Logan Fixed Income

LOGAN FIXED INCOME MARKET COMMENTARY
Q2 | 2024 REVIEW

MARKET ENVIRONMENT

We can all agree inflation is cooling no matter what metric is used. Where a difference of opinion comes into play is whether it's cooling enough for the Federal Reserve to begin cutting rates in the 4th quarter.

There wasn't much surprise that came out of the FOMC's June monetary policy meeting. The Committee left rates unchanged, and now expects higher inflation and less easing this year versus it's previous outlook. As of this writing, the expectations are for two rate cuts by year end.

There was significant upward movement in the dots not just this year but in the out years and the longer-run, suggesting the Fed is starting to lean toward fewer cuts in this cycle than previously suggested.

High Q1 inflation is not likely to repeat, but there's still uncertainty about the pace at which inflation will decline and how quickly the Fed will feel it can react. The labor market is strong enough that inflation risks continue to be the Fed's focus for the time being.

PORTFOLIO REVIEW

Treasuries

Performance has been near zero in the first half of 2024 as we have observed an upward trend in yields through April 30 followed by a roller coaster path the last two months of the quarter. With expectations of at least one rate cut during the back half of the year, the sector may bull steepen and finish the year with positive performance.

Treasuries have been whipsawed this year, with policy-sensitive two-year yields surging above 5% in April as fears over higher-for-longer US rates spurred investors to dump bonds. They have since dropped back to below 4.70% as inflation-to-retail sales data suggested the world's biggest economy may finally be cooling enough to warrant lower borrowing costs.

Corporates

We observed increased issuance to end the period as firms are taking advantage of the lowest borrowing costs of the last few months.

Company bond spreads have widened in June as the same signs of economic weakness that have boosted Treasuries keep credit risks alive — particularly among weaker borrowers. Currently, we do not see much room for spread compression--lower Treasury rates would coincide with softer economic trends, while higher rates would renew concerns of rate volatility and possibly stagflation.

Municipals

We have seen a surge in new issuance in the recent period that has been met by higher demand. Local governments have rushed into the market to get ahead of the anticipated increases volatility expected due to the election in November 2024. Investors are weighing the odds of higher tax rates in the near future and are enticed by the high-quality cash flows and higher yields available in the sector. The period ended with new funds moving

into the sector, specifically into longer maturities.

A slowdown in the economy will lead to a slowdown in tax revenue collections which will be a negative for local government's balance sheets. On the technical side, the continued inflow of assets into the sector via SMAs or ETFs will drive demand for muni assets over the intermediate term.
Liquidity in the sector will be slightly more challenging as both Citigroup and UBS have exited.

Oil
We end the period with prices increasing due to increased demand for gasoline, as the summer driving season commences, and for jet fuel as seasonal demand approaches levels from 2019. This demand added pressure to refined product inventory which has decreased domestically. A key factor is refinery utilization which has dropped and pressured prices higher.

PORTFOLIO OUTLOOK

To fund the growing federal deficit, we expect an increase in Treasury Bills for the remainder of the year due to high liquidity and investor demand. With yields in excess of 5.0% still available and money market funds sitting on over $6 trillion in assets (source: Bloomberg), the matching of supply and demand feels balanced.

We anticipate the majority of the Fed rate cuts will occur in 2025, with he Fed Funds rate eventually moving to the low 3s. When the Federal Reserve initiates cuts, the yield curve will finally achieve a positive slope. The yield curve has been inverted since July 2022.

Consumer resilience has been a key factor of the surprising strength of the economy. Many expected a (light) recession once pandemic savings were drawn down and especially as higher interest rates took a larger bite out of paychecks. It feels like we are entering the next phase of the economic cycle, but as of this writing, household spending shows few signs of slowing.

FOMC participants are echoing Chair Powell's cautious optimism regarding inflation heading to their target in an environment of still solid employment data. If future PCE & CPI reports are satisfactory from a Fed perspective, we could see the Fed signal a September cut at the July 31 meeting.

The one obstacle that we see limiting the central bank's ability to cut rates is the growing view the economy's neutral rate is higher than projected. The growing budget deficit and increase in Treasury auction size are at the root of the higher neutral rate. This would lead to fewer rate cuts in the near term and higher rates in the longer term. We'll keep an eye on this fundamental force along with the multitude of headline items over the coming months.

This material represents an assessment of the market and economic environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Forward-looking statements are subject to certain risks and uncertainties. Actual results, performance, or achievements may differ materially from those expressed or implied. Information is based on data gathered from what we believe are reliable sources. It is not guaranteed as to accuracy, does not purport to be complete and is not intended to be used as a primary basis for investment decisions. It should also not be construed as advice meeting the particular investment needs of any investor. ***Past performance does not guarantee future results.***

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Exchange Traded Funds (ETF's) are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from the Fund Company or your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

The PCE price index (PCEPI), also referred to as the PCE deflator, PCE price deflator, or the Implicit Price Deflator for Personal Consumption Expenditures (IPD for PCE) by the BEA, and as the Chain-type Price Index for Personal Consumption Expenditures (CTPIPCE) by the Federal Open Market Committee (FOMC), is a United States-wide indicator of the average increase in prices for all domestic personal consumption. It is benchmarked to a base of 2012 = 100. Using a variety of data including U.S. Consumer Price Index and Producer Price Index prices, it is derived from the largest component of the GDP in the BEA's National Income and Product Accounts, personal consumption expenditures.

The Consumer Price Index (CPI) is a measure of inflation compiled by the US Bureau of Labor Studies.

U.S. TREASURY YIELDS	12/31/2023	3/31/2024	6/30/2024	YTD Change
2 YR	4.25%	4.62%	4.72%	-0.47%
3 YR	4.01%	4.41%	4.52%	-0.51%
5 YR	3.85%	4.22%	4.34%	-0.49%
7 YR	3.88%	4.21%	4.34%	-0.46%
10 YR	3.88%	4.20%	4.37%	-0.49%
20 YR	4.19%	4.45%	4.54%	-0.35%
30 YR	4.70%	4.34%	4.64%	0.06%
10S MINUS 2S	-37.0bps	-42.0bps	-35.0bps	

Source: FactSet