FIXED INCOME MARKET COMMENTARY

2ND QUARTER 2024

Chris Sebald, CFA
Income Investments

The second quarter of 2024 provided the clearest signals yet that the Fed's interest rate hiking cycle is having its intended effect. Consumer demand downshifted, housing slowed, and corporate loan defaults increased. These moves were all a reverse of the surprisingly strong economic data released in the first quarter. In addition, the unemployment rate rose to 4.1%, up from a low of 3.4%. This higher rate, along with a rise in continuing unemployment claims and lower quit rates, marks a departure from the strong employment trends of most of the past three years.

Meanwhile, inflation continued to cool, albeit slowly. The Fed's favored measure, the personal consumption expenditures index (PCE), eased from 2.7% to 2.6% year-over-year, while the core component moved from 2.8% to 2.6%.

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The Fed held interest rates at 5.25-5.5% during the quarter. Fed Chairman Jerome Powell said at his most recent press conference that he expects inflation and economic activity to slow and be supportive of the Fed lowering interest rates by the end of 2024. Longer-term treasuries were range-bound, with the 10-year yield moving between 4.2 and 4.7% and ending the second quarter at 4.4%.

Fixed income total returns were steady during the quarter, with the Bloomberg Aggregate Bond index rising 0.8%, indicating that investors simply earned their coupon rates. The spread between Treasuries and other sectors like corporate bonds, mortgages, and commercial mortgage-backed securities had minimal impact on total returns. Municipal bond yields, however, rose more than Treasuries, reversing some of the strong performance they have experienced during the Fed's hiking cycle.

At present, the market is pricing in the potential for two Fed rate cuts by year end, though incoming data will always influence those expectations. With the target rate still well above inflation, investors should see further slowing in consumer spending, inflation, and employment–coupled with rising corporate credit stress.

While the slowing economy is important, investors' attention will also turn to the US elections and their potential market impacts. Neither the current nor former president has been a fiscal conservative, as each drove up the Federal debt by $7- 8 trillion during his administration, but perceived policy differences are sure to drive speculation regarding deficits, debt, economic growth, inflation, and long-term Fed policy. Bond market volatility could rise substantially as investors fret about the uncertainty.

While potential impacts from elections and other matters catch our attention, at Riverbridge our clients know we will continue to invest for the long-term, which means staying focused on things we can manage. For fixed income investors, this means identifying value by choosing the most attractive relative yields and appropriate duration, along with a judicious approach to credit selection.