Logan Fixed Income

LOGAN FIXED INCOME MARKET COMMENTARY
Q1 | 2024 REVIEW

MARKET ENVIRONMENT

The ultimate commitment to the Federal Reserve cutting rates this year was the big takeaway from the most recent meeting on March 20. Treasury yields rallied 15-20 basis points in the belly of the curve in the days that followed. Of equal importance, we do not see a unified view across the membership of the Fed. The number of cuts over the coming years vary amongst the group of Fed members and the medium term dots show the Fed Funds rate to be quarter point higher compared to the December dot plot. This incremental dot plot increase means members feel the fed funds rate is not as far above neutral as previously thought.

Fed Chair Powell struck a mildly dovish tone and noted policymakers would be sensitive to any unexpected deterioration in the labor market.

PORTFOLIO REVIEW

Treasuries

Yields increased during the first quarter as stronger then expected growth and inflation data altered the investors' expectations for the Fed's actions from 7 rate cuts in 2024, to a Fed aligned 3 rate cuts. This 'higher for longer' message is vastly different from expectations at the start of the year.

Corporates

We are seeing two differing perspectives in this sector regarding the tightest spread seen in two years (source: FactSet):

Investors are no longer concerned about a major recession while borrowing costs are high. Falling inflation rates are expected to prompt central banks to cut interest rates in the months ahead. Rating agencies are seeing improved debt ratios (source: Bloomberg). The tight spreads observed look more reasonable in this light.

Despite this, greed trumps fear for credit investors preferring to look not at spread, but all-in yields, which are high compared to history because of still high underlying "risk-free" rates. Excess demand will continue to push spreads tighter as recession fears recede, monetary easing hopes rise, and net issuance falls short of demand.

We still see uncertainty for the remainder of the year as the election inches closer, wars continue (and possibly expand), and the timing of the cuts is unclear. Even so, continued investor demand, a large maturity walls in the near term, and M&A funding needs will fuel additional primary growth through the rest of 2024 (source: Bloomberg).

Municipals

The sector has outperformed Treasuries for the first quarter (source: Bloomberg) as supply has not kept up with maturities and calls. In the months ahead, muni yields may rise relative to Treasuries, as issuance increases and investors often sell municipal bonds to fund tax payments. We anticipate this will be short-lived as supply and demand come into better balance. With the threat of tax rates increasing in the future, investors will get a reminder of the benefits of holding an instrument that produces tax-exempt income.

Oil

U.S. energy prices have stayed relatively subdued the last six months despite two ongoing foreign wars in oil-producing regions. The path of WTI crude oil could be a new concern, however, after breaking above $80 the last two weeks of the period for the first time since early November. Gasoline prices have climbed steadily upward this year since reaching as low as $3.07/gallon in mid-January. Limited refinery capacity and lower inventories are contributing factors. Prices at the pump are front and center for consumer inflation expectations. Gas futures are at their highest since August 2023 (source: Bloomberg).

PORTFOLIO OUTLOOK

Achieving the Fed's target inflation level will be difficult in the coming months. Core goods inflation stopped dropping months ago. Core services inflation has stalled at 4%. Inflation in January & February of the current year has been surprisingly high (maybe attributable to seasonality?). The Fed appears to hold a weaker stance on the slowing economy at the moment. By the time the May 1st meeting comes into view, our reading on the strength of the economy will be clearer.

From an economic perspective, the tragedy at the Port of Baltimore is a reminder of the multitude of factors constraining supply and boosting costs. The port is the largest in the country for handling cars and light trucks. In addition, warehousing for companies such as Amazon, FedEx, and Home Depot rely on the port. The disruption to shipping and land freight will take months to resolve and is a reminder of the fragility of our supply chain. A final thought, East Coast port unions are heading into labor talks this year. Goods inflation may be perking up?

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Investments in commodities may have greater volatility than investments in traditional securities, particularly if the instruments involve leverage. The value of commodity-linked derivative instruments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity, such as drought, floods, weather, livestock disease, embargoes, tariffs and international economic, political and regulatory developments. Use of leveraged commodity-linked derivatives creates an opportunity for increased return but, at the same time, creates the possibility for greater loss.

U.S. TREASURY YIELDS	12/31/2023	3/31/2024	YTD Change
2 YR	4.25%	4.62%	-0.37%
3 YR	4.01%	4.41%	-0.40%
5 YR	3.85%	4.22%	-0.37%
7 YR	3.88%	4.21%	-0.33%
10 YR	3.88%	4.20%	-0.32%
20 YR	4.19%	4.45%	-0.26%
30 YR	4.70%	4.34%	0.36%
10S MINUS 2S	-37.0bps	-42.0bps	

Source: FactSet