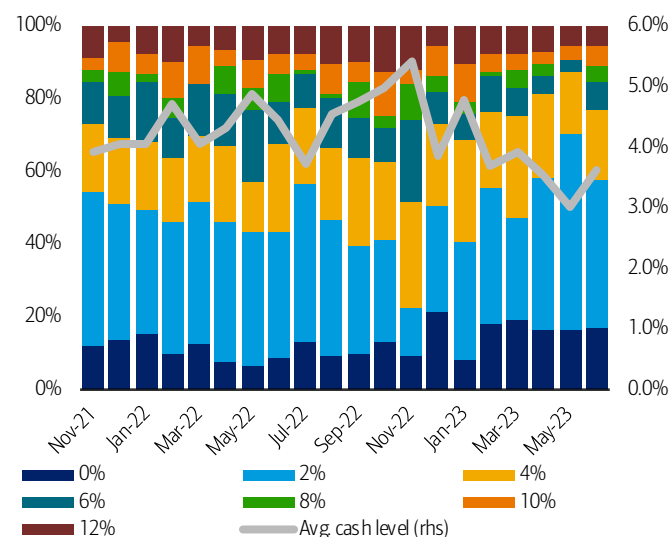
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Global Risk Appetite

Exhibit 25: Which of the following comes closest to your current cash position in your portfolio?

Average cash levels at 3.6%

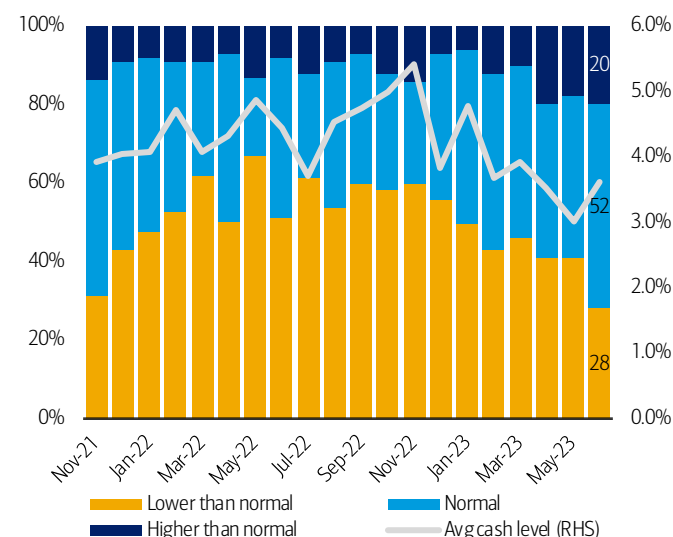


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 26: What level of risk do you feel you're currently taking in your investment strategy / portfolio, relative to your benchmark?

Risk appetite closer to normal levels

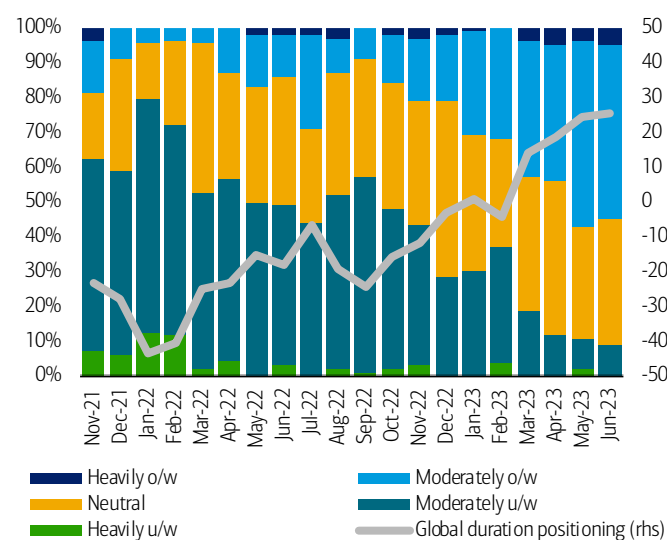


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 27: Duration exposure: Global

Duration exposure stabilizes at high levels...



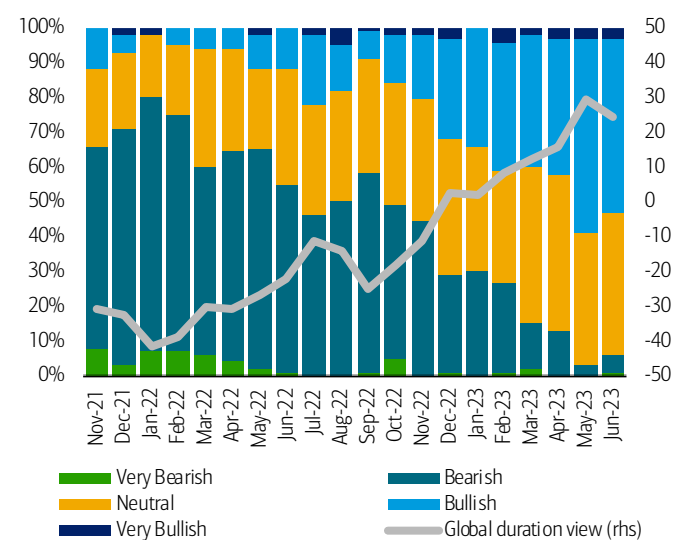
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 28: Duration view: Global

... although bullish duration view retreats following recent sell-off



Source: BofA Global Research FX and Rates Sentiment Survey

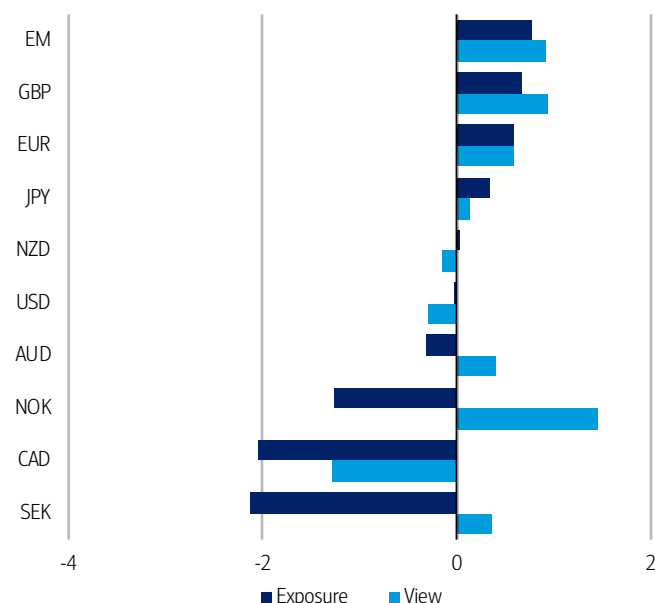
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Positioning and View Summary

Exhibit 29: 1-year FX Exposure and View (z-score)

EM positioning/views have been resilient to strong USD

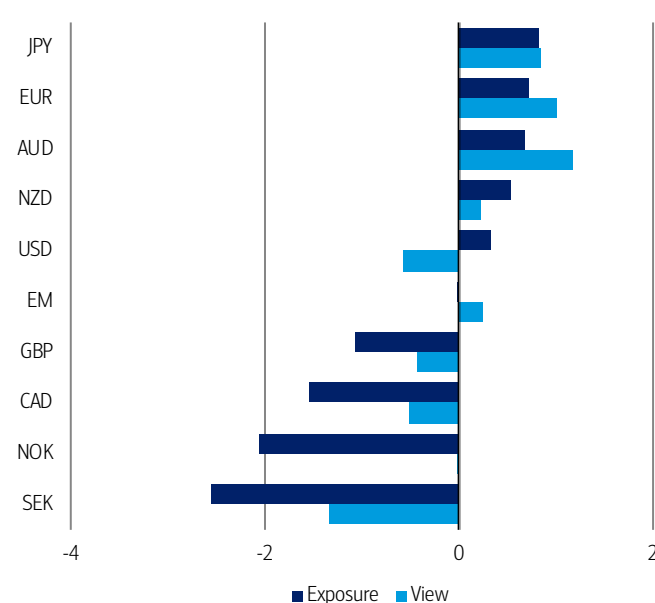


Source: BofA Global Research FX and Rates Sentiment Survey; Note: Data for FX Exposure starts in January 2004 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016; Data for FX View starts in December 2011 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016

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Exhibit 30: Full period FX Exposure & View (z-score)

USD bears have not yet capitulated, at least on the view

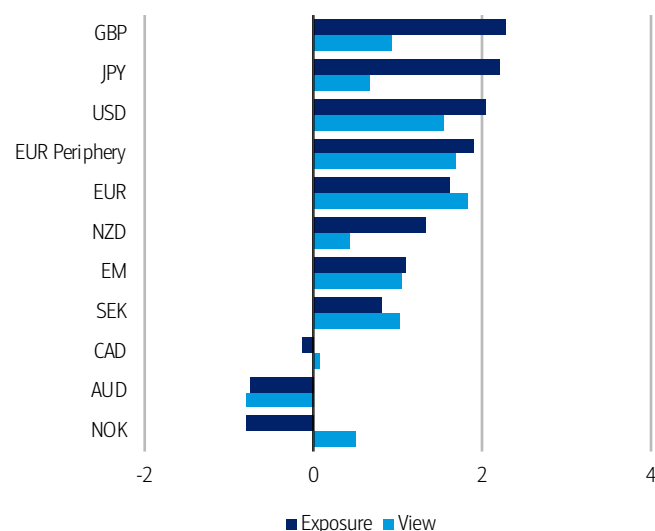


Source: BofA Global Research FX and Rates Sentiment Survey; Note: Data for FX Exposure starts in January 2004 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016; Data for FX View starts in December 2011 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016

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Exhibit 31: 1-year Rates Exposure & View (z-score)

Bullish duration views scaled back, especially GBP, JPY, NZD

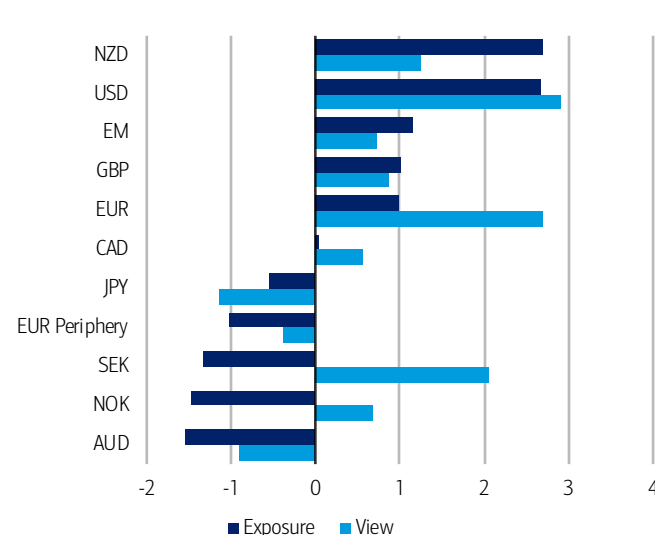


Source: BofA Global Research FX and Rates Sentiment Survey; Note: Data for Rates Exposure starts in January 2004 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016 and EUR periphery starts in April 2013. Data for Rates View starts in December 2011 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016 and EUR periphery starts in April 2013.

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Exhibit 32: Full period Rates Exposure & View (z-score)

NZD and USD positioning still large on longer time-frame



Source: BofA Global Research FX and Rates Sentiment Survey; Note: Data for Rates Exposure starts in January 2004 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016 and EUR periphery starts in April 2013. Data for Rates View starts in December 2011 for USD, EUR, GBP, JPY, CAD and EM, while for AUD, NZD, NOK and SEK the start date is January 2016 and EUR periphery starts in April 2013.

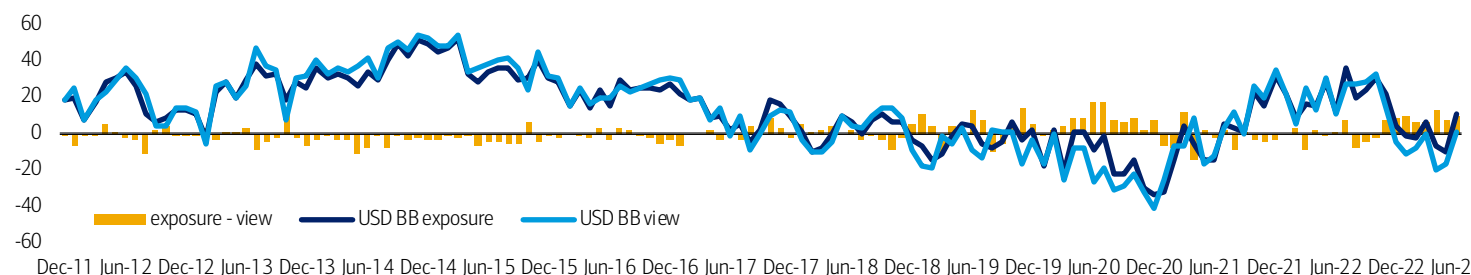
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United States

USD duration exposures has continued to extend, now eclipsing the pandemic high of April 2020 (Exhibit 34). Investors are fully invested in the classic end-of-cycle asset allocation rotation towards an overall duration overweight (Exhibit 27), led by the US, as the high beta asset. On the back of the debt ceiling resolution, USD FX positions have recovered in line with the reduced concerns about consensual USD shorts (Exhibit 6).

Exhibit 33: FX exposure and view: USD

USD exposures bounce post debt ceiling compromise



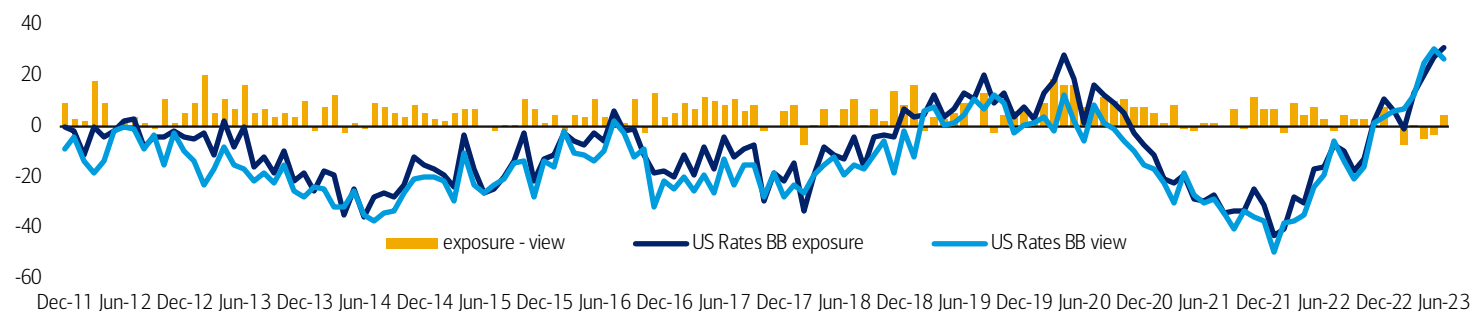
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 34: Duration exposure and view: USD

USD duration exposure continues to climb, even as sentiment turns slightly less bullish



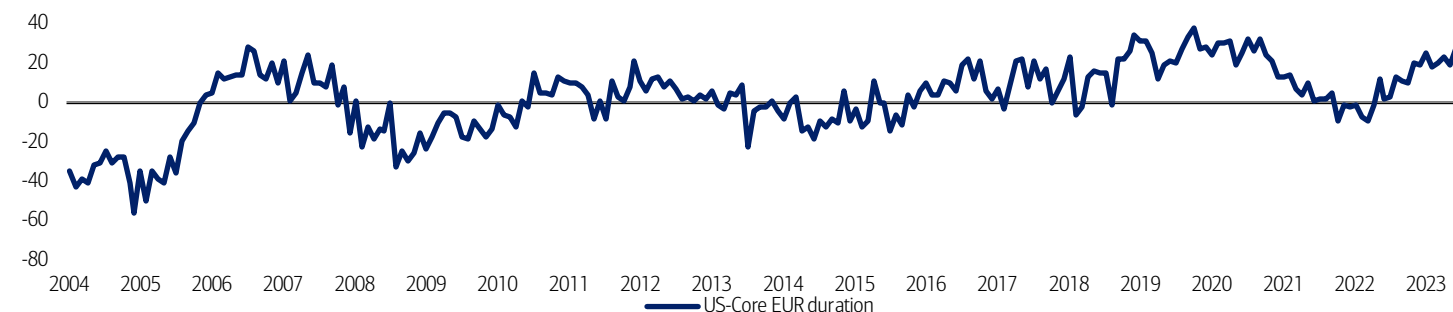
Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 35: US-Core Europe Duration Exposure

US vs Core EUR Bull-Bear rates exposure spread bounces on continued USD duration buying



Source: BofA Global Research FX and Rates Sentiment Survey

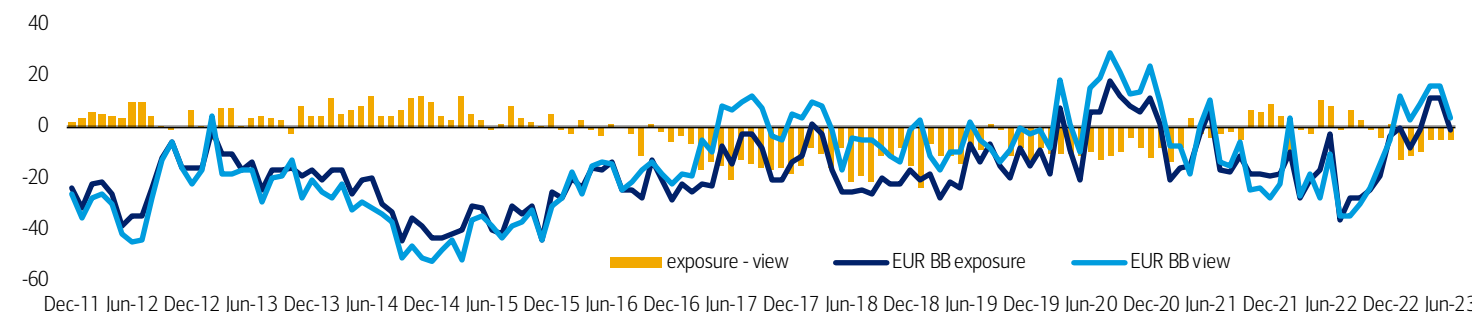
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Eurozone

US debt ceiling resolution sees a significant unwind of EUR longs with both FX exposures and sentiment taking a sharp turn lower. Core duration exposures are cut back even as sentiment stays very bullish, in contrast to price action which has seen US rates underperform EUR rates. Periphery exposures and sentiment are largely unchanged, as spreads remain a side show.

Exhibit 36: FX exposure and view: EUR

EUR exposures and sentiment take a sharp turn lower



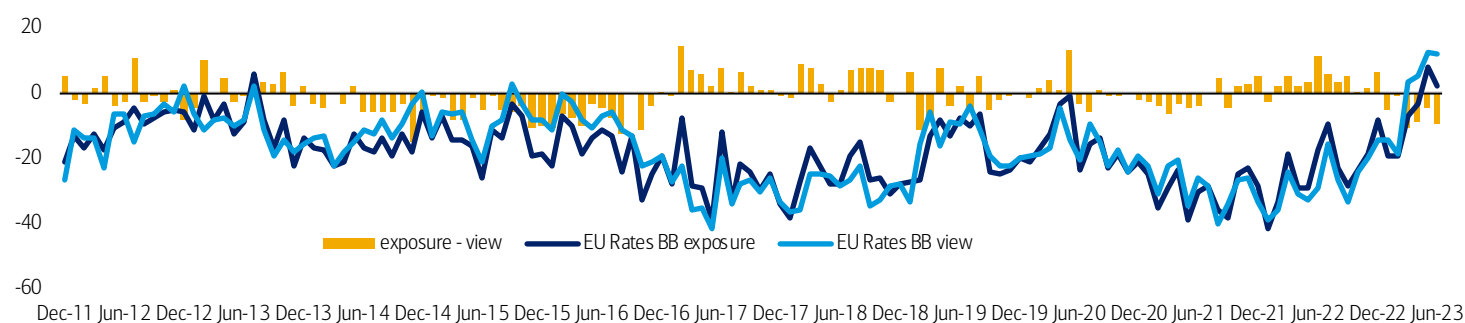
Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 37: Duration exposure and view: Core Europe

Core duration is sold even as sentiment remains bullish



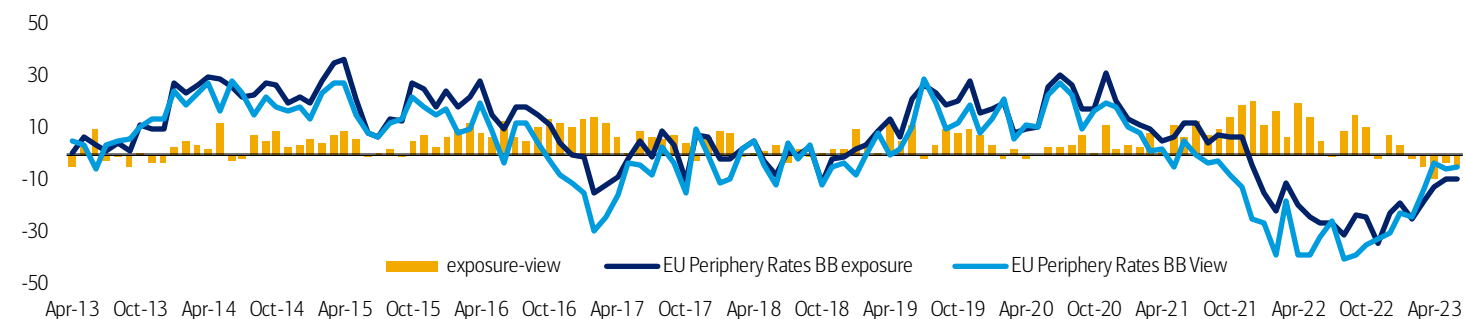
Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 38: Duration exposure and view: Peripheral Europe

Periphery exposures are largely unchanged on the month



Source: BofA Global Research FX and Rates Sentiment Survey

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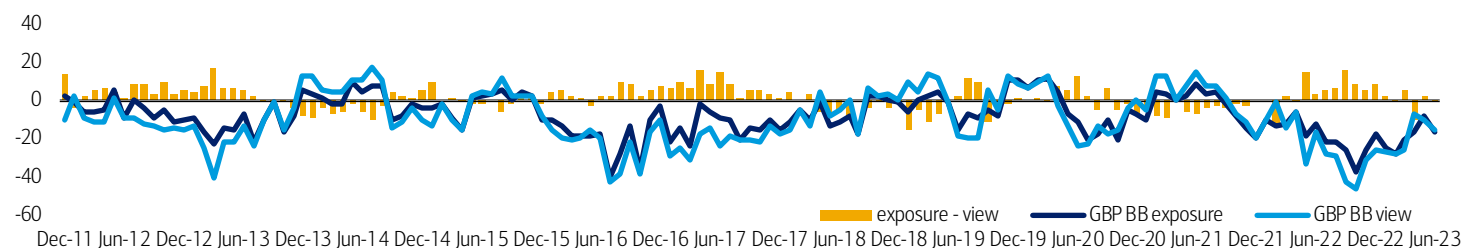
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United Kingdom

GBP is again sold, in line with last month's deterioration in sentiment, as investors take a negative view of the implication of sticky core inflation for the currency (Exhibit 24). Gilt short covering continues, even as sentiment deteriorates slightly after the latest inflation surprise.

Exhibit 39: FX exposure and view: GBP

GBP exposures decline in line with last month's turn in sentiment



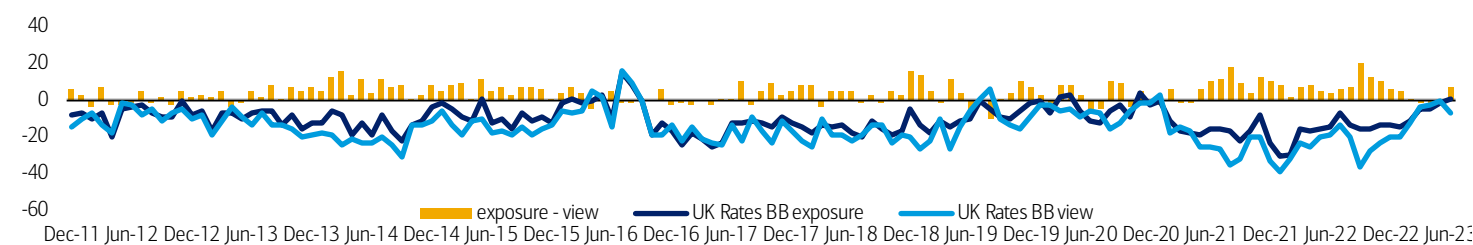
Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 40: Duration exposure and view: UK

Gilt short covering continues, even as sentiment deteriorates slightly



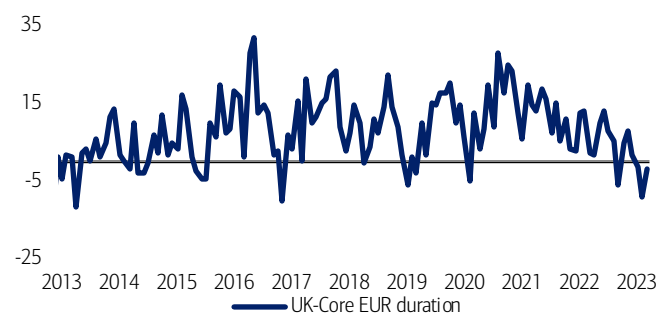
Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 41: UK-Core Europe Duration Exposure

UK vs Core EUR Bull-Bear rates exposure spread

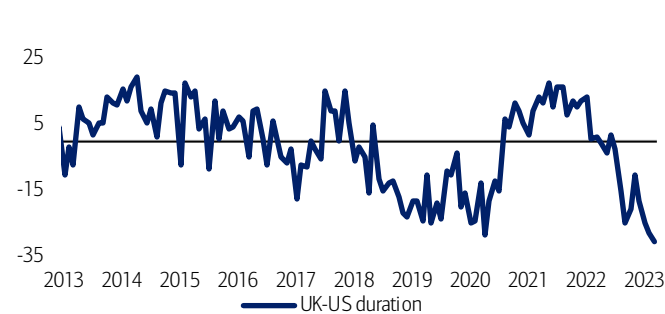


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 42: UK-US Duration Exposure

UK vs US Bull-Bear rates exposure spread



Source: BofA Global Research FX and Rates Sentiment Survey

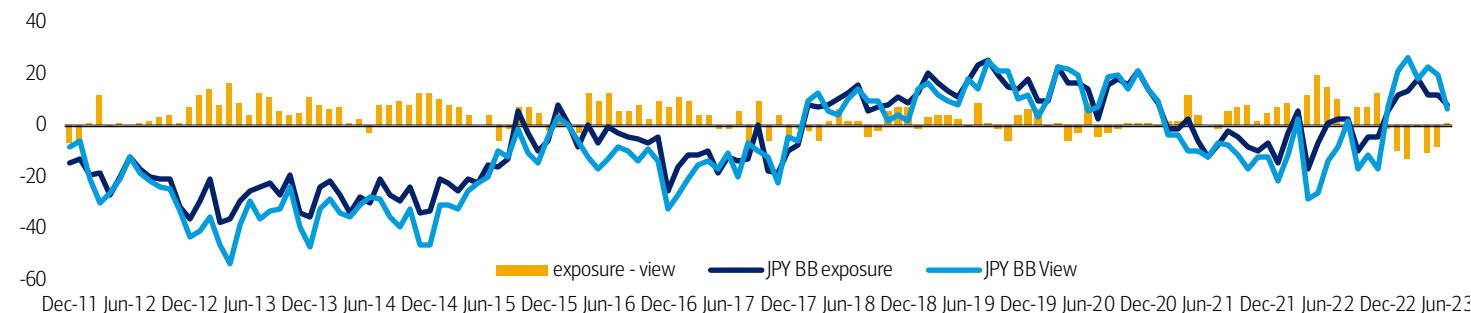
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Japan

JPY longs were unchanged on the month, despite growing conviction in FX as the best Japan trade. In rates, we actually saw renewed selling of JGB duration, albeit only at the margin.

Exhibit 43: FX exposure and view: JPY

JPY sentiment deteriorates sharply to catch up with much more sanguine JPY FX exposures which moderate further



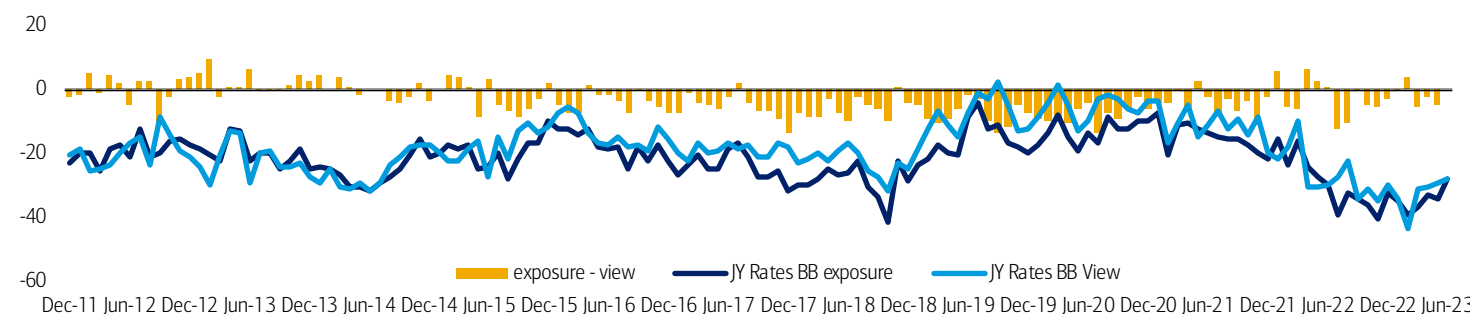
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 44: Duration exposure and view: JY

JGB shorts are covered back slightly but remain sizeable cross market



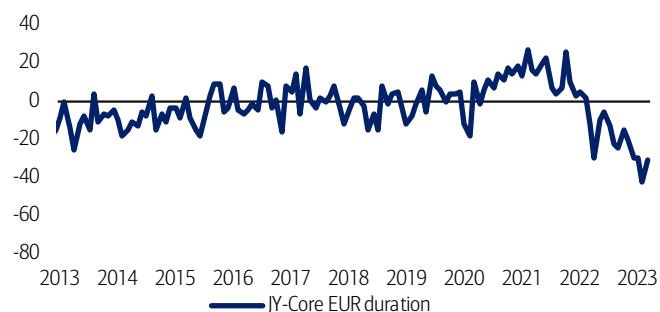
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 45: JY-Core Europe Duration Exposure

JY vs Core Europe Bull-Bear rates exposure spread

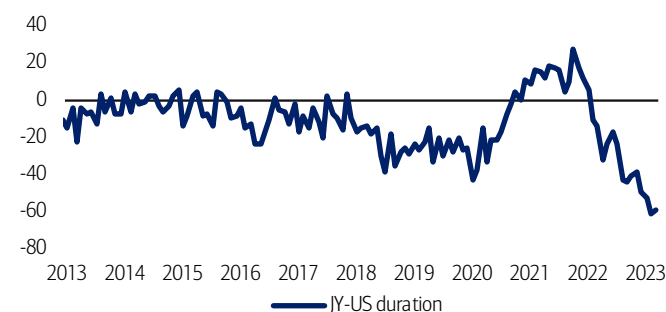


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 46: JY-US Duration Exposure

JY vs US Bull-Bear rates exposure spread



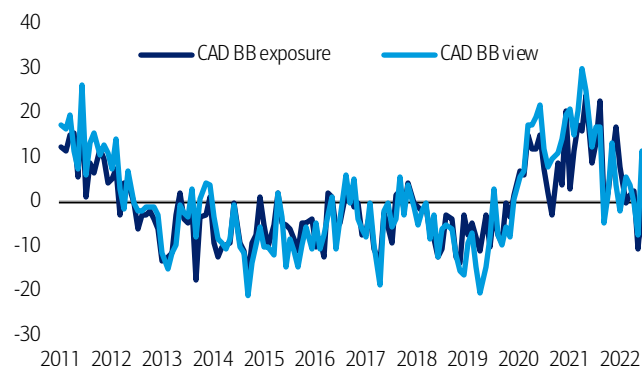
Source: BofA Global Research FX and Rates Sentiment Survey

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Canada, Australia and New Zealand

Exhibit 47: FX exposure and view: CAD

FX exposure deteriorates sharply but survey predates BoC rate hike...

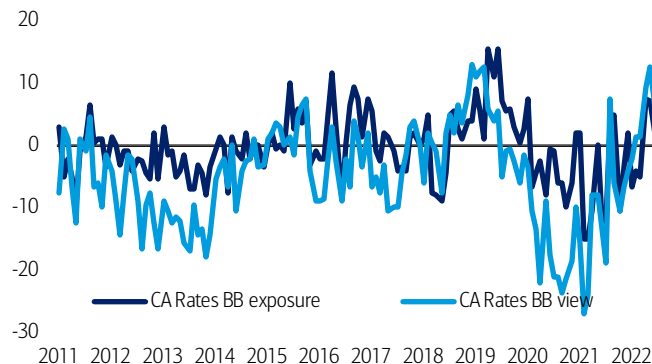


Source: BofA Global Research FX and Rates Sentiment Survey
BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 48: Duration exposure and view: CA

... duration sold aggressively into this week's BoC meeting

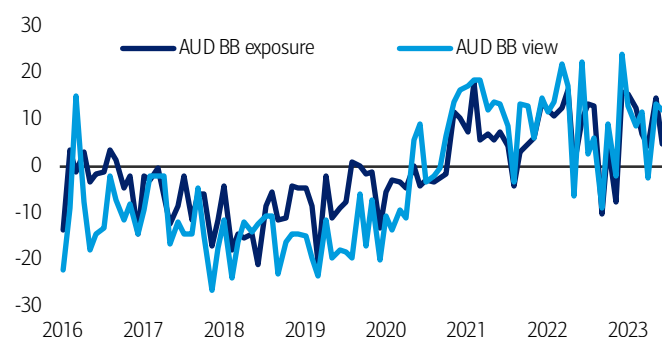


Source: BofA Global Research FX and Rates Sentiment Survey
BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 49: FX exposure and view: AUD

AUD FX exposure declines as sentiment stays more constructive

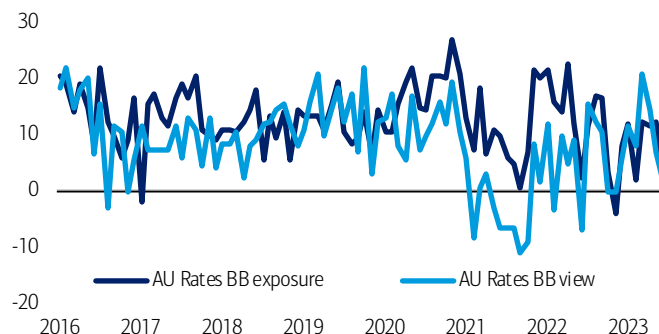


Source: BofA Global Research FX and Rates Sentiment Survey
BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 50: Duration exposure and view: AU

Duration exposures and sentiment fall sharply as RBA surprise hits survey period

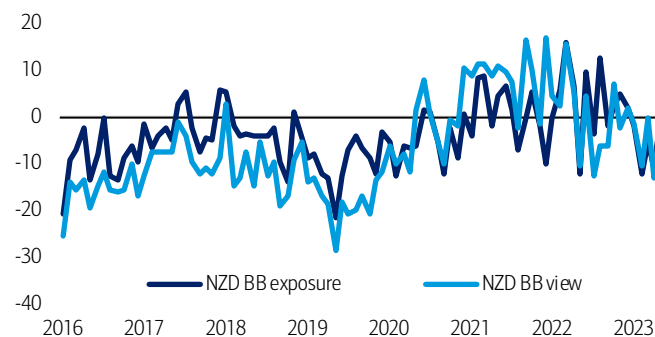


Source: BofA Global Research FX and Rates Sentiment Survey
BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 51: FX exposure and view: NZD

Exposures and sentiment remain close to neutral

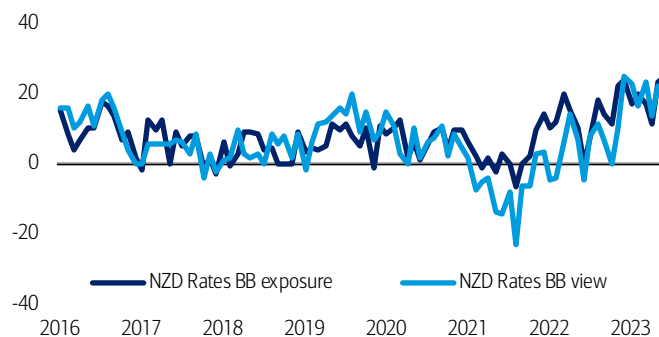


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BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 52: Duration exposure and view: NZD

NZD duration overweights continue to build post RBNZ dovish surprise



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BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

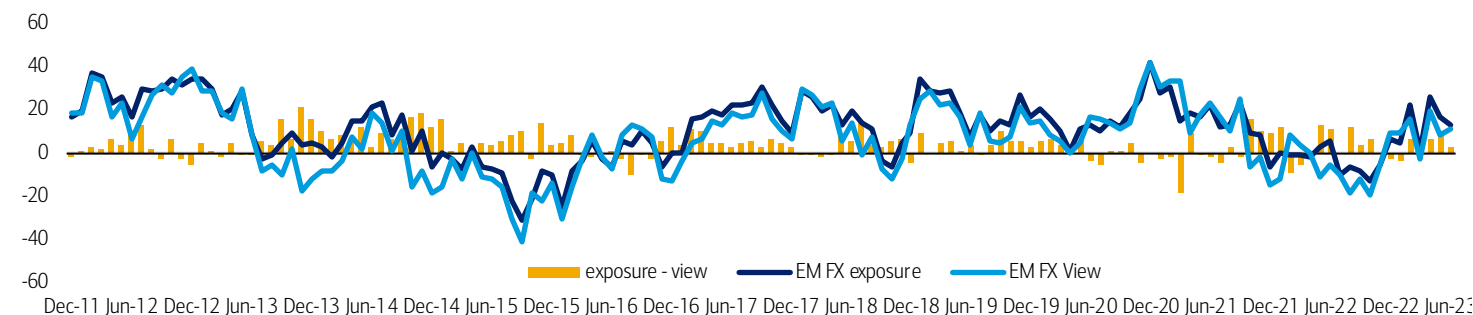
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Emerging Markets

EM FX positioning continues to correct lower after April's sharp bounce in contrast to the reported bullishness on EMFX (Exhibit 23). EM duration exposures finally catch up to much more conservative sentiment and correct lower on the month but remain sizeable.

Exhibit 53: FX exposure and view: EM

EMFX exposure continues to moderate after April's bounce



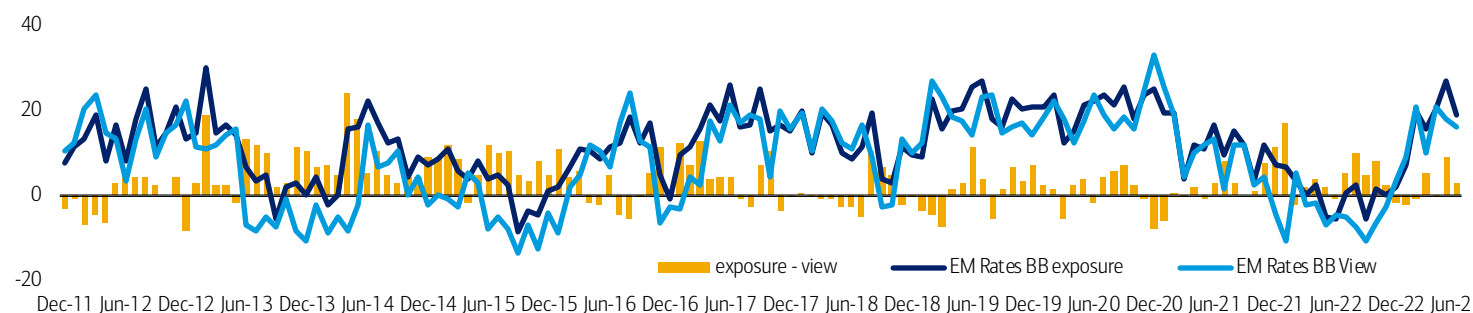
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 54: Duration exposure and view: EM

Duration exposure gets cut back sharply to catch up with more conservative sentiment



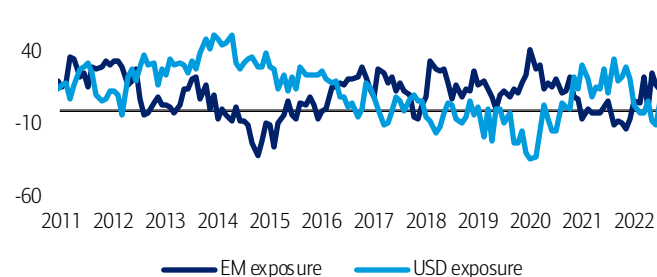
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 55: EM and USD FX exposure

EM vs US Bull-Bear fx exposure spread

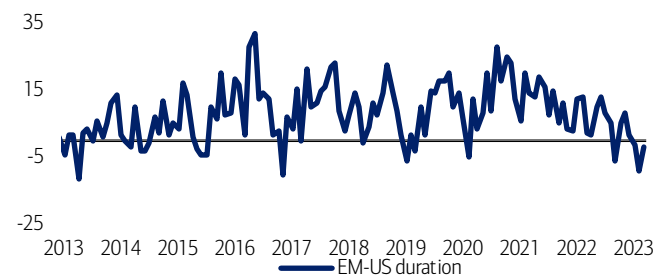


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 56: EM vs. US duration exposure

EM vs US Bull-Bear rates exposure spread



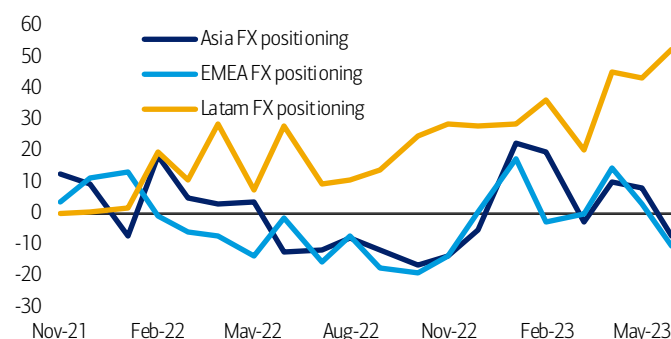
Source: BofA Global Research FX and Rates Sentiment Survey

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Regional EM Rates Positioning and View

Exhibit 57: FX positioning

LATAM exposures continues to grow...



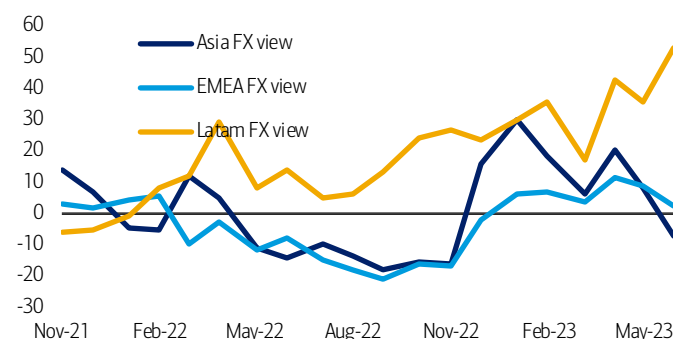
Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 58: FX view

... as sentiment turns ever more bullish



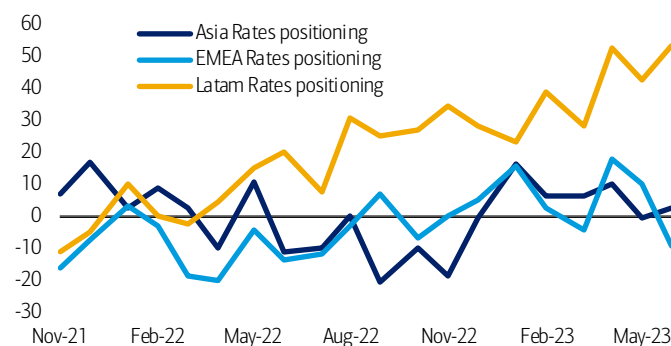
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 59: Rates local currency positioning

Duration bullishness also sees LATAM as the outlier...



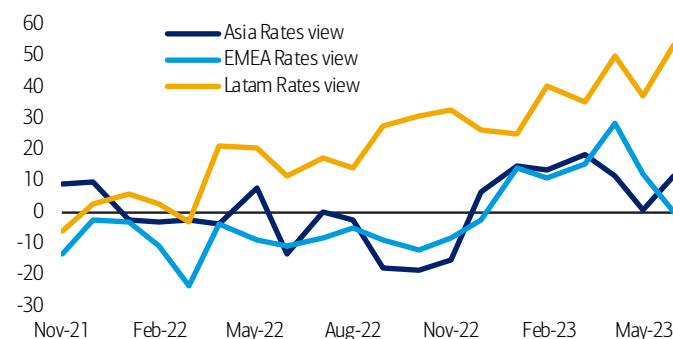
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 60: Rates local currency view

... with sentiment following closely



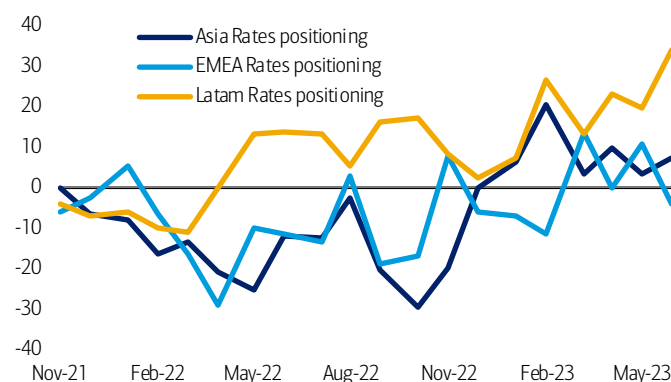
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 61: Rates hard currency positioning

While not as extreme, hard currency positioning also sees LATAM top



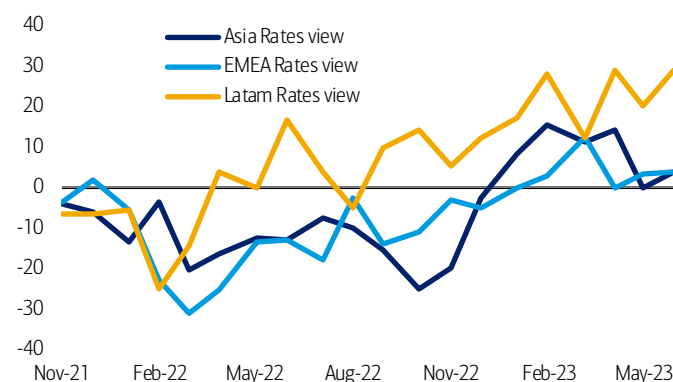
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 62: Rates hard currency view

But exposures ahead of sentiment



Source: BofA Global Research FX and Rates Sentiment Survey

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BofA GLOBAL RESEARCH

A Guide to the BofA Global Investor Survey

Our survey was conducted between 2 June 2023 and 7 June 2023. A total of 81 global fixed income fund managers responded to the survey. Responses came from the UK, Continental Europe, APAC and the US.

Our monthly survey has asked the same two questions since its May 1989 start date: “Relative to your own benchmark: 1) How is your portfolio structured in terms of currency exposure? and 2) How is your portfolio structured in terms of duration exposure?”. In December 2011 we added two questions: 1) “How would you describe your view on the following currencies? And 2) How would you describe your view on the following bond markets?”. Regarding “exposure” there are five responses from which to choose: Heavily Overweight, Moderately Overweight, Neutral, Moderately Underweight, and Heavily Underweight, while for “view” the equivalent responses are: Very Bullish, Bullish, Neutral, Bearish, and Very Bearish. In both cases responses are weighted to create a Bull-Bear index from -100 to 100, with zero representing neutral.

¹ The formula used to calculate the Bull-Bear Index (B/B) is as follows:

$$B/B \text{ (exposure)} = (\% \text{ Heavy Overweight} * 1.0) + (\% \text{ Moderately Overweight} * 0.5) + (\% \text{ Neutral} * 0) - (\% \text{ Moderately Underweight} * 0.5) - (\% \text{ Heavily Underweight} * 1.0).$$

$$B/B \text{ (view)} = (\% \text{ Very Bullish} * 1.0) + (\% \text{ Bullish} * 0.5) + (\% \text{ Neutral} * 0) - (\% \text{ Bearish} * 0.5) - (\% \text{ Very Bearish} * 1.0)$$

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