MONTHLY FIXED INCOME MARKET UPDATE

VICTORY income investors®
A VICTORY CAPITAL® INVESTMENT FRANCHISE

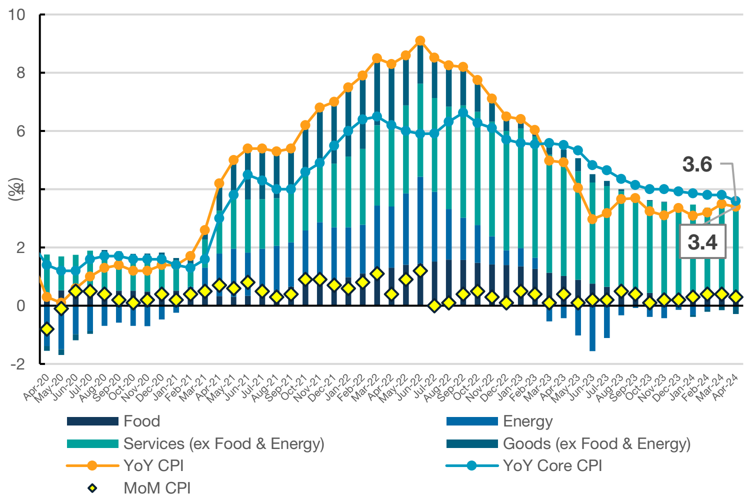
As of May 31, 2024

Key Takeaways

1. Treasury yields decreased across the curve in May. The 10-year Treasury decreased 18 basis points to end the month at 4.50%.
2. The Consumer Price Index and Personal Consumption Expenditure Index figures for April met expectations. Still higher than the Federal Reserve's (the Fed's) 2% target but indicates positive progress.
3. Market participants have solidified their position that the Fed will cut once this year following mild inflation reports, but the timing remains uncertain.

The Month in Charts

Year-over-year CPI for April came in at 3.4% driven by services inflation. This is down from 3.5% in March. Year-over-year Core CPI decreased as well, from 3.8% to 3.6%. With cooler inflation data the market is eagerly awaiting additional guidance from the Fed. In addition to CPI falling, the Fed's preferred inflation gauge PCE, Personal Consumption Expenditure Index, advanced at the slowest pace this year. While generally Fed officials agree that patience is needed going forward, i.e. they will need to see more than one month of decreasing inflation, there is still debate surrounding whether current conditions are restrictive enough to entertain easing monetary policy. Come June 11th and 12th, the next FOMC meeting, we will likely receive more information.

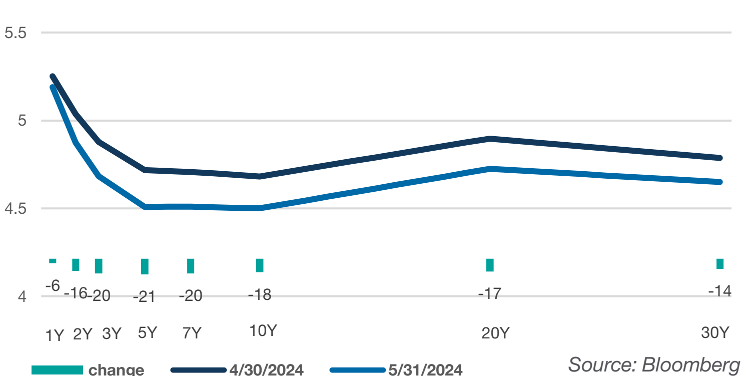


˙Basis point "bps" is 1/100th of a percentage point.

Source: Bloomberg

The Treasury yield curve dropped in May in response to softer inflation data and a cooling job market, after reaching year-to-date highs in late April. This decrease was driven by fresh data that bolstered bets that the Fed will cut at least once this year, but tempered by Fed officials' comments that more months of good inflation data are needed.

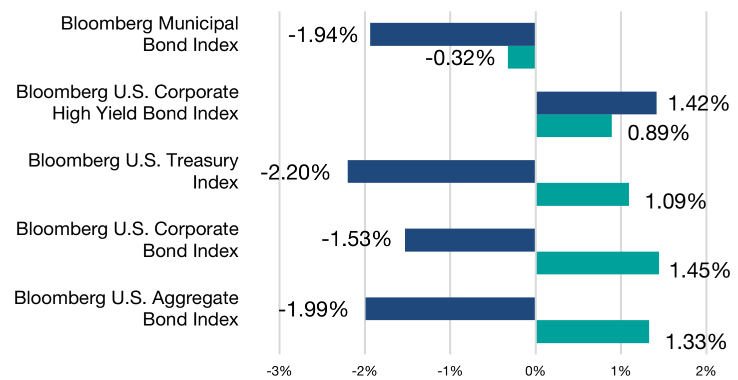
US Treasury Yield Curve



Source: Bloomberg

The downward shift in the Treasury curve resulted in positive performance across most fixed income indices for May, except for municipal bonds. U.S. Treasuries posted a gain for the second time this year in May, and the largest since the rally markets experienced in December.

Returns (%) for Fixed Income Indices



Performance as of May 31, 2024

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

Credit spreads remained tight for most fixed income asset classes throughout the month, aside from aside from high yield and ABS. Investment grade and spreads were 3 bps tighter, while high yield widened slightly.

				Quarter		Change		
Asset Class	Yield	Spread	Trend	Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	4.69							
U.S. MBS	5.34	50		42	56	-5	-1	-5
U.S. Corporate	5.52	84		84	97	-3	-12	-53
U.S. Corporate High Yield	8.18	306		288	326	6	-9	-159
CMBS	5.59	94		92	103	-5	-9	-42
ABS	5.41	52		49	56	3	-1	-25
A	5.40	73		73	84	-2	-10	-45
BBB	5.73	105		105	120	-3	-13	-62
BB	6.77	183		171	205	4	-12	-117

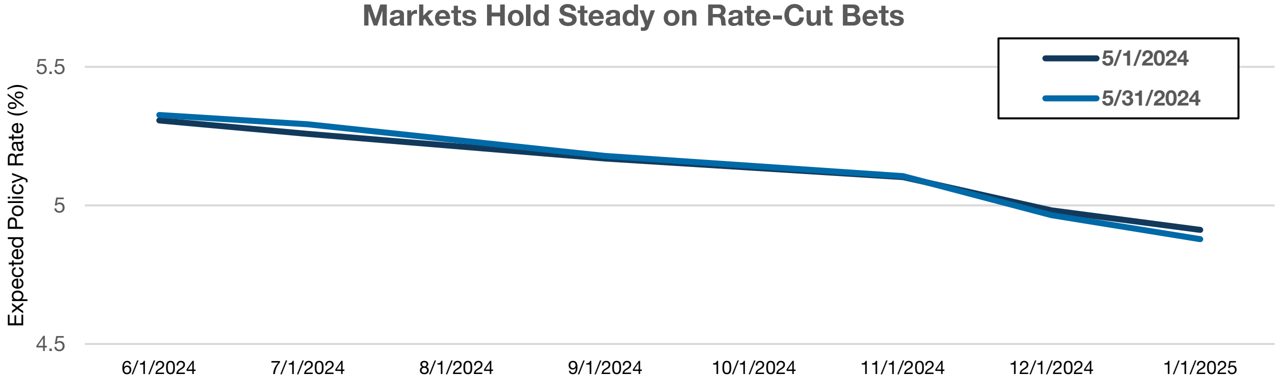
Source: Bloomberg; Asset Classes represented by: ICE BofA US Treasury & Agency Index, Bloomberg US Agg Total Return Value Unhedged USD, ICE BofA US High Yield Index, ICE BofA US Fixed Rate CMBS Index, ICE BofA US Fixed Rate Asset Backed Securities Index, Bloomberg US Agg A Total Ret Index, Bloomberg US Agg Baa Total Ret Index, Bloomberg Ba US High Yield TR Index. MoM/QoQ/YoY as of 05/31/2024

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

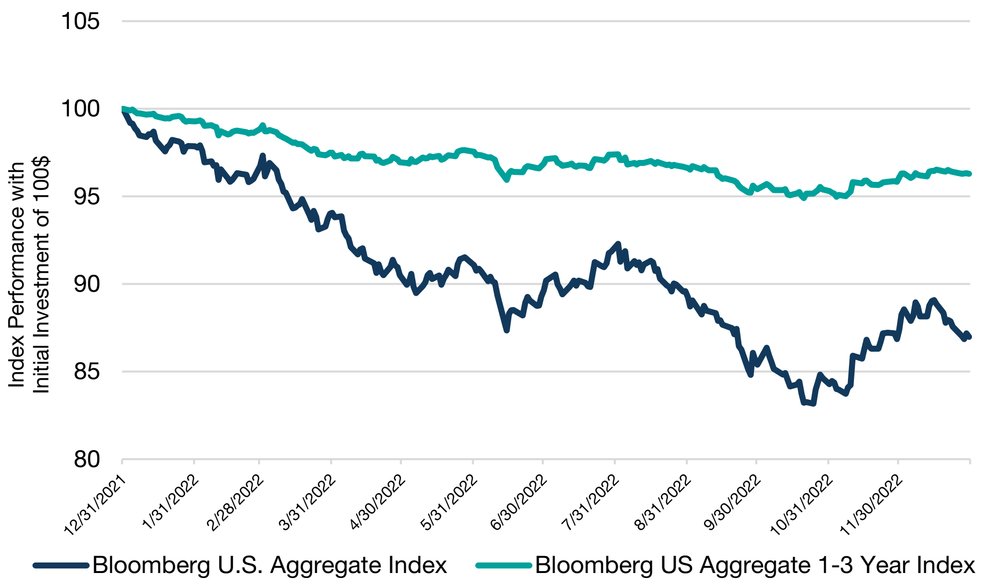
Expectations for the June FOMC meeting are no cuts – Chair Powell and committee members will likely keep the federal funds rate at a restrictive 5.25%-5.50%. Investors expect one rate cut in 2024 according to futures contracts pricing.



Source: Bloomberg

Our Current Thinking

What role should duration play in an investors fixed income portfolio? We have argued for a long time that bets on duration are an unreliable way to generate alpha. Certainly, if an investor held onto shorter term fixed income in 2022, as seen in the graph at right, they would have experienced a lower degree of loss. However, 2022 presented fixed income investors with an unprecedented hiking cycle. One could have tried to forecast the length and magnitude of what was to come next, but hindsight is 20/20. The cost of being incorrect reinforces our belief that duration exposure should be used as a form of risk management instead of an alpha generator, and it should be driven by the level of interest rate risk an investor is willing to endure. Attempting to time the market and extend duration at the perfect time is incredibly challenging and, in our view, somewhat of a fool's errand. Consider the following, a recent organizational behavior study completed by the University of California, Berkeley, examined the single longest and most complete forecasting project, the Survey of Professional Forecasters. They concluded that while forecasters report 53% confidence in their forecasts, they are only correct 23% of the time. This study covered 16, 559 predictions of unemployment, inflation, economic growth and other key economic indicators. If professional forecasters only have a 23% accuracy rate since 1968, then surely the rest of us will struggle as well. We believe that constructing a portfolio with a diversified mix of fixed income assets to meet the desired interest rate risk profile is a more sound strategy.



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:

June 7th, the next Nonfarm Payrolls and Unemployment Rate: These reports will be important data points for the market and Fed to consider prior to the June FOMC meeting.

June 11-12th, the next FOMC Meeting and rate decision: We, like the market at large do not expect a rate cut to come from this meeting, but we expect the press conference to follow may offer additional insight to what the Fed may do in the future.

June 12th, 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.

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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