# Market Update

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## February 2024

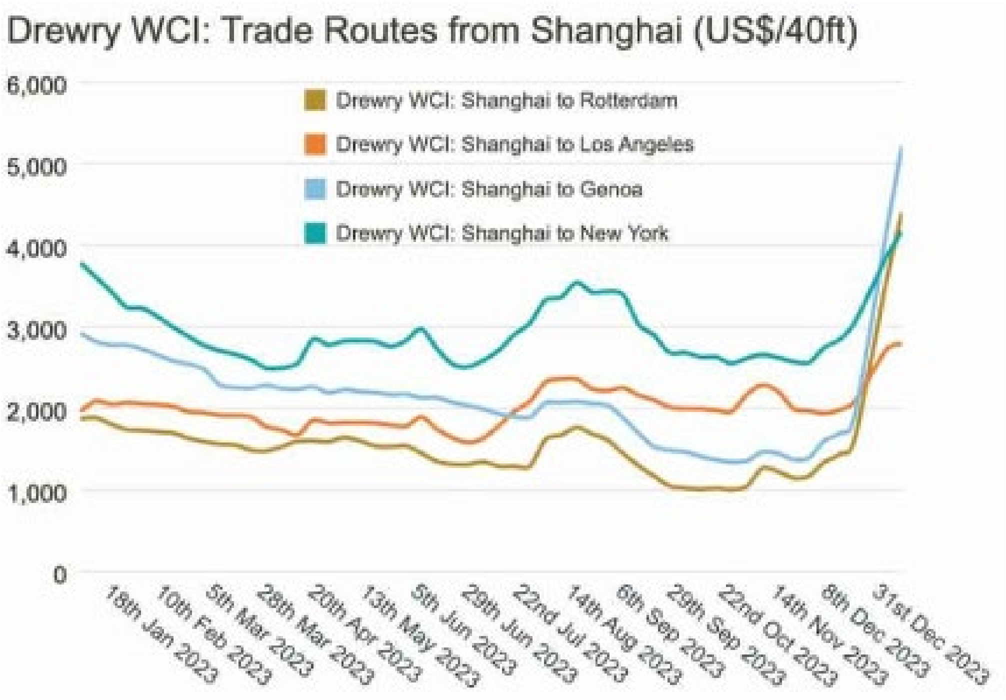
The Federal Open Market Committee (FOMC) has maintained interest rates at a 22-year high of 5.25%-5.50%. During the recent Fed meeting, Chair Powell dismissed the likelihood of an imminent rate cut, stating, "it's not likely that the Committee will reach a level of confidence by the time of the March meeting." The Fed's official statement underscored the uncertainty in the economic outlook, emphasizing vigilance against inflation risks. The latest payroll report, released on Friday, further solidifies the unlikelihood of a March easing. The Committee remains highly attentive to inflation risks, with the personal consumption expenditure price index, a key measure used by policymakers, at 2.6% on an annual basis as of December. However, the lag in shelter costs should help bring inflation metrics down.

The equity markets are currently reflecting a "no landing" scenario, achieving all-time highs. This suggests investors are not anticipating a substantial economic downturn and 125 basis points of rate cuts. While the market's resilience is noteworthy, it prompts questions about the sustainability of current valuations.

In the coming weeks, we will be able to assess whether stress in the commercial real estate sector is broader than the issues identified by New York Community Bank (NYCB). We are also monitoring the Red Sea shipping issues and their potential impact on shipping costs. Despite a recent uptick (graph below), costs remain below the levels seen in 2021, where prices were in the $10-15 thousand range, but are accelerating.

On the global growth front, it is interesting that despite geopolitical disruptions, oil prices have remained in check. This challenges the global growth narrative and suggests that the market may be underestimating the potential impact of these disruptions on energy prices and the broader economy.

In conclusion, the market environment remains near the end of the cycle, as economic data continues to reflect mixed signals across the economy, inflation, and earnings. Our view is that the Fed will ease by 50 to 75 basis points later this year, much less than current market pricing, barring a major deterioration in economic conditions.



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## Product Views

We think market volatility will remain elevated and will present an opportunity for skilled managers to take advantage of opportunities.

**Rates** - The outlook on rates suggests a neutral stance due to balanced risks associated with both higher and lower rates. Market expectations of a 125 basis points easing this year seem overly optimistic, with a potential realization leading to a sell-off in front-end. Conversely, should economic conditions deteriorate, it could justify aggressive Fed easing and substantially lower yields.

**Credit** - The investment grade (IG) corporate bond market kicked off 2024 with a record-breaking pace, amassing over $200 billion in January. Despite this surge in supply, demand has remained robust, evidenced by tight new issue concessions and a tightening of secondary market spreads. However, with spreads at the bottom quartile, we hold a cautious outlook. The expectation is for IG spreads to fluctuate within a range. However, we emphasize the importance of credit assessment in navigating potential downturns.

**Securitized** - In the securitized market, AAA and AA-rated Collateralized Loan Obligations (CLOs) are highlighted as our preferred asset class, offering attractive risk-adjusted returns and structural credit protection. Separately, despite recent tightening, Mortgage-Backed Securities (MBS) are also seen as appealing, serving as a hedge against tail risk in credit downturns. This preference is underpinned by expectations that the Federal Reserve will ease monetary policy less aggressively than the market anticipates.

**Municipals** - Taxable municipals, are slightly favored over corporate credit of similar ratings. This preference is attributed to their alignment with corporate credit spreads, given municipals offer a better risk-return profile for similarly rated issuers.

| Long Comp Name | Previous 1 Month | 1Y Tot Ret | Indx OAD | YTW (1 Year) | Indx Cpn | Avg. Rating |
|---|---|---|---|---|---|---|
| Short Duration | | | | | | |
| Bloomberg US Floating Rate Notes TR Index Value Unhedged USD | .639 | 6.433 | .03 | 5.97 | 6.10 | AA3/A1 |
| Bloomberg USFRN <18mos Total Return Index Unhedged USD | .636 | 6.395 | .02 | 5.93 | 6.18 | AA3/A1 |
| Bloomberg Short-term Index 1-3 mo Total Return Index Unhedged USD | .452 | 5.399 | .17 | 5.41 | 2.12 | AA1/AA2 |
| Bloomberg Short-Term Government/Corporate TR Index Unhedged USD | .433 | 5.198 | .53 | 5.21 | 2.27 | AA1/AA2 |
| Bloomberg Short-term Index 9-12 mo Total Return Index Unhedged USD | .418 | 5.155 | .85 | 5.04 | 2.47 | AA1/AA2 |
| Agg Index | | | | | | |
| Bloomberg US Agg 1-3 Year Total Return Value Unhedged USD | .397 | 4.141 | 1.82 | 4.65 | 2.80 | AA2/AA3 |
| Bloomberg US Agg 3-5 Year Total Return Value Unhedged USD | .284 | 3.358 | 3.63 | 4.48 | 3.18 | AA2/AA3 |
| Bloomberg US Agg Total Return Value Unhedged USD | -.275 | 1.761 | 6.23 | 4.67 | 3.14 | AA2/AA3 |
| Credit | | | | | | |
| Bloomberg Short-term Corporate Index TR Index Unhedged USD | .511 | 5.657 | .49 | 5.62 | 3.07 | A2/A3 |
| Bloomberg 1-3 Yr Credit Total Return Index Value Unhedged US | .447 | 4.650 | 1.76 | 5.03 | 3.27 | A2/A3 |
| Bloomberg US Credit 5-10 Yr Total Return Index Value Unhedge | -.094 | 3.966 | 6.06 | 5.06 | 3.87 | A3/BAA1 |
| Bloomberg US Corporate High Yield Total Return Index Value Unhedged USD | -.004 | 8.126 | 3.17 | 7.76 | 6.13 | B1/B2 |
| Securitized | | | | | | |
| Bloomberg US MBS Index Total Return Value Unhedged USD | -.462 | .708 | 6.12 | 4.87 | 3.08 | AA1/AA1 |
| Bloomberg US CMBS 2.0 Aaa Index Total Return Index Unhedged | 1.070 | 4.091 | 3.86 | 5.43 | 3.47 | AAA/AAA |
| Bloomberg ABS Credit Card Total Return Index Value Unhedged USD | .469 | 4.313 | 2.03 | 4.91 | 3.94 | AAA/AAA |
| Bloomberg ABS Auto Total Return Index Value Unhedged USD | .541 | 4.926 | 1.84 | 5.11 | 4.58 | AAA/AA1 |
| Muni | | | | | | |
| Bloomberg Municipal Index Taxable Bonds 1-3 Yr | .479 | 4.649 | 1.74 | 4.76 | 2.66 | AA2/AA3 |
| Bloomberg Municipal Index Taxable Bonds 1-5Yr | .480 | 4.618 | 2.55 | 4.69 | 3.05 | AA2/AA3 |
| Bloomberg Municipal Bond 1 Year (1-2) Total Return Index Unhedged USD | -.033 | 2.652 | 1.37 | 3.06 | 4.54 | AA2/AA3 |
| Bloomberg Municipal Bond 7 Year (6-8) Total Return Index Unhedged USD | -.404 | 2.237 | 4.54 | 2.84 | 4.70 | AA2/AA3 |
| Bloomberg Municipal Bond 10 Year (8-12) TR Index Unhedged USD | -.499 | 2.594 | 5.29 | 2.85 | 4.55 | AA2/AA3 |

The following risks could cause the Strategy's portfolio to lose money or perform more poorly than other investments.

Investments in bonds and other debt securities will change in value based on changes in interest rates. If rates rise, the value of these investments generally drops. Some investors may be subject to the Federal Alternative Minimum Tax and to certain state and local taxes.

Investing in fixed income products is subject to certain risks, including interest rate, credit, inflation, call, prepayment, and reinvestment risk. Any fixed-income security sold or redeemed prior to maturity may be subject to substantial gain or loss.



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