Monthly Fixed Income Market Update

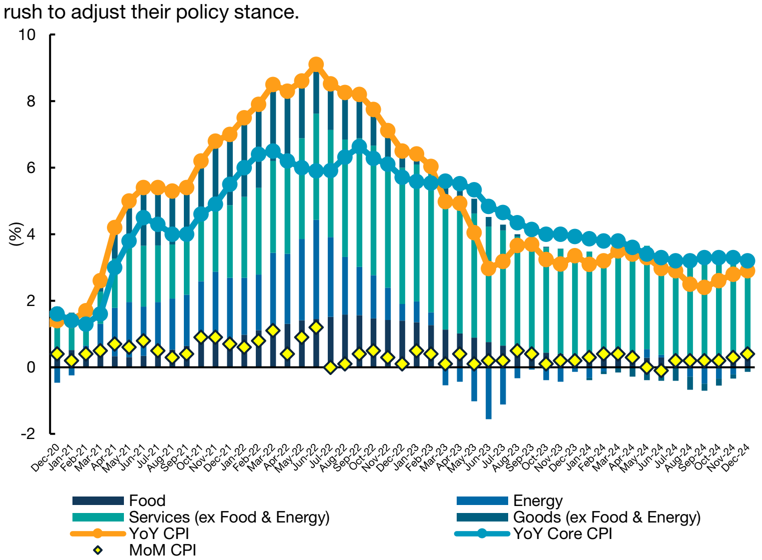
As of January 31, 2025

Key Takeaways

1. Inflation figures for December, the Consumer Price Index (CPI) and the Personal Consumption Expenditure Index (PCE), came in at expectations at 2.9% and 2.6%, respectively.
2. As expected, the Federal Reserve (the Fed) held rates steady in January, maintaining a Fed Funds Target Range to 4.25%-4.50%. The Fed emphasized the uncertain economic outlook and data dependency for future decisions.
3. Are risk markets priced for perfection? Credit spreads and equity valuations are at levels that have historically indicated lower expected returns.

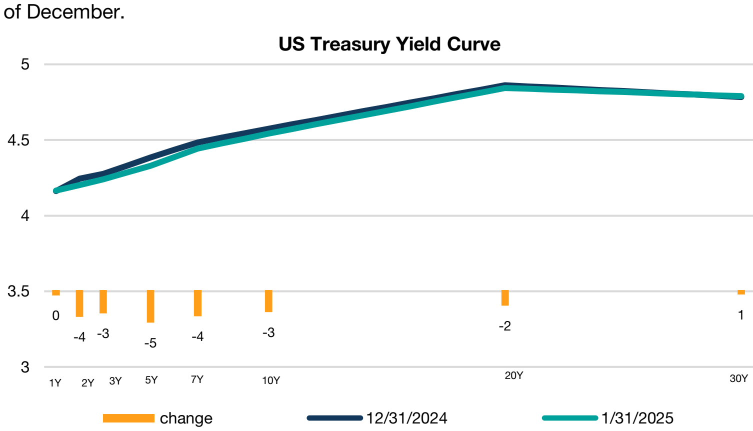
The Month in Charts

December CPI, reported in January, was 2.9% year-over-year and Core CPI was 3.2% year-over-year. The Fed did not reduce rates in January as inflation remains somewhat elevated, while the economy continues to expand at a solid pace. Payroll job gains averaged 170k per month over the past three months and unemployment is stable. In their statement following their January meeting, the Fed reconfirmed their focus on price stability and maximum employment, and bar any surprises is in no rush to adjust their policy stance.



Source: Bloomberg

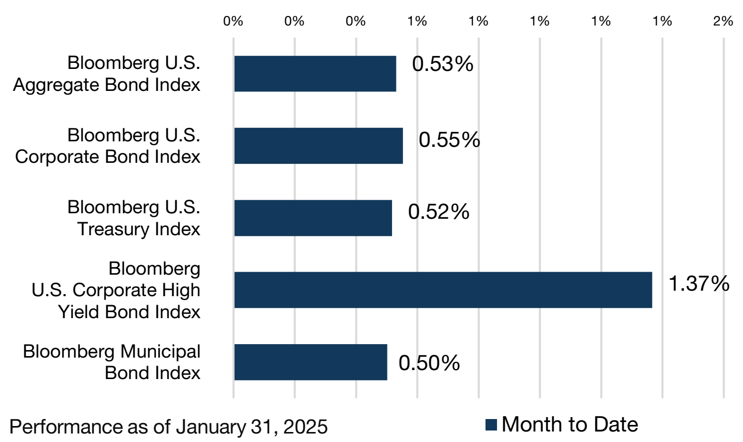
The Treasury yield curve barely moved month-over-month. The rise in long-term yields held from last month and no change to monetary policy led to little to no movement across the curve. Yields rose in the first half of the month as markets speculated on the impact of tariffs but concluded the month slightly lower than end of December.



Source: Bloomberg

Performance was positive across all indices in January as yields moved modestly downward and future policy narratives relaxed slightly.

Returns (%) for Fixed Income Indices



Performance as of January 31, 2025

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

Credit spreads tightened in January, with investment grade spreads near decade tights. Investment grade spreads were 2 bps tighter and high yield spreads tightened 26 bps.

Asset Class	Yield	Spread	Qtrly Trend	Quarter Tight	Quarter Wide	Change MoM	Change QoQ	Change YoY
U.S. Treasury	4.42							
U.S. MBS	5.19	34		33	48	-9	-14	-12
U.S. Corporate	5.30	78		74	83	-2	-5	-17
U.S. Corporate High Yield	7.41	261		253	287	-26	-22	-82
CMBS	5.12	77		76	91	-3	-15	-36
ABS	4.73	46		42	54	2	-9	-16
A	5.19	68		63	71	-2	-4	-16
BBB	5.52	98		94	105	-2	-7	-21
BB	6.30	155		149	179	-23	-18	-57

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 01/31/2025

Bonding over Bonds

Our video series on the fixed income markets

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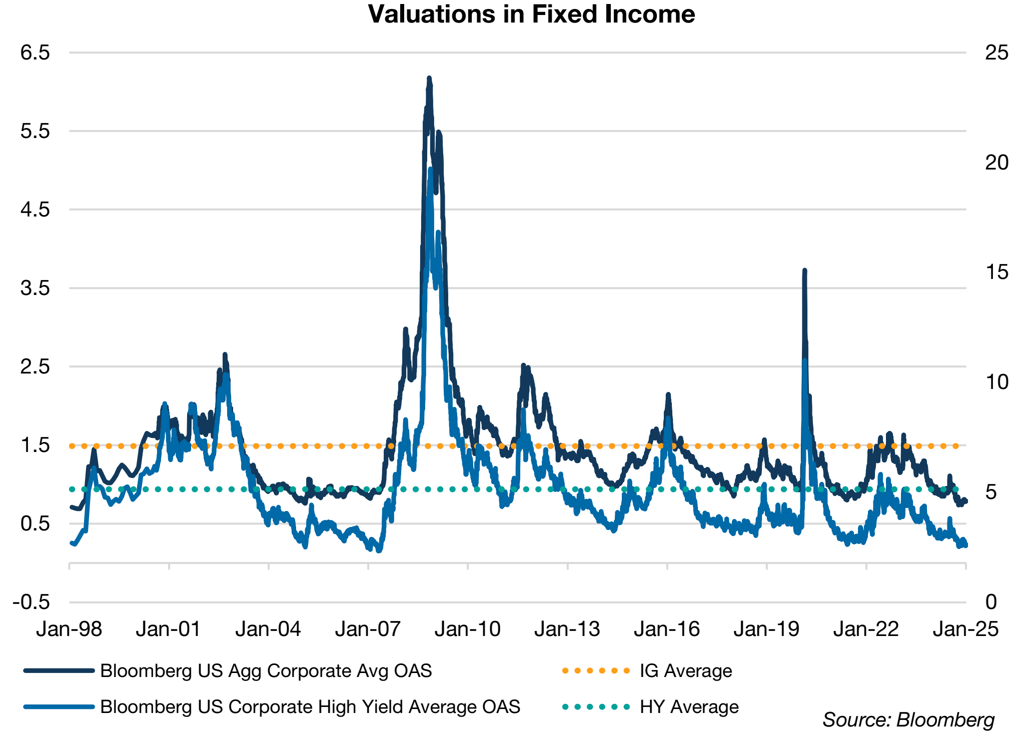
Frequently Asked Questions

As we exit the first month of 2025, inflation is still somewhat elevated but inching closer to the Fed's target, the economy continues to push forward with a solid Q4 2024 GDP reading of 2.3%, the labor market is stable, and equities reach new highs seemingly weekly. Simultaneously, we also face elevated risks of a global trade war and the uncertain impact on the global economy. Risk markets are pricing in a smooth ride, with both credit spreads and equity valuations extended relative to historical averages. What does this mean for fixed income investors?

First, we believe fixed income can serve as a ballast to your equity holdings when valuations are extended. Our analysis indicates that equity returns are weak when valuations are at this level. Second, historically when credit spreads are at this tight level, credit has underperformed Treasury securities. At the end of January investment grade credit spreads were 78 basis points over Treasuries, which our research finds has a median excess return of -1.0% over the subsequent year. The practical implication is to carefully manage the amount of credit risk in your fixed income portfolio. Third, the positive real yields in fixed income remain compelling. So fixed income can serve not only as a portfolio ballast, but as a source of returns in a diversified portfolio.

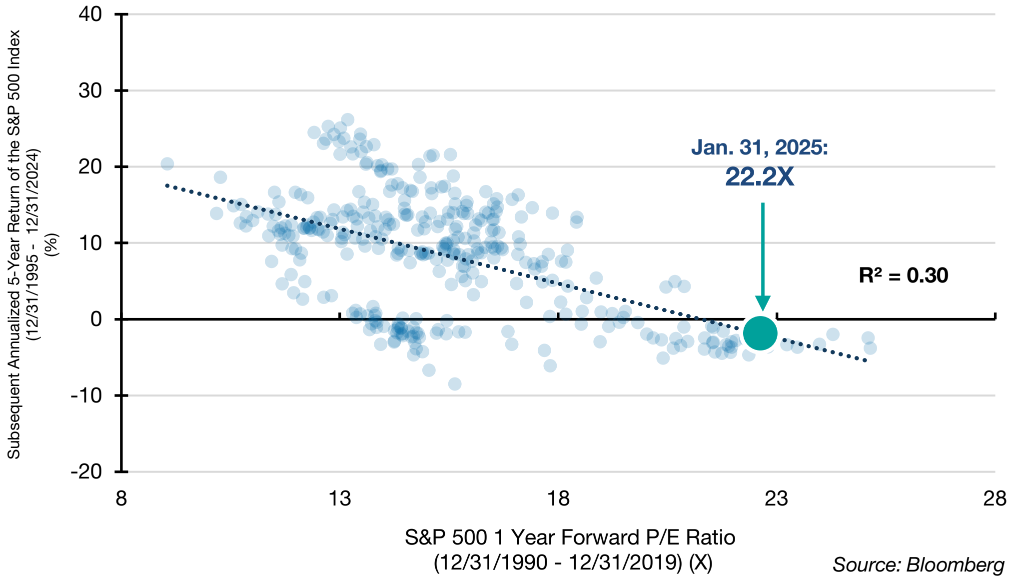


Source: Bloomberg

What We'll Be Watching in the Month Ahead

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

- **February 7th, the Nonfarm Payrolls and Unemployment Rate:** These reports will be critical for the Fed in assessing the health of the labor market and help inform future rate reductions.
- **February 12th, the next CPI will be released:** This report will offer insight into whether inflation remains somewhat sticky or is moving closer towards the Fed's 2% target.
- **February 28th, the next PCE will be released:** Like the CPI release, this report will offer additional insight into progress on inflation and may help inform the Fed's decision in March.



Source: Bloomberg

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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