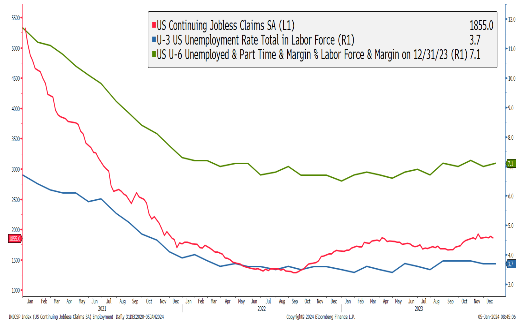
BOND MARKET UPDATE

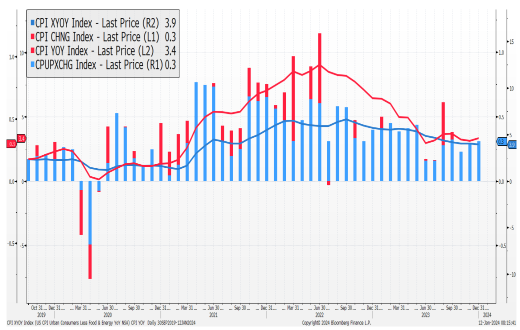
As of 12/31/23 | Volume 12, Issue 4 | FFTAM.com

In the 4th Quarter of 2023, total returns for both taxable and tax-free investments were massively positive for the quarter. For taxable portfolios in the 4th Quarter, the Barclays Aggregate generated a total return of 6.82%. For tax-free portfolios in the 4th Quarter, the Barclays 1-10yr Muni generated a total return of 5.46%. YTD returns are 5.53% for the Barclays Aggregate and 4.61% for the Barclays 1-10yr Muni. The economy continued to show its resiliency and grew above expectations, inflation continues to dis-inflate, and the Fed pivoted to a more balanced monetary policy stance that realigns forward expectations within its dual mandate.

Economy

GDP in the 3rd Quarter of 2023 came in with a final Q/Q reading of +4.9%. GDP Q/Q projections for the 4th Quarter sit at 1.3%. It looks like 2023 will have grown at 2.3% Y/Y, far exceeding most estimates at the beginning of the year. Projections for 2024 GDP Y/Y currently sit at 1.3%. US Unemployment and US Continuing Jobless Claims have leveled off at very low levels as the economy continues to display signs of overall weaker positive momentum in every category except personal consumption. Continuing claims have inched up over the past few months, however, labor has and continues to be very resilient. Per the December jobs report, job growth continues to slow as the 3 month average declined to 165k from 180k. Inflation has drifted lower on a Year over Year (YoY) basis, and we continue to see signs of disinflation in most segments of the CPI on a monthly and quarterly basis. US Labor Productivity appears to have finally turned the corner from Covid, as the past several quarters have been impressive. The positive turn in labor productivity, in-conjunction with current inflation readings, is the reason the Fed has pivoted to a more balanced monetary stance that realigns forward expectations with its dual mandate of full employment with stable prices.





FIRST FINANCIAL TRUST LOCATIONS

ABILENE
400 Pine Street
Suite 300
Abilene, TX 79601
325-627-7100

BEAUMONT
3515 Dowlen Road
Beaumont, TX 77706
409-600-6460

BRYAN/COLLEGE STATION
1716 Briarcrest Dr
Suite 400
Bryan, TX 77802
979-260-2134

FORT WORTH
1000 Forest Park Blvd
Suite 200
Fort Worth, TX 76110
682-703-6404

HOUSTON
24080 Hwy 59 N
Kingwood, TX 77339
281-318-4625

ODESSA
3555 Billy Hext Rd
Odessa, TX 79765
432-367-8912

SAN ANGELO
222 S. Koenigheim St San Angelo, TX 76903 325-659-5987

STEPHENVILLE
2201 W. South Loop
Stephenville, TX 76401
254-918-6262

SWEETWATER
201 Elm Street
Sweetwater, TX 79556
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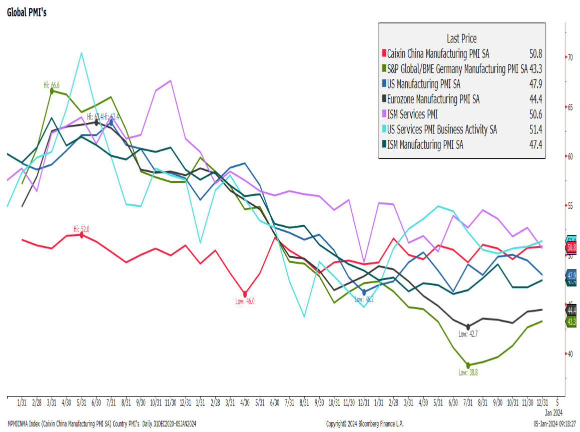
Over the past several years, we have seen a steady decline in both manufacturing and service PMI's. Manufacturing (30% of the US economy) has been in contraction now for 14 months in a row, however, manufacturing appears to be stabilizing at these lower levels. If rates start to move lower, manufacturing PMI's may start inching back up. Housing is a good example, mortgage rates have moved down into the upper 6% handle and we are starting to see some uptick in activity. Services (70% of the US economy) is still expanding but at much slower levels. The consumer with a job continues to buoy the economy, however, depletion of savings in conjunction with higher prices will continue to cause overall demand to weaken at some point, as it hasn't happened yet.



Rates

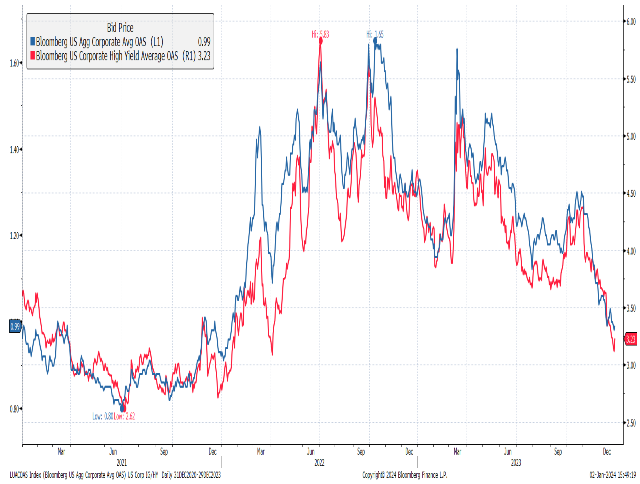
Year to date 2yr, 5yr, and 10yr U.S. risk free rates (nominal) are down approximately 17bps, 21bps, and 0bps, respectively. This has created a less inverted UST yield curve. The 10yr to 2yr UST spread hit a high of Ƅ160bps in early 2022, a low of -108bps in the summer of 2023, to currently an inverted -37bps. Real rates have also risen substantially starting in 2022. Currently, 10yr TIPS are pricing at 1.71%. This validates that market rates are restrictive, and that the Fed’s policy will eventually succeed in its fight against inflation. Mortgage rates have drifted lower the past several months, 30yr mortgage rates ǑdzǈǈŜƴǘƭè ăƚǘ l·ǘ 6.94 .

The Fed

The Fed had two meetings in the 4th quarter, November and December. The Fed at both meetings elected to maintain the cash rate at a range of 5.25% to 5.50%. This makes five consecutive months with no change in the cash rate. At the press conference in December, Powell's first comments referenced the Fed's dual mandate. This is very important as this is the pivot everyone was looking for. In addition, Powell reiterated that members of the committee will view inflation in the context of the real rate. What does this mean? If inflation continues to move the direction they anticipate (lower), their may be an opportunity in the back half of 2024 to ease policy due to real rates becoming more restrictive even with a Fed on hold, hence, the Goldilocks outcome of the illusive soft landing. Quantitative Tightening (QT) continues to work in the background at $95B/month, it will stay at this level until further notice. We have never experienced QT of this magnitude, and the effects are still unknown.

Credit

Credit risk was positive versus risk free in the 4th Quarter of 2023. Spreads were tighter for both Investment Grade (IG) and High Yield (HY). For the quarter, IG spreads tightened by roughly 22bps and HY spreads tightened by roughly 75bps. YTD, spreads have tightened by 31bps and 146bps, respectively. Risk premiums, starting in November, started to ease with a very good inflation print. Then in December, after the Fed meeting, risk premiums eased again with the Fed pivot. Overall, risk premiums are close to where they were when the Fed started raising interest rates in early 2022, however, financial conditions are still much tighter due to the rise in the risk free rate.



Looking Forward

2023 finished extremely strong. November and December returns for most asset classes exceeded even the rosiest of predictions. This strength was predicated on a Fed pivot that the market got in December. The market and the Fed are now forecasting rate cuts in 2024. The Fed is forecasting 75-100bps and the market is pricing in 150bps. Here in-lies the rub, has the market moved too far too fast? And will the Fed follow through on what they are forecasting? There is no doubt the Fed's pivot is a really big deal. This is the first time in two years that the market and the Fed are on the same side of the table of rate cuts. This does skew rates to the downside and all backups in rates should be bought, however, the massive move in the past two months seems excessive and needs to be consolidated. 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. Forward returns continue to look attractive, and this is something we haven't been able to say in over a decade. If the Fed does start to cut rates, at some point in 2024 we will see the UST curve normalize and become positively sloped. 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.