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Income Investments

As investors wrestle with tariffs and their potential adverse economic and market effects, bonds are outperforming stocks for the first time in five years. In the first quarter, the Bloomberg Aggregate Bond index was up 2.8%, while the S&P 500 was down 4.3%. The federal funds rate was unchanged, and the 10-year Treasury yield fell from 4.6% to 4.2%.

Then, on April 2, the tariffs announced by the White House were much higher than the market expected. As a result, stocks extended their first quarter losses, and several banks called for a recession in 2025. Interest rates also fell further as the market now anticipates the Fed will lower the federal funds rate by 1% in 2025. Fixed income continues to perform as expected with bond prices rising as interest rates fall, providing a cushion and a source of income for investors.

While the actual economic impacts of this are difficult to parse individually or in the aggregate, with growth initiatives backloaded and tariff costs upfront, the market is pricing in a hit to GDP in the near term. The growing concern about economic growth and recession may add momentum to bonds if trade tensions continue.

Additionally, real interest rates, the difference between Treasury yields and inflation expectations, are an indicator of value in bonds, and their movement is an economic signal. As real rates continue to fall along with similar maturity Treasury yields, it provides a market signal that investors are more concerned about economic growth than they are about rising inflation.

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But not all bonds are performing alike. Policy uncertainty negatively impacted municipal bonds in the first quarter; the Municipal Bond Index was down 0.2%. As part of the budget process, Congress has included possible elimination of some or all the municipal bond interest exemption to finance the extension of the 2017 tax cuts. The prospect of doing so is pushing up municipal bond yields, and resolution on this issue may not come soon. Along with other budget issues, it will likely take several months to see how the municipal bond interest exemption is prioritized in the year's budget reconciliation process.

Riverbridge manages investments with a steadfast commitment to our clients' long-term objectives. While near-term events related to government policy, the economy, and markets often bring unpredictability and volatility, maintaining a long-term mindset is paramount during such periods. Focusing on quality investments and resisting the urge to time the market remain crucial principles for navigating volatility and achieving long-term financial goals.

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