National Investment Services

Client Focused | Flexible Solutions | Consistent Results

FIRST QUARTER 2024 INVESTMENT REVIEW

FIXED INCOME OVERVIEW

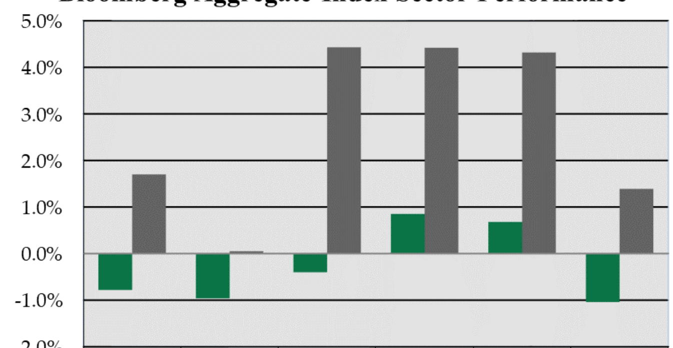
Not surprisingly, the Bond Market gave back some of its blistering performance from late last year. Federal Funds rate cut expectations got ahead of reality as inflation remained above the Federal Reserve's comfort level, thus pushing yields higher over the quarter.

The Bloomberg Aggregate Index lost almost 1% in the quarter, led lower by longer duration securities such as 10+ yr. holdings were down 2.44%. Treasuries and Agency MBS were the laggards, as credit performed relatively well. Corporate bonds within the index were down 0.40%; however, ABS and CMBS index names bucked the trend and finished up 0.68% and 0.85%, respectively. The Bloomberg Intermediate Govt./Credit Index ended down 0.15%, but the short duration Bloomberg 1-3yr. Govt./Credit Index finished up 0.42%.

ARTICLE HIGHLIGHTS

- Longer duration securities lagged
- Credit spreads continued to grind tighter
- Resilient Economy
- Inflation is slowing

Bloomberg Aggregate Index Sector Performance



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q1' 24	-0.78%	-0.96%	-0.40%	0.85%	0.68%	-1.04%
Last 12 Mo.	1.70%	0.05%	4.43%	4.42%	4.32%	1.39%

Source: Bloomberg

For the latest on NIS happenings and firm updates

SCAN IT & GO

777 E Wisconsin Ave
Suite 2350
Milwaukee, WI
53202

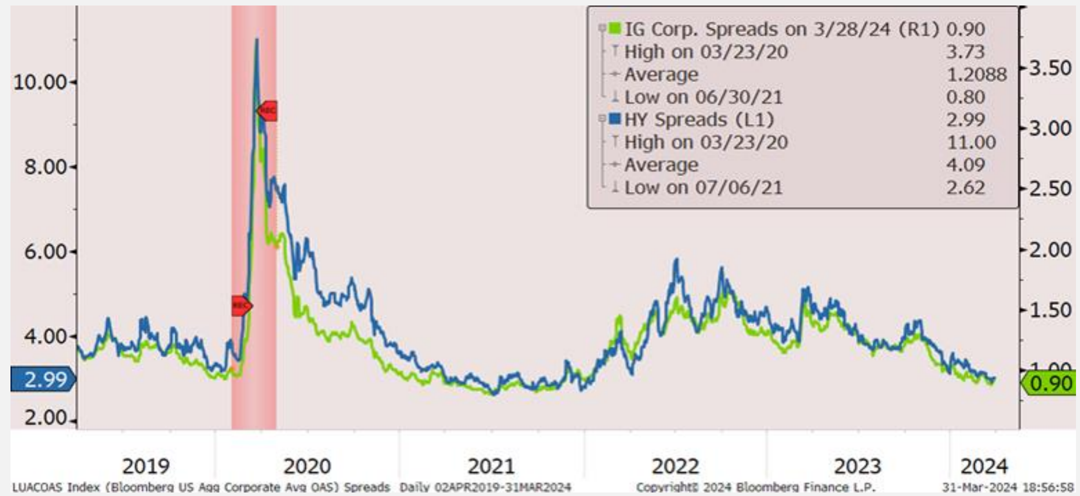
Phone:
414.765.1980

CHICAGO
MILWAUKEE

CREDIT SPREADS

Investment-grade corporate credit spreads (green line) again tightened as the U.S. economy showed signs of steadiness, if not a bit of re-acceleration. IG spreads finished the quarter at 90bps after starting at 99bps. High Yield bonds also enjoyed a strong showing, as spreads in this area rallied 24bps to close at 299bps. The chart to the right shows that the markets are trading close to longer-term tight levels, which seems to leave little room for negative earnings, guidance headlines, or general economic weakness.

Credit Spreads



Source: Bloomberg

THE ECONOMY

Resilient is perhaps the best word to describe the current state of our domestic economy. Employment remains strong, consumers continue spending, and manufacturing and services data are moving forward. We note some signs of a slight easing in the tightness of the labor market. The unemployment rate rose to 3.9% in February from 3.7% in January and a low of 3.4% in April of last year. The number of job openings, while still elevated, has fallen from a peak of 12.2 million in March 2022 to 8.9 million in January 2024. Meanwhile, GDP growth reaccelerated on a strong consumer that seems willing to spend even with higher prices. The "soft" or "no-landing" camp looks correct for now, and even the Cleveland Fed Probability of Recession interest rate/GDP model appears to be rolling over but is still very elevated.

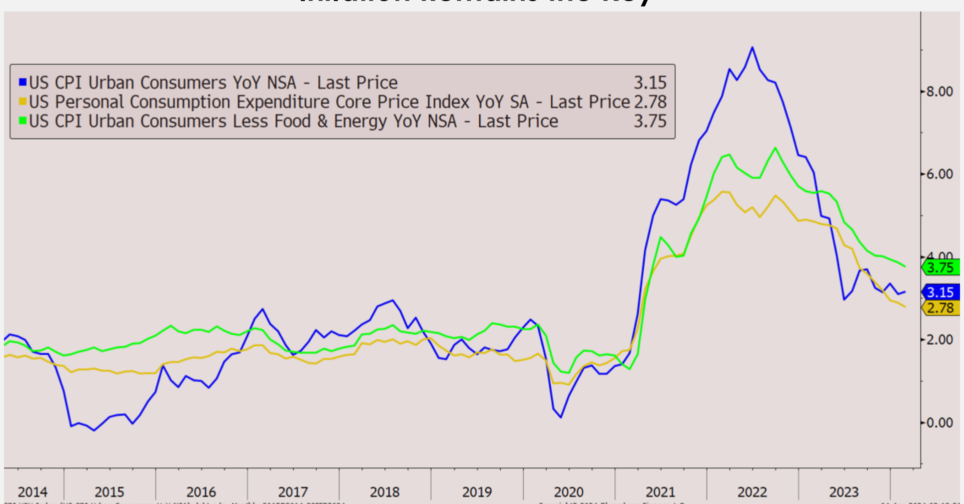
Cleveland Fed Probability of Recession

Source: Federal Reserve Bank of Cleveland, Bloomberg

FISCAL AND MONETARY POLICY

Speaking of interest rates, the Fed Funds Futures market began the year thinking there would be several rate cuts totaling 150 basis points in 2024. Headline CPI has remained in the low 3% area, driven mainly by stickiness in the services area, but most importantly, the data was above market expectations. The Core PCE, the Federal Reserve's preferred inflation gauge, just registered a 2.8% reading, which aligns with the prior month. The Fed finds itself in a tricky spot, as they seemingly do not want to stay hawkish at the risk of a significant slowdown. With employment buoyant and inflation still uncomfortable, we cannot see the justification for a near-term cut. We are also keeping an eye on the U.S. fiscal deficit and its overall relationship to GDP. It does not seem like too many people are worried about it. Still, it might be another reason interest rates remain elevated, given supply realities and demand concerns. Ultimately, this reality will take a while to play out, but the bottom line is that the U.S. Government has borrowed and not collected much money over the last five years. This approach cannot go on forever.

Inflation Remains the Key



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Bloomberg

SECOND QUARTER STRATEGY

While inflation is slowing we are not in the camp that it will drop enough and soon enough to move rates meaningfully lower. We are therefore, a touch lower than the indices regarding duration. We have been increasing duration on rate selloffs, taking off a larger duration underweight. The inverted yield curve has been moving closer to normal, and we are underweight the long tail in anticipation of an eventual steepening.

We remain constructive on corporate credit despite record issuance/supply to start the year, as demand appears very strong as pensions, asset managers, and insurers all seem willing to buy at current yield levels. Opportunities to find value are becoming difficult, and we are reticent to move down in quality in an attempt to add yield. We will keep credit quality steady or move up in quality modestly while minimizing our yield give-up. This means a continued overweight in Utilities and favoring less cyclical names. Within ABS, the preference for higher-quality issuers remains across the sector, but there is potential for volatility in the second half of the year. Non-Agency CMBS has outperformed YTD after significant underperformance in 2023. We believe spreads are now roughly fair to corporates with supportive technicals and low dealer inventories. Fundamentals for most sectors are doing reasonably well, with some pockets of weakness, as always, but nothing broadly concerning, with office properties the notable exception. A major wild card for all commercial real estate is the path of interest rates. The longer rates remain this high or higher, the more stress faced by borrowers looking to refinance and the more pressure there is on asset valuations.

Mark R. Anderson, CFA
Chief Strategy Officer