

# BOND MARKET UPDATE

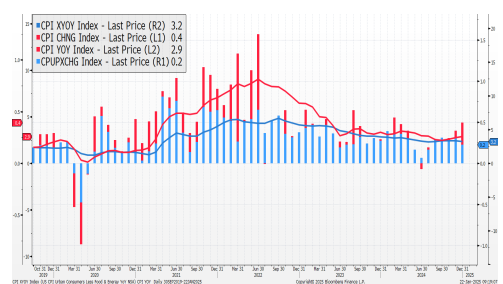
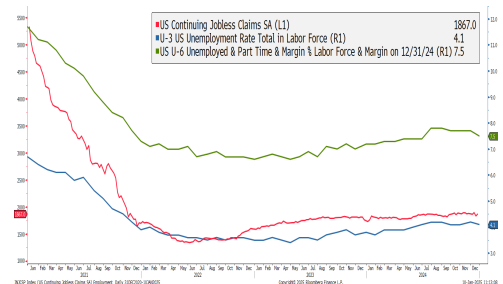
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In the 1st Quarter of 2025, total returns for both taxable and tax-free bonds were positive. For taxable portfolios in the 1st Quarter, the Barclays Aggregate generated a total return of 2.78%. For tax-free portfolios in the 1st Quarter, the Barclays 1-10yr Muni generated a total return of 0.70%. The economy continued to show its resiliency and grew in the face of elevated interest rates. Inflation continues to dis-inflate (at a slower rate), job growth continues to moderate, and the Fed cut the cash rate 50bps in the quarter.

## Economy

GDP in the 3rd Quarter of 2024 came in with a final Q/Q reading of

+3.1%. GDP Q/Q projections for the 4th Quarter of 2024 sit at 2.3%. GDP Y/Y projections for 2024 have been revised higher again to 2.7%, up slightly from 2.6% at the end of the 3rd Quarter. GDP Y/Y projections for 2025 are 2.1%. US Unemployment and US Continuing Jobless Claims have elevated slightly over the past several years as job growth shows signs of stabilization at lower levels. The unemployment rate is 4.1% (low from a historical perspective), but up from a low of 3.4% in early 2023. Continuing Claims have stabilized after a modest uptrend, indicating that jobs have become harder to find. Inflation has drifted lower over the past two years but has recently stalled. With Trump winning the Presidency, expectations of better economic growth prospects and the potential for tariffs has stalled the Fed's disinflationary forecast and may prove to be a little sticky. The good news on inflation is that the shelter component (1/3rd of the index) appears to finally be in a downtrend.



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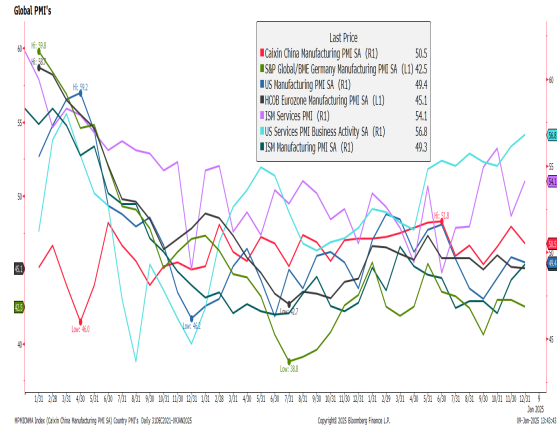
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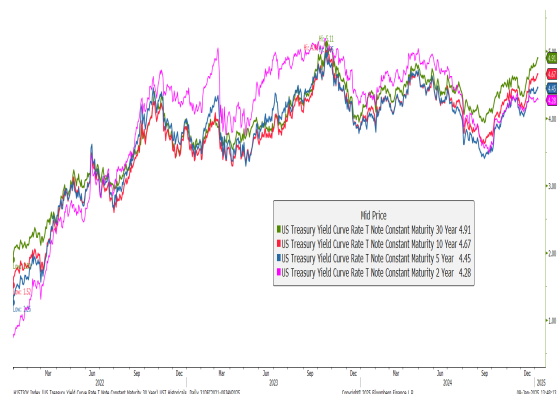
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Manufacturing (30% of the US economy) continues to be in the doldrums. ISM Manufacturing readings continue to print in contraction (reading below 50) territory. Restrictive interest rate policy continues to weigh heavily on this segment of the economy. At some point, Manufacturing will find a new base at these lower levels and has the potential to be a contributor to GDP growth going forward. The Services ISM (70% of the US economy) is still expanding (reading above 50) and had excellent prints in the last four months of the year. The consumer with a job continues to buoy the economy. Personal savings as a % of disposable income has stabilized at levels lower than Pre-Covid norms, this has the potential to pressure future spending.



## Rates

For 2024, 2yr, 5yr, and 10yr U.S. risk free rates (nominal) are up approximately 0bps, 54bps, and 69bps, respectively. The UST yield curve is now mostly upward sloping, ending the longest inversion on record of over 2 years. The 10yr to 2yr UST spread hit a high of 160bps in early 2022, a low of -108bps in the summer of 2023, to currently a positive 43bps. Real rates have risen substantially since 2022. Currently, 10yr TIPS are pricing at 2.27%. This rate has moved up over the past quarter and shows that the market believes President elect Trump's policies will be inflationary. In tandem, mortgage rates have moved up significantly over the past few months. 30yr mortgage rates are currently at 7.18.



## The Fed

The Fed had two meetings in the 4th Quarter, November and December. At both meetings, the Fed elected to cut the cash rate by 25bps, taking the year end cash rate to a range of 4.25% to 4.50%. At the December press conference, the Fed communicated that they feel much better with where they are after the 100bps of cuts from a policy perspective. The Fed still believes they are restrictive in policy and that inflation should continue to move in the desired direction, which is lower. However, Powell did communicate that they will need to see further data points that reaffirm their inflation forecast is still moving in the right direction. At this meeting, the Fed's forecast on future cuts did change from the prior. Currently, the median forecast is for two more 25bps cuts in 2025. The reduction of the Fed's balance sheet is still in motion behind the scenes and will shrink monthly by \$30B in UST debt and the monthly mortgage paydown.

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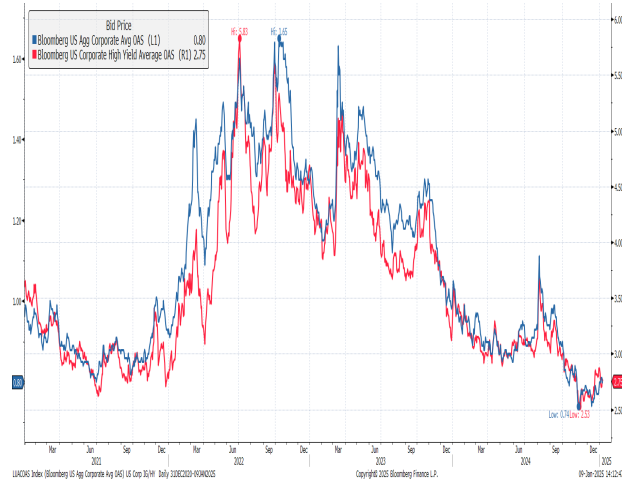
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## Credit

Credit risk was positive versus risk free in the 4th Quarter of 2024. Spreads were slightly tighter for both Investment Grade (IG) and High Yield (HY). For the quarter, IG spreads tightened by roughly 9bps and HY spreads tightened by roughly 8bps. YTD, IG spreads tightened 19bps and HY spreads tightened by 36bps. Risk premiums have had excellent performance since the Fed pivot in the back end of 2023, in addition to an economy that continues to exceed expectations. Overall, risk premiums are close to where they were when the Fed started raising interest rates in early 2022, however, financial conditions are still tighter due to the rise in the risk free rate.



## Looking Forward

The economy continues to exceed all expectations and finished strong to close out the year. The people of the United States of America elected Donald Trump to the Presidency and a Republican controlled House and Senate. The red wave has ignited enthusiasm, raised perceived economic growth forecast and, unfortunately, inflation expectations. While I did partake in a little jubilee with the outcome of the red wave, the move up in rates does feel excessive. To be fair, intermediate to longer term rates started moving up after the first rate cut in September and have continued that move after the election. The positive over the past few months is that the yield curve is steepening. Without going into too much detail, a steepening curve is a bond guys best friend as positive returns become the higher probability. The Fed has stated that they are back to data dependency after the quick 100bps of rate cuts and future cuts will take place if inflation performs as expected. Fed and market expectations are somewhat aligned on future cuts, most likely only one or two 25bps cuts this year. Currently, most parts of the bond market offer positive carry versus the current cash rate, with the potential for that carry to expand with any cuts by the Fed in the future. We continue to be void of High Yield, and continue to build up our US Treasury and Agency MBS/CMBS exposure in lieu of the excellent credit performance in 2023 and 2024. Forward returns look very attractive. As always, we run a high-quality portfolio that looks to take advantage of opportunities as they present themselves. We have been active in seeking those opportunities and feel good about the changes that have been made.

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