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MONTHLY FIXED INCOME MARKET UPDATE

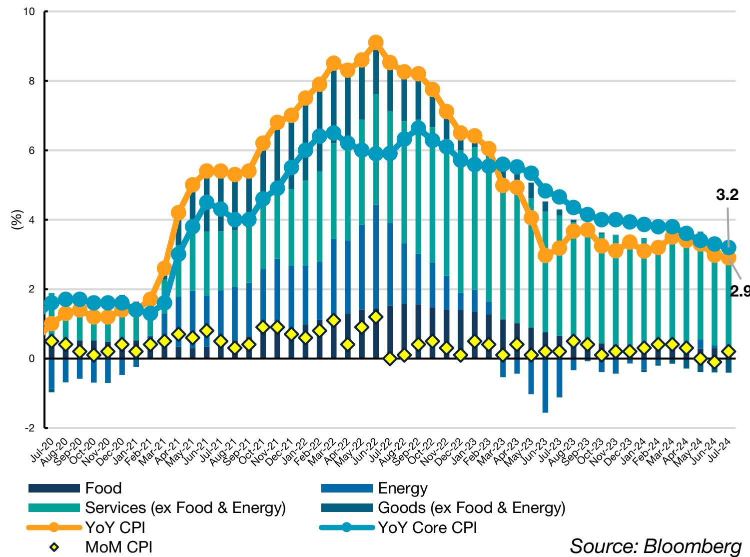
As of August 31, 2024

Key Takeaways

1. Treasury yields decreased across the curve in August as inflation continued to trend downward and markets absorbed dovish comments from Federal Reserve Chair Jerome Powell.
2. The Consumer Price Index and Personal Consumption Expenditure Index figures for July came in below 3%, indicating slow but fairly steady progress for the Federal Reserve (the Fed) despite the bump in household spending.
3. With inflation seemingly in an acceptable place, the Fed has grown more attentive to the other arm of their dual mandate – the labor market. Employment data could well determine the magnitude of the first rate cut.

The Month in Charts

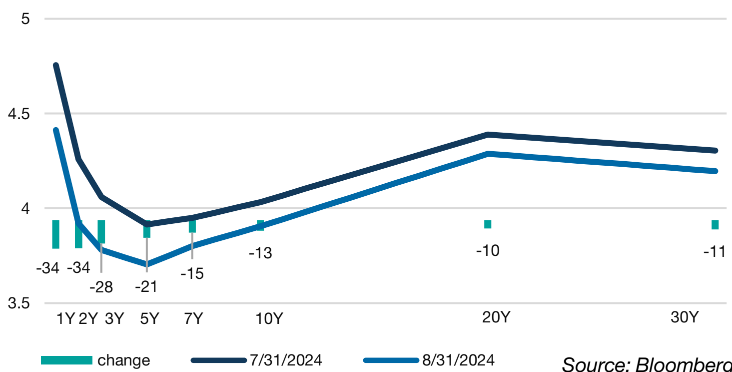
July CPI, reported in August, came in barely under 3% right before Chairman Powell was slated to speak at Jackson Hole. A positive omen for the economy at large and particularly for those focused on the outcome of the next Federal Open Market Committee (FOMC) meeting. Inflation appears to be slowing consistently, and to quote Powell, "the time has come" for rates to decrease. This sentiment echoed through markets allowing for renewed focus from market participants on how labor market data will factor into the FOMC's decision to cut in September. Incoming labor market data will impact how aggressively the Fed lowers rates.



Source: Bloomberg

The Treasury yield curve moved down across all tenors as markets reacted to Chairman Powell's signals at Jackson Hole that a rate cut is coming. While magnitude is somewhat debated, markets have begun pricing in future cuts with some confidence, causing yields to drop.

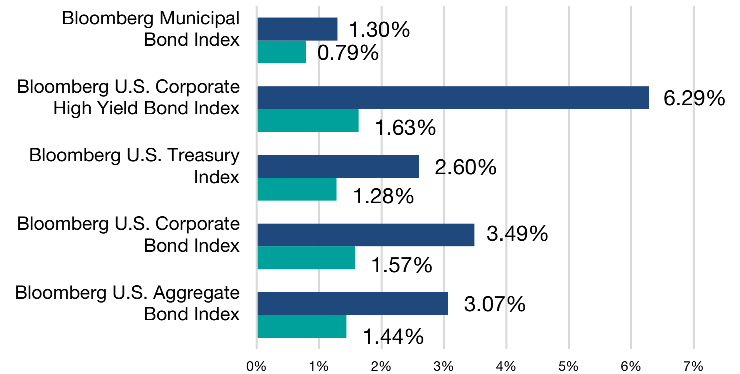
US Treasury Yield Curve



Source: Bloomberg

Bonds rallied notably this month amidst volatility in the equity markets. The drop in yields caused by dovish commentary from the Fed and investors pricing in a rapid series of rate cuts drove positive performance across indices.

Returns (%) for Fixed Income Indices



Performance as of August 31, 2024 ■ Year to Date ■ Month to Date

Past performance is no guarantee of future results. *Source: Bloomberg*

Credit spreads tightened across most fixed income classes in August. Investment grade spreads were 1 bps tighter, while high yield spreads narrowed 12 bps.

Asset Class	Yield	Spread	Qtrly Trend	Quarter		Change		
				Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	3.96							
U.S. MBS	4.67	39		38	49	-5	-11	39
U.S. Corporate	4.94	92		86	110	-1	8	92
U.S. Corporate High Yield	7.52	302		296	380	-12	-4	302
CMBS	4.84	98		95	104	-1	4	98
ABS	4.65	63		54	65	6	11	63
A	4.81	80		74	98	-1	7	80
BBB	5.17	115		107	134	-1	9	115
BB	6.14	176		168	242	-12	-7	176

Source: Bloomberg; Asset Classes represented by: ICE BofA US Treasury & Agency Index, Bloomberg US MBS Index, Bloomberg US Agg Total Return Value Unhedged USD, ICE BofA US High Yield Index, ICE BofA US Fixed Rate CMBS Index, ICE BofA US Fixed Rate Asset Backed Securities Index, Bloomberg US Agg A Total Ret Index, Bloomberg US Agg Baa Total Ret Index, Bloomberg Ba US High Yield TR Index. MoM/QoQ/YoY as of 08/31/2024

Bonding over Bonds

Our video series on the fixed income markets

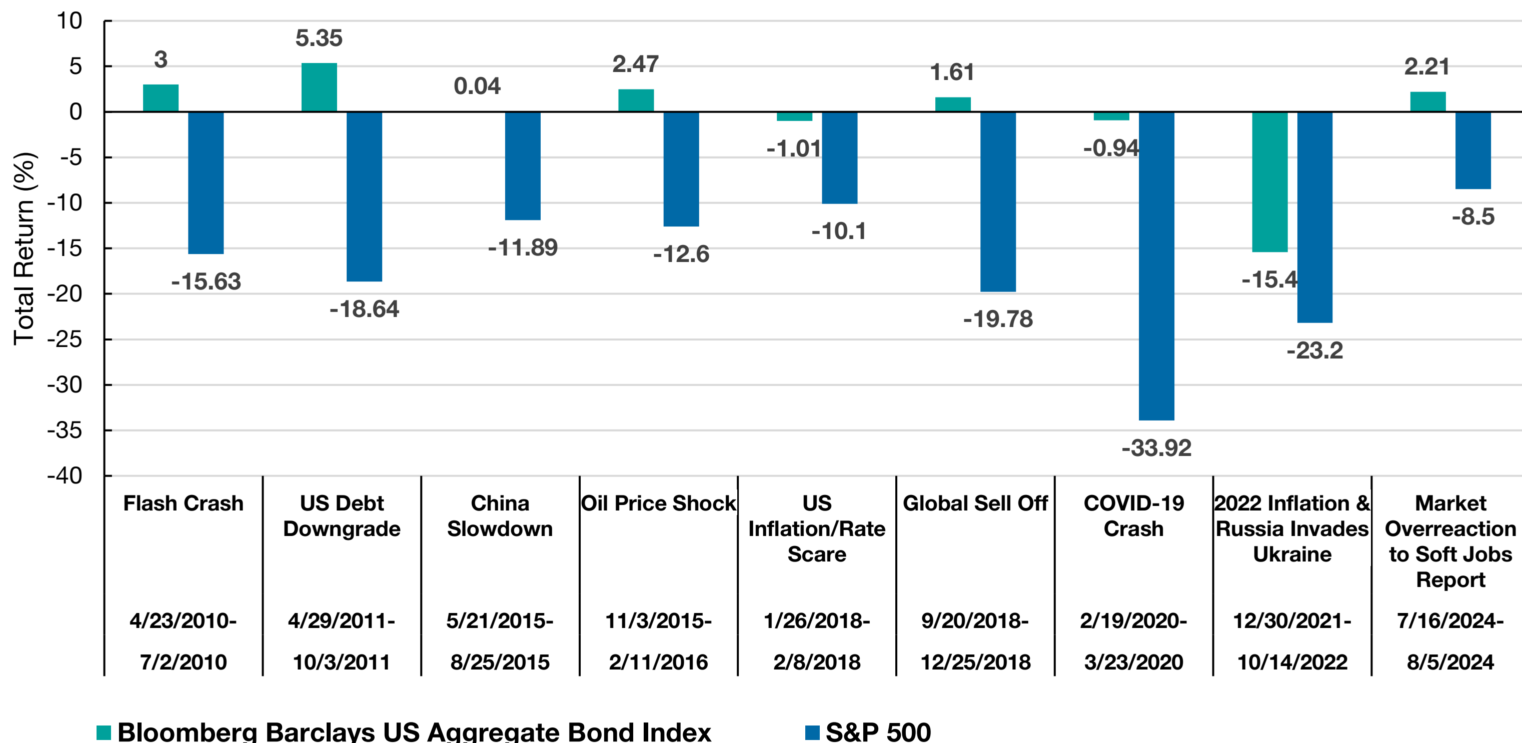
In our #BondingOverBonds video series, experts discuss notable activity in the fixed income markets: Watch Now

Our Current Thinking

Bonds rallied in August on expectations that the Federal Reserve will cut rates beginning in September and continue to cut at a brisk pace. There is a risk that traders are overeager – interest rate futures are showing that they expect the Fed to cut rates by more than 2% in the next twelve months. A shift like that in monetary policy has historically been driven by an economy in recession, which doesn't entirely align with the resilience we have been seeing in the U.S. economy. To reiterate a core tenet of our investment philosophy, forecasting interest rates is a fool's errand and, in our view, an unreliable way to generate consistent alpha.

Something we would like to remind investors of that may have gotten lost amidst the flash crash in early August and the rallying cries for rate cuts is this: **Bonds are back as ballast.**

Recency bias from the past few years may have made investors wary of bonds ability to hedge stock market downturns, but this August served as a reminder to investors that 2022 was an outlier. Of course, fixed income is still a risk asset[1] and there are no guarantees, but this month's results may assuage the concerns of investors that have been holding out for fear that 2022 was the new normal.



[1]A risk asset is a broad umbrella term used to describe any financial security or instrument that is not risk-free and may fluctuate in value.

Source: Bloomberg

What We'll Be Watching in the Month Ahead

We will be watching the economic health indicators, inflation, and the following in the month to come:

- **September 6th, the next Nonfarm Payrolls and Unemployment Rate**: These reports will be critical inputs for the market and Fed, as they are likely to impact the magnitude of future rate cuts.
- **September 11th, the next CPI will be released:** This report will offer insight into whether inflation is continuing to moderate and moving towards the Fed's 2% target.
- **September 18th, the next FOMC meeting:** We, like the market at large, expect the Fed to reduce rates at this meeting. We also expect the press conference following may offer more information on the decision and what the Fed may do in the future.

All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class. Interested parties are strongly encouraged to seek advice regarding the best options for their particular circumstances from qualified tax and financial experts.

The opinions are as of the date noted and are subject to change at any time due to changes in market or economic conditions.

Index returns are provided to represent the investment environment during the periods shown. Index performance includes reinvestment of dividends and other income. Index returns do not include transaction costs, management fees or other costs. Non-US indices are net of withholding taxes, if any.

Basis point "bps" is 1/100th of a percentage point. **Credit spread** is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury. **The Treasury Yield Curve** shows the relationship between the US bond yield and the time to maturity. Yield and price have an inverse relationship. As the yield curve lowers, the price of bonds increase. **Tenor:** the length of time until a debt is due. **Core CPI:** CPI excluding food and energy. **Consumer Price Index (CPI),** a popular measure of inflation and deflation calculated by the Bureau of Labor Statistics, measures the monthly change in prices paid by U.S. consumers. **Personal Consumption Expenditure Price Index** is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services and is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

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