# MONTHLY FIXED INCOME MARKET UPDATE

VICTORY income investors
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of May 3, 2023

## Key Takeaways

1. Compared to the several bank failures and high market volatility of March, April was quiet. Treasuries and corporate spreads remained relatively flat and carry, or the interest debtors pay on their bonds and loans, drove the positive performance of fixed income indexes.
2. Corporate earnings stayed strong and guidance for coming quarters was guarded but optimistic. S&P 500 forward earnings have come down to $219 per share from $237 as of summer 2022 but remain up from the low of $217 before Q1 2023 earnings started.
3. Against this background, The Federal Reserve ("The Fed") increased interest rates by 25 basis points ("bps") on May 3, 2023, to combat persistent inflation but hinted at a potential pause in continued rate hikes to assess any economic weakness.

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

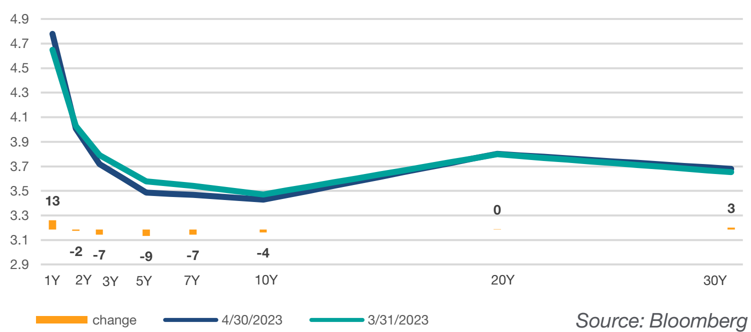
## The Month in Charts

**Spreads remained relatively flat over the month, as March's volatility faded.** Investment grade spreads were ~2 bps tighter on the month and high yield spreads were ~5 bps tighter:

| Asset Class | Yield | Spread | Trend | Quarter Tight | Quarter Wide | Change MoM | Change QoQ | Change YoY |
|---|---|---|---|---|---|---|---|---|
| U.S. Treasury | 3.79 | | | | | | | |
| U.S. MBS | 4.48 | 66 | | 36 | 69 | 3 | 25 | 25 |
| U.S. Corporate | 5.10 | 135 | | 114 | 163 | -2 | 19 | 1 |
| U.S. Corporate High Yield | 8.55 | 447 | | 384 | 516 | -5 | 26 | 69 |
| CMBS | 5.11 | 141 | | 100 | 143 | -2 | 33 | 53 |
| ABS | 4.92 | 82 | | 51 | 86 | -3 | 18 | 13 |
| A | 4.92 | 117 | | 95 | 144 | -2 | 19 | 5 |
| BBB | 5.38 | 164 | | 141 | 190 | -3 | 20 | 1 |
| BB | 6.84 | 282 | | 240 | 350 | -4 | 14 | 10 |

*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.*

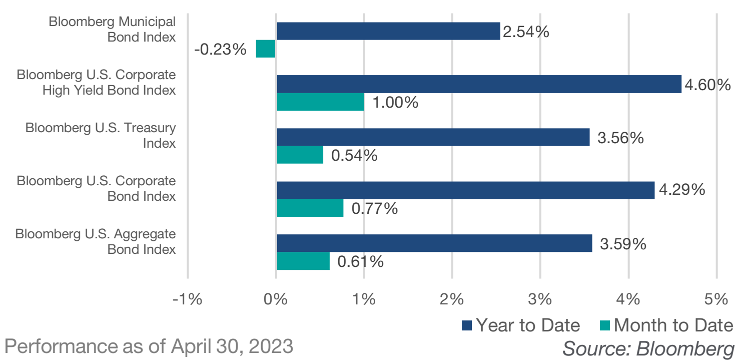
**The Treasury curve barely budged as investors watched and waited for hints on the economy's direction:**




*Source: Bloomberg*

**Most fixed income indices had positive returns.** With the Treasury curve and corporate spreads hardly moving, simple carry—again, the interest issuers pay on their bonds and loans—drove March's positive returns:

### Returns (%) for Fixed Income Indices




Performance as of April 30, 2023

*Source: Bloomberg*

## Our Current Thinking

**Shorter term instruments may pay better now, but…** Looking at the Treasury curve, above, the short end obviously offers better yield compared to longer maturities. This argues for keeping all one's fixed income holdings in a money market or short-term bond fund, right? Well, no. This is because, over the past twelve months, the market's view of where rates would peak has shifted considerably. In June 2022, the market consensus was that rates would still be below 3.5% in May 2023. Move forward a year and the Fed's target rate is now 5% - 5.25%, and the consensus expects rates to decline into 2024. What that tells us is that market observers do not expect rates to rise very much further and that they should either remain roughly where they are or even start to fall.

**Past performance is no guarantee of future results.**
Index returns do not reflect management fees, transaction costs or expenses; one cannot invest directly in an index.

**Bonding over Bonds**
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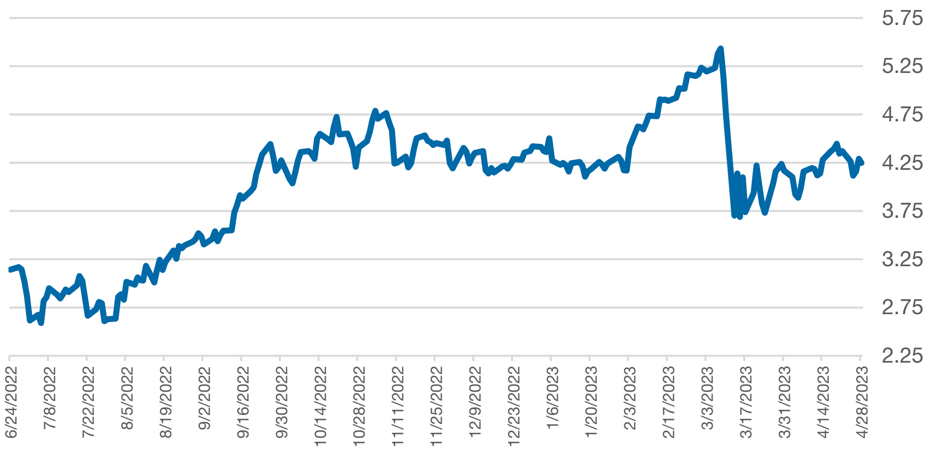
## Fed Funds Futures for January '24




*Source: Bloomberg*

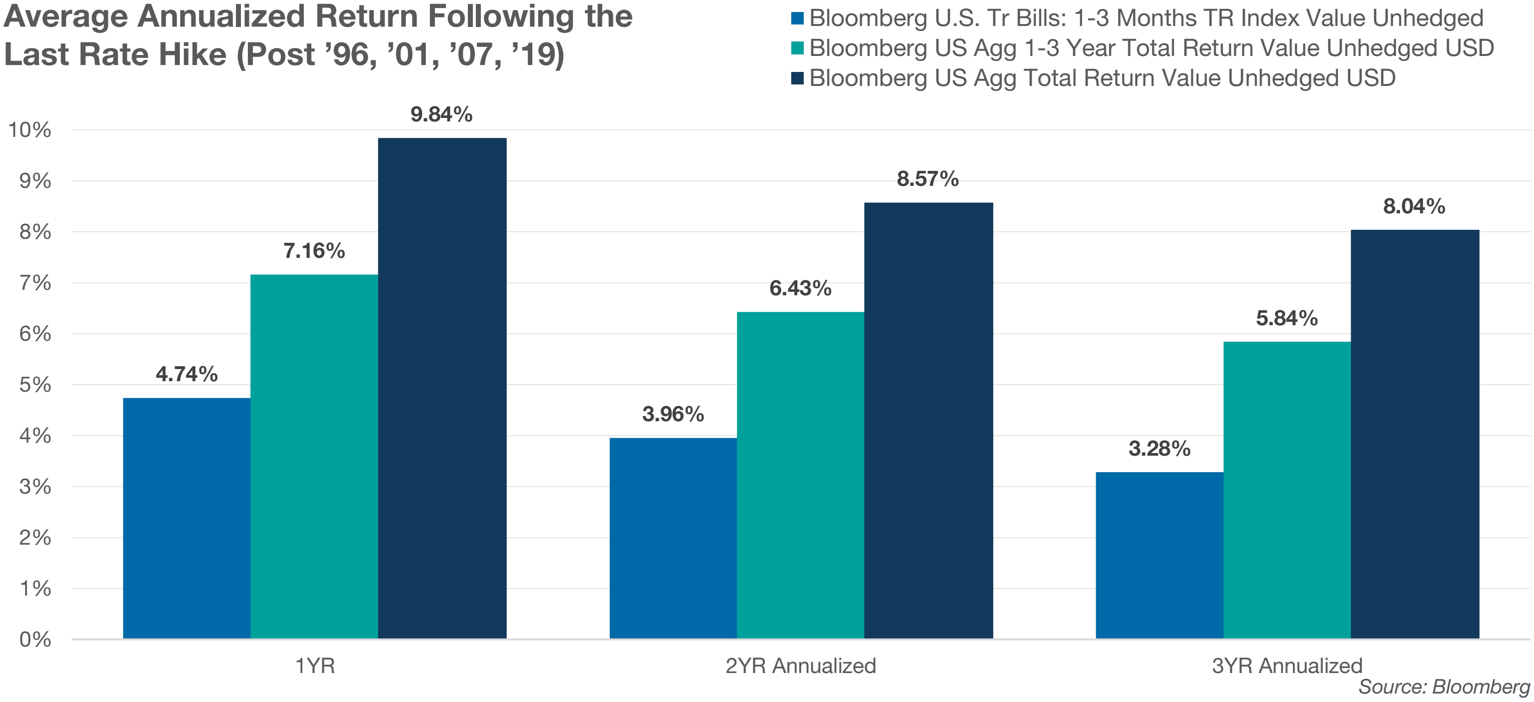
## What to Watch in the Month Ahead

Over the coming month, we will monitor the following events for further insight into financial conditions:

- Implications for the market post the Fed's most recent decision on May 3rd.
- On May 7th: The next CPI release, which may indicate if inflation remains stubbornly high.
- The health of the domestic banking industry after the distressed purchase of First Republic Bank.
- Remaining first quarter earnings from the corporate sector, especially their expectations for the economy and the health of the consumer.
- Developments with respect to the federal government's debt ceiling.

**Where the puck is going:** In this stable or falling rate environment, history tells us that fixed income outperforms money markets as rates are cut. Longer bonds either appreciate in value on the rate cuts or hold that carry—because their coupons are most often fixed—longer than money market securities. This is because money markets require continuous repurchase since they mature within days of issuance. This requirement to reinvest proceeds is called "reinvestment risk" and is an inherent risk in all short-term instruments. Longer bonds, in contrast, do not face immediate reinvestment risk because they mature over the course of years and can even appreciate with falling rates.

## Average Annualized Return Following the Last Rate Hike (Post '96, '01, '07, '19)




*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.

**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.

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