Monthly Fixed Income Market Update

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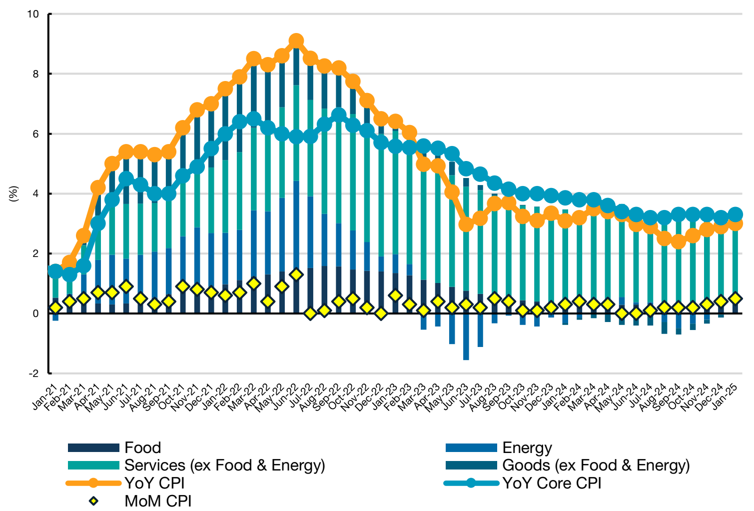
As of February 28, 2025

Key Takeaways

1. Treasury yields dropped in February as markets absorbed weaker economic data and uncertainty surrounding future inflation. The 10-year yield ended the month at 4.21%, down from January's 4.54%.
2. Forecasts for future rate cuts moved minimally despite the drop in consumer sentiment and higher inflation expectations. Markets have priced in two cuts through the end of the year.
3. Credit spreads widened for seven consecutive days into the end of February. However, they remain in the 2nd lowest decile we have seen in the past 25 years. We explore why credit spreads have widened historically.

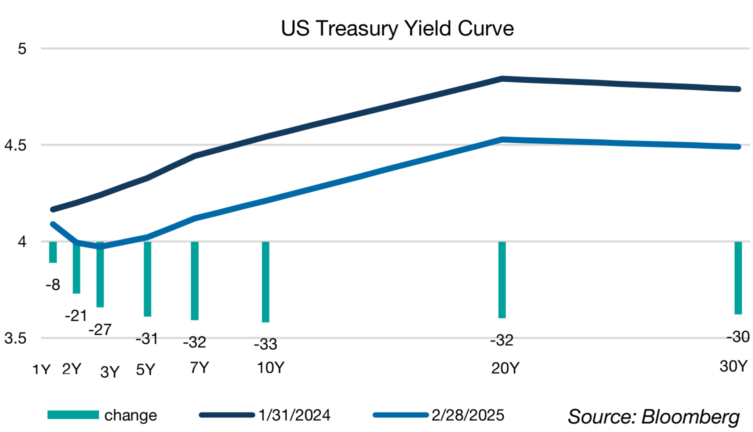
The Month in Charts

January CPI, reported in February, rose to 3.0% year-over-year and Core CPI to 3.3% year-over-year. The Federal Reserve (the Fed) did not have an FOMC meeting in February, but the minutes released from their January meeting indicate that monetary policy could remain restrictive should inflation continue to be stubborn. The Fed's preferred inflation gauge, the Personal Consumption Expenditure Index, decreased in January to 2.6% from 2.8% in December. This report boosted confidence among those expecting two rate cuts this year, but much uncertainty remains given the murkiness of future tariff policy and labor market activity.



Source: Bloomberg

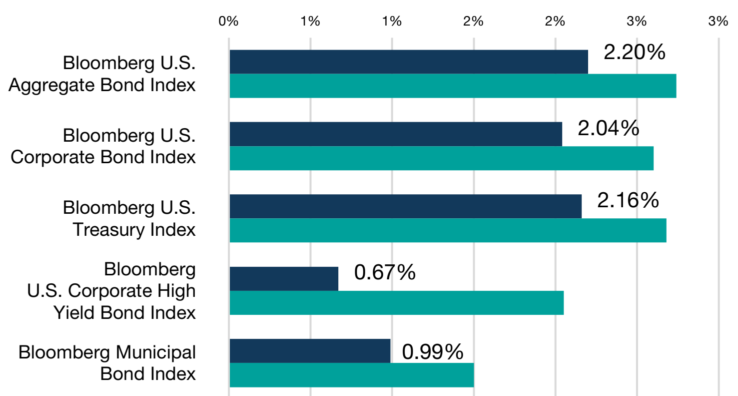
The Treasury yield curve shifted downward in February. Long-term yields decreased more relative to the front of the curve as investors look to balance weaker economic data and persistent inflation above the Fed's target.



Source: Bloomberg

Performance was positive across all indices in February as yields moved modestly downward in response to market uncertainty.

Returns (%) for Fixed Income Indices



Performance as of February 28, 2025 ■ Month to Date ■ Year to Date

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

Credit spreads widened for seven consecutive days in the last week of February but are still tight relative to historical averages. Investment grade spreads were 8 bps wider and high yield spreads widened 22 bps.

				Quarter		Change		
Asset Class	Yield	Spread	Qtrly Trend	Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	4.14							
U.S. MBS	4.85	31		31	48	-3	-10	-19
U.S. Corporate	5.09	86		74	86	8	9	-8
U.S. Corporate High Yield	7.37	283		256	287	22	18	-35
CMBS	4.86	79		76	85	2	-6	-25
ABS	4.55	50		42	50	4	5	-6
A	4.97	75		64	75	8	8	-7
BBB	5.31	107		95	107	9	9	-11
BB	6.25	177		151	179	21	18	-20

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 02/28/2025

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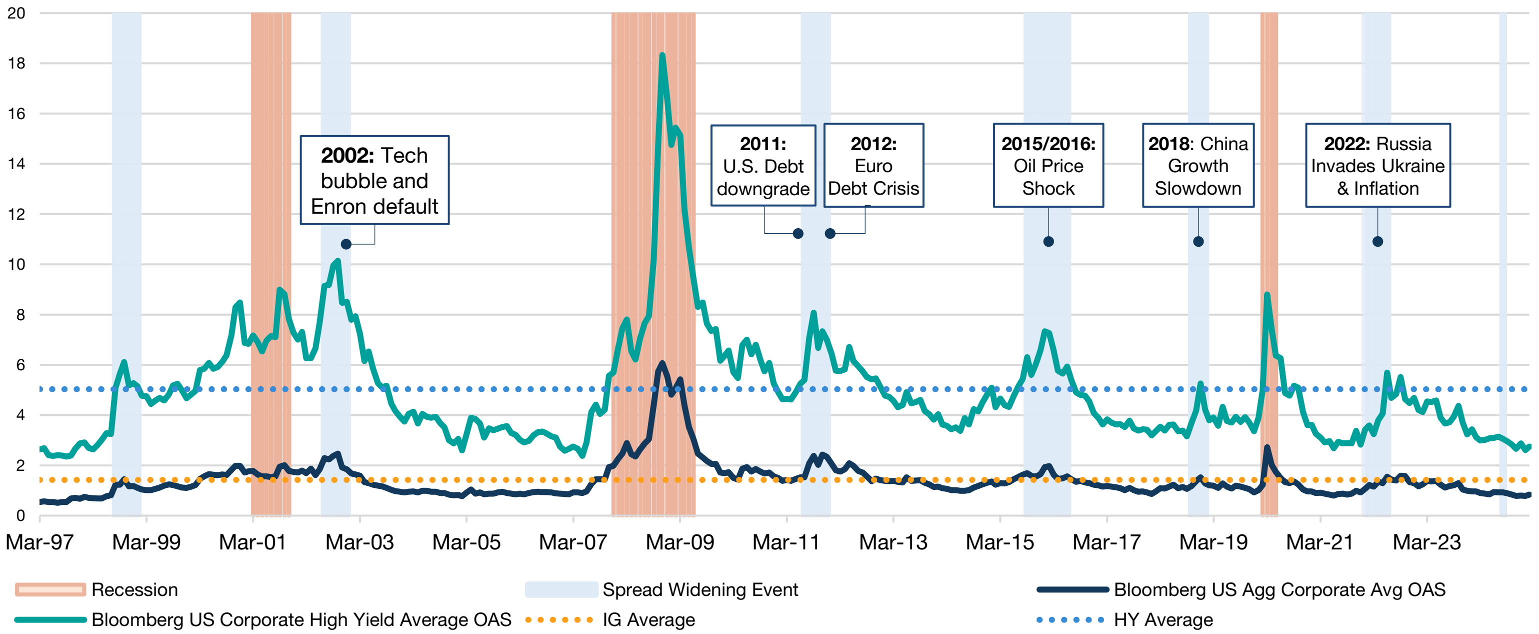
Frequently Asked Questions

As fixed income investors, we are always paying attention to the level of credit spreads. Credit spreads are the additional compensation investors receive over Treasuries to take credit risk. Tighter credit spreads generally indicate a positive outlook and vice versa. With spread volatility being stable over the past year and spread levels at or near historical lows, we've assessed that investors are not getting paid as much as they may have been historically for taking on additional credit risk. While spreads widened somewhat toward the end of the month, likely driven by lower treasury yields, the uncertain future of tariff policy and weaker economic data, they are still low relative to historical averages.

The stability of spreads at low levels has caused many investors to ask if spreads will ever widen? Based on history and movement we saw this past month, we think the answer is a definitive "yes". In the below graph we show the option-adjusted spread for investment grade and high yield corporate bonds and marked U.S. recessions and other smaller, but still material, widening events. Spread widening events occur for any number of reasons, as indicated in the graph. And the widest points across the three recessions below aren't necessarily precursors to the economic downturns but rather occur once the recession has already begun. The one commonality, in our view, for all the widening events is that the timing and magnitude of any widening is unpredictable.

With current spread levels so tight, still below the 27-year averages represented by dotted lines, it is our view that investors are pricing in a very narrow range of outcomes. The modest widening this month *might* indicate some initial cracks in the credit markets or it is simply a market reaction to lower Treasury yields. Despite tight spreads, Treasury yields remain elevated and, in our view, fixed income's role as a ballast in portfolios has been resolidified.



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:

- **March 7th, 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.
- **March 12th, 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.
- **March 19th, the next FOMC Rate Decision:** The market is not predicting a rate cut at this meeting following slower progress on inflation. 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. **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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