VICTORY income investors
A VICTORY CAPITAL® INVESTMENT FRANCHISE

MONTHLY FIXED INCOME MARKET UPDATE

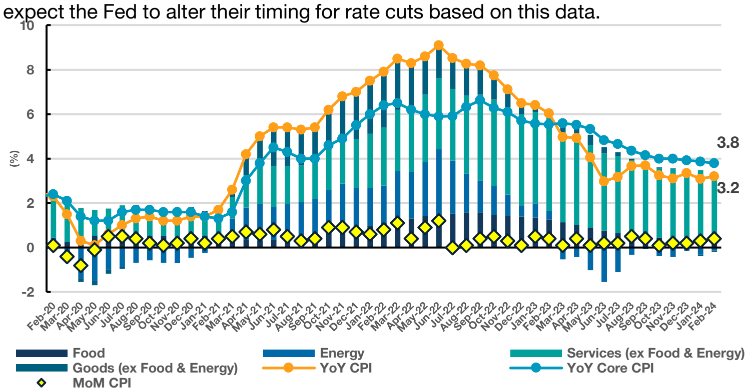
As of March 31, 2024

Key Takeaways

1. The Treasury yield curve declined slightly in March, with the yield of the 10-year Treasury decreasing to 4.20% from 4.25%. Fixed income performance for the month was positive.
2. The Consumer Price Index and Personal Consumption Expenditure Index figures for February came in at or slightly above survey. Chairman Powell and the Federal Reserve Board (the Fed) reemphasized that these figures are in line with the Fed's expectations and the path to lower inflation is sometimes bumpy.
3. Credit spreads in the current market environment are close to cycle tights, reinforcing our defensive positioning. Compensation for taking on additional credit risk is low.

The Month in Charts

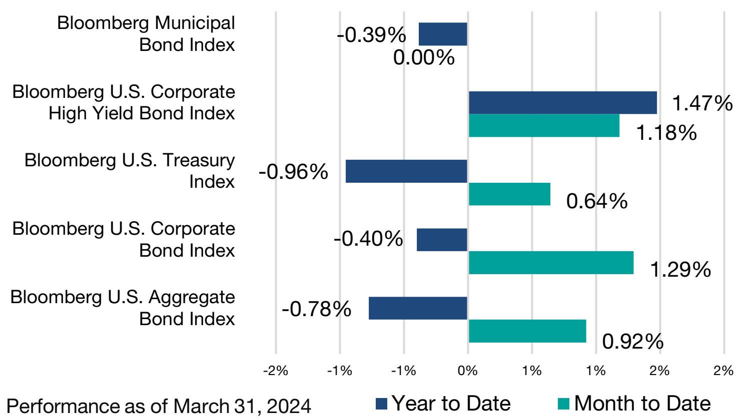
Year-over-year CPI for February, as reported March 12th, came in at 3.2%. This is slightly up from 3.1% in January. Year-over-year Core CPI lowered to 3.8%. Granted the February report showed inflationary pressures easing, we do not expect the Fed to alter their timing for rate cuts based on this data.



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

Source: Bloomberg

Returns (%) for Fixed Income Indices

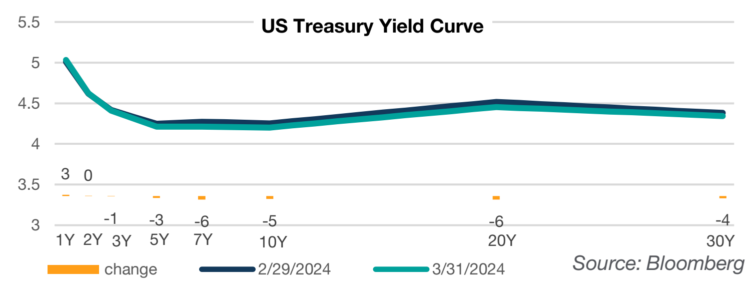


Performance as of March 31, 2024

Past performance is no guarantee of future results.

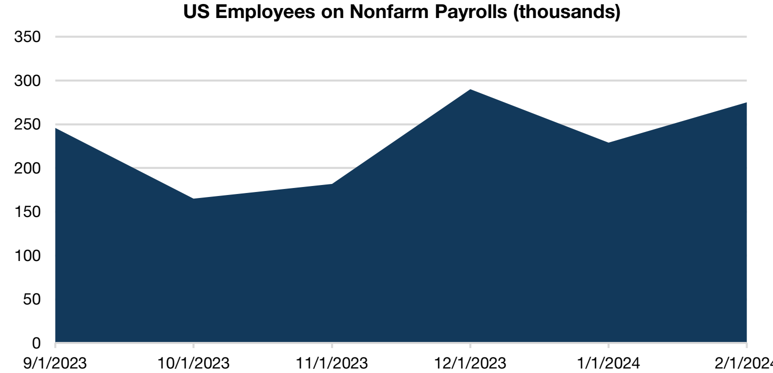
Source: Bloomberg

The Treasury yield curve experienced a slight decline in March, but yields were steady, driven by dovish Fedspeak and decreased momentum in bets that the Fed will begin cutting rates in June. At the end of March, the market priced in a 56% chance of the first 25bps cut occurring in June versus nearly 70% at the beginning of the month.



Source: Bloomberg

Nonfarm payrolls were revised down from 353,000 to 229,000 in January (reported 2 February), still greater than estimates of 185,000. February, as reported in March, came with a 275,000 increase. While this figure is likely to experience revisions, this beat initial estimates of 198,000 for payroll growth. The unemployment rate increased for the first time since November of 2023, from 3.7% to 3.9%. Amidst conflicting economic signals and a highly data dependent Fed, market participants are eager to interpret these types of reports. However, we believe that aside from any dramatic surprises the Fed has no reason to alter their plan to be patient.



Source: Bloomberg

Credit spreads did not change month-over-month for most fixed income asset classes, remaining staunchly tight. Investment grade spreads were 6 bps tighter. High yield spreads tightened 20 bps throughout March. Spreads concluded the month near or at their lows.

				Quarter		Change		
Asset Class	Yield	Spread	Trend	Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	4.43							
U.S. MBS	5.04	49		44	53	-2	2	-14
U.S. Corporate	5.30	89		87	104	-6	-9	-49
U.S. Corporate High Yield	7.83	303		292	360	-12	-20	-149
CMBS	5.33	96		96	126	-7	-30	-47
ABS	5.19	54		52	68	1	-14	-30
A	5.18	78		75	93	-5	-9	-41
BBB	5.52	112		110	128	-7	-11	-56
BB	6.57	184		177	221	-10	-17	-102

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 03/31/2024

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]

Our Current Thinking

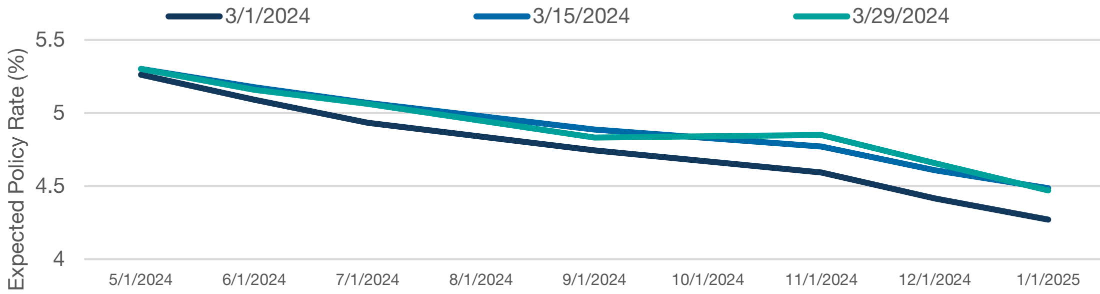
In the past few months, our team has fielded one question more than most – that being "I am still holding cash, when should I rotate into bonds?"

One consideration in answering this question is interest rate movements. It is our firm belief that interest rates are unpredictable and present a challenge that very few can get correct for both timing and magnitude. As seen in the first chart, market assessment of the future of interest rates is ever evolving. While these shifts do impact the bond market and forward-looking views, we do not think attempting to perfectly time the movement from cash into risk assets should be an investor's primary focus.

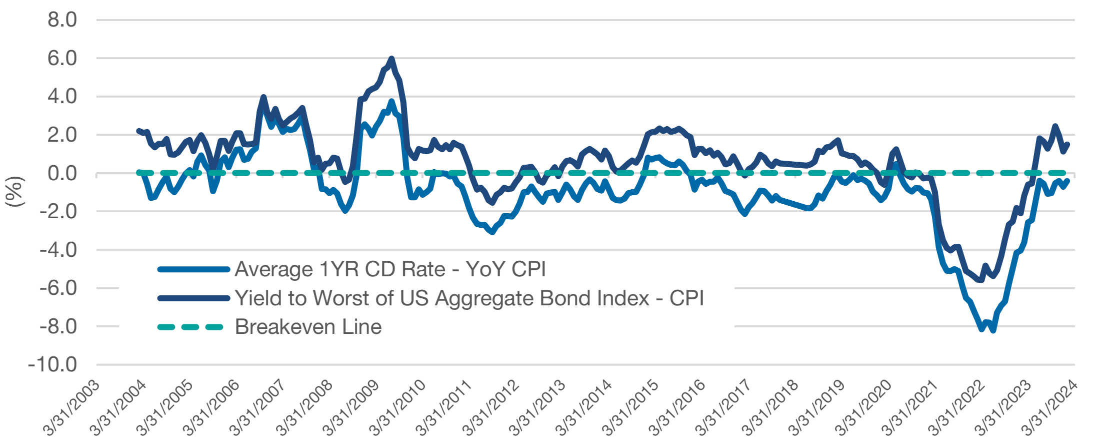
This is not to say that there isn't a great opportunity to enter fixed income in the current environment. While we argue against interest rate bets in portfolios as an alpha generator, with rate cuts on the horizon, the short end of the curve is likely to experience more drastic declines once the rate cutting cycle begins due to the inverted yield curve. Knowing that 5% yields on cash are not here forever, fixed income investors may want to consider that the pause during which the Fed prepares to pivot to cutting rates offers an attractive entry point. Historically, the annualized returns for fixed income have outperformed cash following a pause as shown in the third chart to the right.

Lastly, we acknowledge that cash and cash equivalents offer competitive yields and capital preservation right now. However, over the long-term, cash has a harder time keeping up with inflation than fixed income. The second chart shows how the average 1 YR CD and the Bloomberg U.S. Aggregate returns fare against inflation. While inflation is seemingly trending down, the road to 2% may not be smooth for cash and fixed income could present an improved allocation if capital preservation is your goal.

Markets Pull Back on Rate-Cut Bets

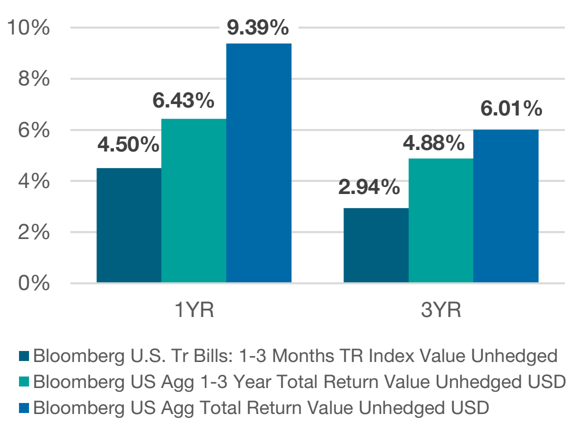


Source: Bloomberg



Source: Bloomberg

Average Annualized Return Following the Last Rate Hike



Source: Bloomberg

What We'll Be Watching in the Month Ahead

Alongside Chairman Powell and other FOMC Members scheduled to speak the first week of April, we will be watching the strength of the economy, inflation, and the following in the month to come:

April 5th, the next Nonfarm Payrolls and Unemployment Rate: These reports and accompanying revisions will be important data points for the market and Fed to consider prior to their April meeting.

April 10th, the next CPI release: this report will offer insight as to if inflation is still moderating towards the Fed's targeted 2% rate.

April 20th and May 1st, the next FOMC Meeting: We, like the market at large, do not expect a rate cut to come out of this meeting, but we do expect to learn more about what the Fed plans for June and the FOMC's assessment of inflation.

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.

Index returns are provided to represent the investment environment during the periods shown. Index performance includes reinvestment of dividends and other income. Index returns do not include transaction costs, management fees or other costs. Non-US indices are net of withholding taxes, if any.

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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