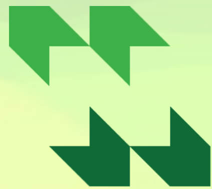

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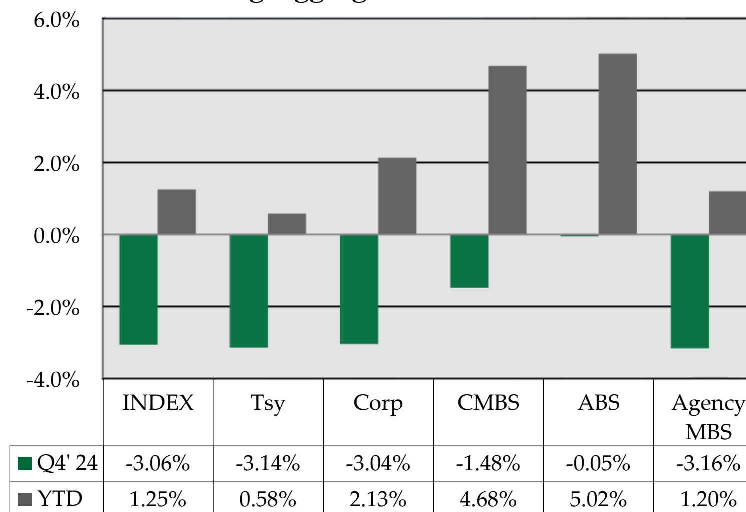
FOURTH QUARTER, 2024 ***Investment Review***

FIXED INCOME OVERVIEW

The bond market struggled near the finish line but managed low single-digit gains on the year. The Bloomberg Aggregate Index paid the duration penalty as investors eschewed duration. It lost 3.06% in the final quarter to finish the year up only 1.25% despite a relatively robust market for credit risk-taking throughout the year. The Bloomberg Intermediate Govt./Credit Index finished down 1.6%, and the short-term Bloomberg 1-3 year Govt./Credit Index broke even with a return of -0.02% for the fourth quarter, with all marketplace areas finishing lower. While duration was a key determinant of overall performance, it is worth noting that the CMBS and ABS sectors performed relatively well, and our sector overweight in these areas helped many portfolios' overall efficiency. Sticky inflation and policy uncertainty are not going away, and this past quarter was a stark reminder of this for all.

Article highlights

- Yields Rise on a Fed Surprise
- Inflation Remains Sticky
- Resilient Job Market
- Continued Cautious Positioning

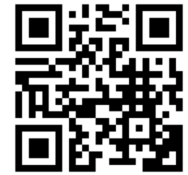


Bloomberg Aggregate Index Sector Performance

	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q4' 24	-3.06%	-3.14%	-3.04%	-1.48%	-0.05%	-3.16%
YTD	1.25%	0.58%	2.13%	4.68%	5.02%	1.20%

Source: Bloomberg

For the latest on NIS happenings and firm updates



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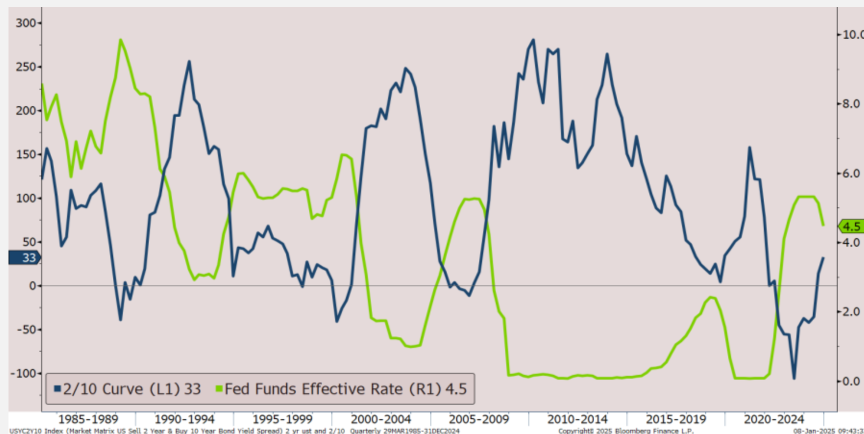
Interest Rates

Bond yields moved notably higher after the Fed cut their benchmark lending rates again. The cautionary tone around future easing spooked the market as inflationary readings remain above the Fed's apparent comfort level while the labor market maintained its strength. Yields on the very short end of the curve remained anchored but rates jumped higher out the curve. 2-year yields moved up 60bps to almost 4.25%, while the 10-year moved up 79bps to close the year at 4.57%. It is interesting to note that since the early 1980's the yield curve tends to steepen as the Fed cuts rates. We feel there is more steepening to come.

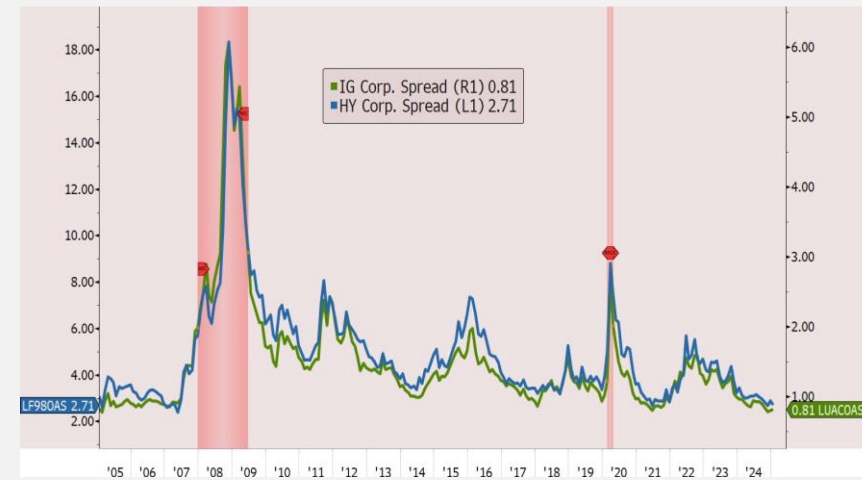
2/10's Treasury Curve



Source: Bloomberg

Corporate bond valuations remain stretched as both investment grade and high-yield bond spreads rebounded after some election-related uncertainty. However, high corporate margins and a relatively strong economy underpin the fundamentals. The technical backdrop has also been impressive, with new issue supply being met with robust demand. Higher all-in yields are also attracting international buyers. Overall, investment grade and high-yield corporate bond spreads are trading near multi-decade tights.

Bond Spreads

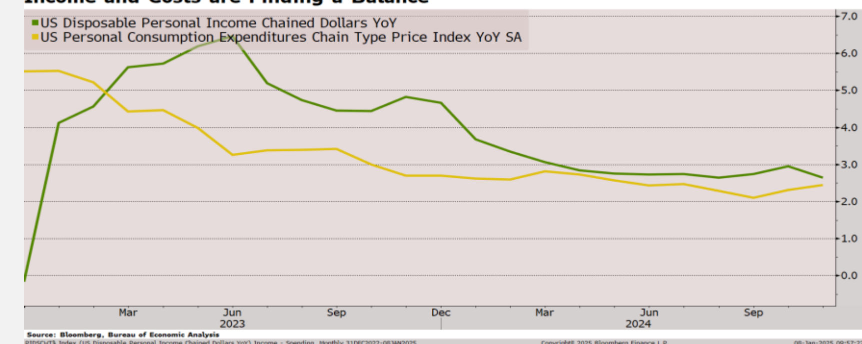


Source: Bloomberg

Employment & the Economy

We concede that the labor market is moderating but not as fast as many expected. Non-farm payroll readings continue to hover around 200k jobs added monthly, down from about 250k a year ago. Job openings per unemployed remain above one or more, which aligns close to its longer-term average. However, consumers seem to feel good about their prospects and continue spending as retail sales in the upper 3% area year-over-year indicate.

Income and Costs are Finding a Balance

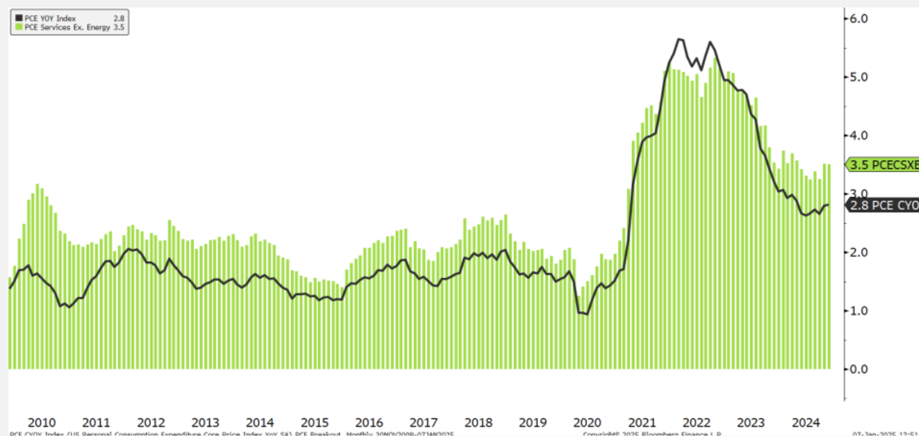


Source: Bureau of Economic Analysis, Bloomberg

According to the Bureau of Economics of Analysis, Americans have been enjoying a balance between income and costs, and the risk markets have responded accordingly. While we recognize this reality, we also know that the recovery has not been equal for all. We closely monitor consumers' health via Credit Card and Auto debt metrics. Although delinquencies have ticked up in both areas year over year, they remain well below GFC highs and look very manageable within the issuers which we invest.

FIRST QUARTER, 2025 STRATEGY

Inflation remains the sticky wicket in the Fed's balancing act. The recent uptick in Consumer prices has been met with similar readings within Personal Expenditures and calls into question the entire thesis of declining inflation. We are also witnessing an acceleration of the ISM Prices Paid Index to levels last seen in early 2023.



Source: Bureau of Economic Analysis, Bloomberg

The market is still trying to come to reality with higher than expected inflation, a less certain Fed, and unknown trade policies. Unfortunately, we are not predicting quick resolutions to any of the above issues. Our cautious stand on spread levels going into Q4 was somewhat rewarded as spreads widened to close out 2024. However, the move was not dramatic, and with continued heavy supply, we maintain our near-term caution heading into Q1 2025. If heavy supply creates additional headwinds, we expect to become more opportunistic during the quarter as fundamentals and the technical backdrop in corporate credit remain sound. We also believe longer-duration corporate credit has become marginally more attractive as 10/30's corporate credit curves have steepened during Q4. Coupled with higher Treasury yields, we anticipate that "yield" buyers will be back, providing some opportunities in longer duration corporate credit during Q1 2025.

Meanwhile, the tone remains positive in ABS, with a robust new issue pipeline meeting strong demand. With most spreads tight, we prefer to go down the capital structure for value but stick to more experienced, liquid issuers. Following the recent rally in corporates, structured products appear relatively cheap, and we are comfortable with our overweighting in the sector.

Mark R. Anderson, CFA
Chief Strategy Officer

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