Monthly Fixed Income Market Update

VICTORY income investors®
A VICTORY CAPITAL® INVESTMENT FRANCHISE

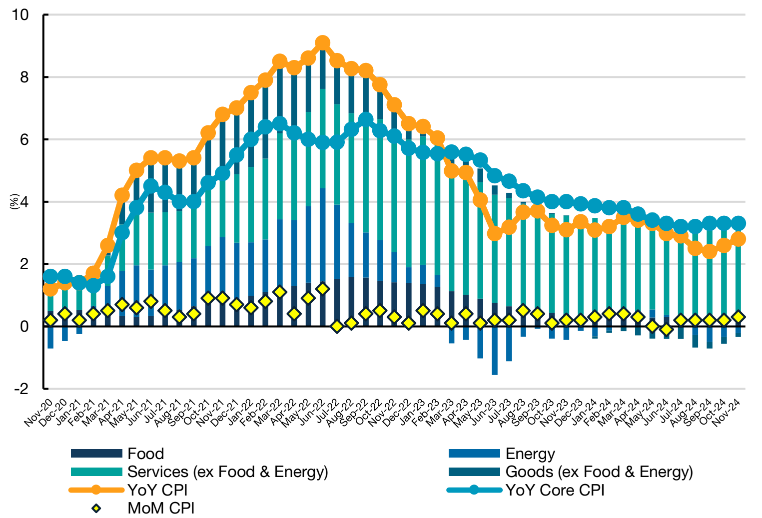
As of December 31, 2024

Key Takeaways

1. Fixed income yields increased in December, driving negative performance across indices for the month. Year-to-date fixed income performance was positive through the end of 2024.
2. As expected, the Federal Reserve (the Fed) reduced rates in December by 25 bps. This brings the Fed Funds Target Range to 4.25%-4.50%, but the future of rate cuts has become more unclear.
3. How should you think about future rate cuts? Market pricing has a spotty record.

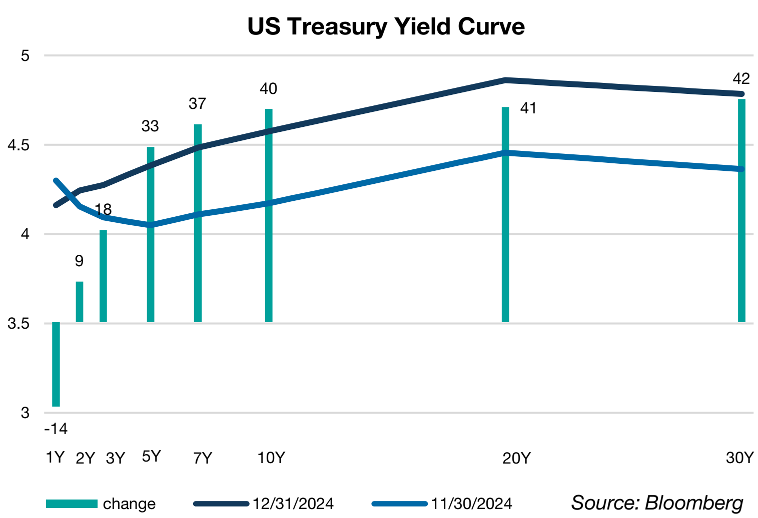
The Month in Charts

November CPI, reported in December, was 2.8% year-over-year and Core CPI was 3.3% year-over-year. The Fed cut rates in December as markets expected, however, made clear in the press conference following the rate decision that they will be more cautious in 2025. The soft-landing narrative continues to prevail over recessionary forecasts despite increased uncertainty surrounding future monetary policy.



Source: Bloomberg

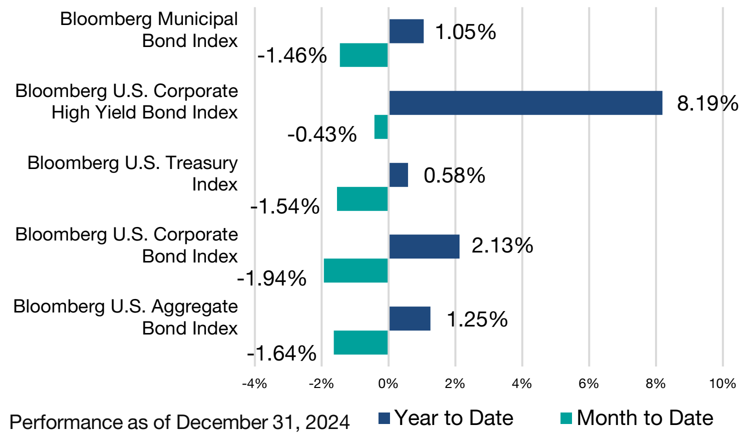
The short end of the Treasury yield curve disinverted in December and rose across most tenors in response to additional uncertainty surrounding inflation and increased Fed caution. Rising long-term yields and continued monetary policy easing pushed the 10yr-3m spread into positive territory for the first time in two years.



Source: Bloomberg

Performance was negative across all indices in December as yields crept upwards, but year-to-date performance was positive for fixed income.

Returns (%) for Fixed Income Indices



Performance as of December 31, 2024

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

Credit spreads widened slightly in December. Investment grade spreads were 2 bps wider and high yield spreads widened 23 bps.

Asset Class	Yield	Spread	Qtrly Trend	Quarter: Tight	Quarter: Wide	Change: MoM	Change: QoQ	Change: YoY
U.S. Treasury	4.45							
U.S. MBS	5.27	43		38	49	2	1	-3
U.S. Corporate	5.34	80		74	87	2	-8	-19
U.S. Corporate High Yield	7.64	287		253	299	23	-12	-35
CMBS	5.19	81		80	94	-4	-13	-45
ABS	4.73	43		42	64	-2	-20	-25
A	5.23	70		63	74	3	-5	-17
BBB	5.55	101		94	111	3	-11	-22
BB	6.51	179		149	184	20	-1	-22

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 12/31/2024

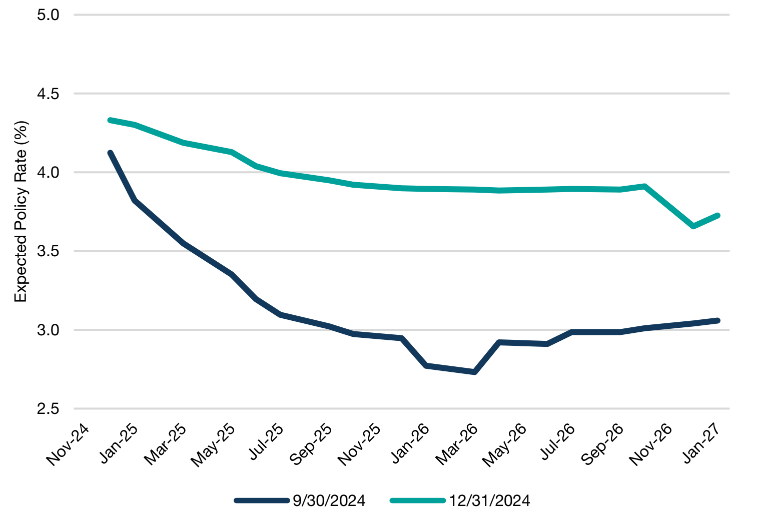
Bonding over Bonds

Our video series on the fixed income markets

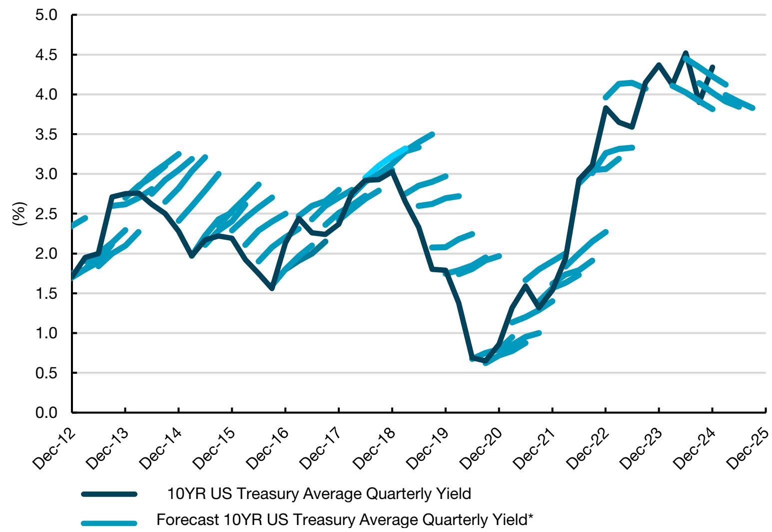
In our #BondingOverBonds video series, experts discuss notable activity in the fixed income markets: [Watch Now]

Our Current Thinking

Amidst the strong economic backdrop and markets factoring in the potential inflation risk future policies may bring, investors might be wondering who they should listen to about the future of monetary policy. In our view, forecasting interest rates is incredibly difficult and even experts are frequently wrong. As the narrative shifted away from whether the Fed will reduce rates period, there has been renewed focus and concern on the magnitude and pacing of future cuts. The Fed reduced their official dot plot forecasts from four cuts in 2025, from their September meeting to two cuts in 2025 at their December meeting. The charts below show market pricing for reductions to the federal funds rate through 2025, and the average quarterly forecast (light blue) contrasted with the average yield of the 10-year Treasury (dark blue), as forecasted by the Survey of Professional Forecasters.



Source: Bloomberg



Source: Bloomberg, philadelphiafed.org

**Mean Forecast of the 10 Year US Treasury Quarterly Average Yield from the Survey of Professional Forecasters*

Markets have priced in this slower pace of rate cuts, but for investors interested in fixed income we would advise some caution in how you let this affect your portfolio. We believe sticking to a long-term investment strategy that matches your risk appetite is a more prudent management approach than attempting to strategically forecast rate movements.

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:

- **January 8th, the Nonfarm Payrolls and Unemployment Rate:** These reports will be critical input for the Fed in assessing the health of the labor market and help inform future rate reductions.
- **January 15th, the next CPI will be released:** This report will offer insight into whether inflation remains somewhat sticky or is moving towards the Fed's 2% target.
- **January 29th, the next FOMC Rate Decision:** The market is less certain that the Fed will cut at this meeting and expects rate cuts to slow in 2025. We expect that the press conference will provide further insight.

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. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

Index performance includes reinvestment of dividends and other income but does not reflect management fees, transaction costs or expenses. One cannot invest directly in an index. **Past performance does not guarantee future results.**

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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