PIMCO Expects Erosion in Value of U.S. Dollar

By Editor Test *Wed, Jul 22, 2009*

In its third-quarter market outlook report, the fixed-income giant shares its strategy for this year and beyond.

Over the next few years, investors should focus on the front end of the yield curve, invest in income-producing securities, look outside the U.S. for credit opportunities and hedge against a weak U.S. dollar, according to Bill Gross, CIO of PIMCO, and his colleagues.

“The key assumption of our Secular Outlook is that following the severe shocks to the global economy in the second half of 2008, the world embarked upon a journey of change not likely to be reversed over the next few years,” PIMCO officials wrote in the firm’s third-quarter market outlook report, released in mid-July. They said the journey would be marked by “starts, stops and volatility.”

As such, the firm plans to overweight “duration” and take exposure out to the five- to 10-year part of the yield curve. “However, consistent with our Secular Outlook, we plan to also retain an emphasis on the short end of curves in the U.S., Europe and the U.K. as central banks are likely to tighten more slowly than markets expect,” the report said.

In addition, the firm plans to retain an overweight position in agency mortgages but at lower levels than earlier in the year; PIMCO also will trim its holdings of corporate bonds in the financial sector while retaining a focus on industries such as pipelines, utilities, telecoms and energy companies—sectors that exhibit, in PIMCO’s words, “defensive characteristics and assets that provide strong collateral.”

PIMCO managers also expect to maintain their municipal bond positions focused on longer maturities, “which currently offer the most attractive relative value after recent gains,” the report said.

Finally, the firm is focusing on the currencies of emerging markets like Brazil and Mexico. “In light of an expected long-run erosion in the value of the U.S. dollar, PIMCO will look to take positions in select emerging market currencies that we believe have the most compelling appreciation potential.” the report said.