ACADEMY ASSET MANAGEMENT

Market Update

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The U.S. economy continues to expand, though at a moderating pace. The advance reading for 4Q'24 GDP growth was 2.3%, down from 3.1% in 3Q'24, largely driven by inventories. Slower government spending and cooling residential construction could further weigh on growth in future quarters.

Inflation remains sticky, complicating the Fed's path to its 2% target. The December 2024 CPI rose to 2.9% annually, with core inflation steady at 3.2%. While energy price declines and easing supply chains have helped, labor-intensive services—such as healthcare and transportation—continue to drive core inflation. The Fed's preferred core PCE metric held at 2.8% in December, prompting Chair Powell to emphasize caution. Breakevens edged slightly higher on concerns that inflation will remain more persistent than hoped.

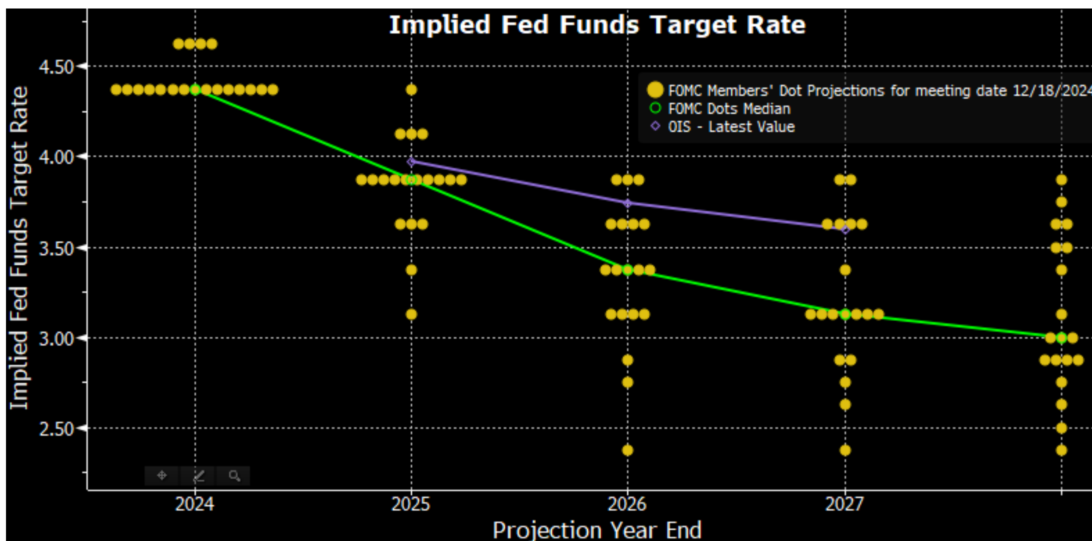
Today's payroll report revealed a gradually cooling labor market. January added 143k jobs, while the unemployment rate fell 0.1% to 4.0%. Wage growth ticked up to 4.1% year-over-year, supporting real income gains but keeping services inflation elevated. Sector-wise, healthcare and education led hiring, while leisure, construction, and professional services saw declines.

Geopolitical risks remain a key focus. Trade tensions loom as the administration considers tariffs on imports, threatening supply chains and inflation. Additionally, labor shortages from stricter immigration policies could pressure wages and productivity. Globally, markets are monitoring Middle East disruptions and China's economic slowdown, which may dampen export demand and commodity prices.

On tariffs, we remain less concerned, viewing President Trump's approach as a negotiation tactic to achieve broader policy objectives. Furthermore, the strengthening dollar against tariffed countries will partially offset any inflationary impact. A similar dynamic occurred during Trump's first term when he enacted 20% tariffs on China, yet inflation saw limited effects.

The Fed held rates steady at 4.25-4.50% in January, emphasizing data dependency. With inflation still above target and growth resilient, markets now price in only one 25-basis-point cut by late 2025. Chair Powell reiterated that premature easing risks reigniting inflation, while delayed cuts could weaken economic momentum—a delicate balance the Fed aims to maintain. We continue to expect just one 25bps rate cut by year-end 2025 but lean toward no cuts.

The U.S. economy faces a pivotal year shaped by policy uncertainty, inflation persistence, and labor market recalibration. While consumer resilience and business investment support growth, fiscal and trade policies introduce volatility. Investors should prepare for a "higher-for-longer" rate environment and heightened sensitivity to geopolitical developments.



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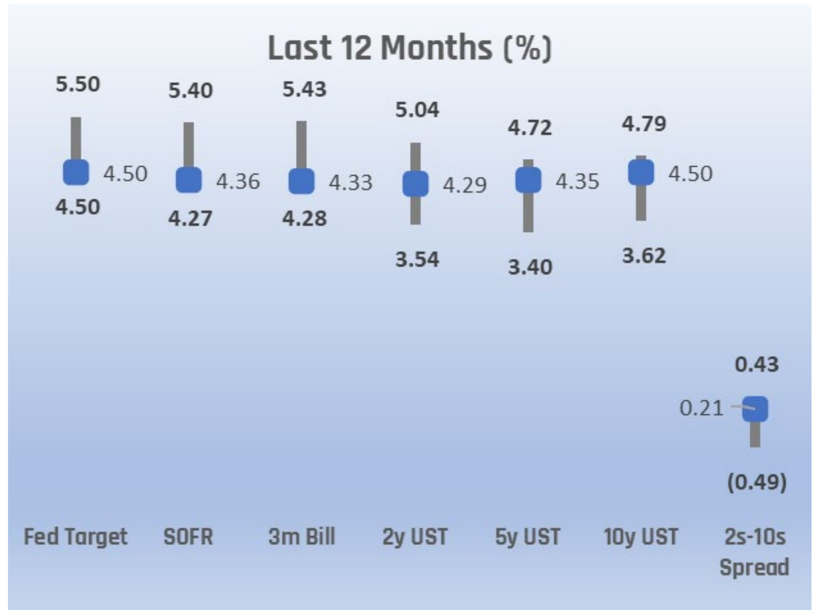
Product Views

Rates: The curve flattened as the 10-year yield fell to 4.50% on moderating inflation data and shifting supply dynamics, while the 2-year rose to 4.29% as Fed moves were increasingly priced out of the market. Treasury Secretary Bessent recently emphasized his focus on lowering 10-year rates, which could be achieved through increased bill issuance (supply), bank regulatory relief (demand), or lower term premiums (DOGE). We are closely monitoring how these initiatives evolve, as the Trump administration remains focused on achieving its definition of "success" through lower long-term rates. On the short end, markets continue to price in just one 25-basis-point rate cut by year-end 2025, largely in line with our outlook. We maintain a modestly constructive stance on the short end and belly of the curve.

Credit: Investment-grade (IG) credit spreads widened modestly this month, while high-yield spreads tightened across all ratings. With limited room for further compression, the relative value for investors has diminished. Management and disciplined credit selection remain crucial for navigating potential volatility ahead.

Securitized: OAS spreads have tightened significantly this month. While certain policy-driven technical factors (discussed in previous outlooks) could support increased demand and further tightening, we are reducing our overweight. However, we still continue to favor securitized assets over corporate credit.



12 month high

Current

12 month low