Logan Fixed Income

LOGAN FIXED INCOME MARKET COMMENTARY
Q4 | 2024 REVIEW

MARKET ENVIRONMENT

A hawkish Federal Reserve is causing the U.S. Treasury curve to be recalibrated with a notion of higher for longer. A stronger than expected economy, led by a resilient consumer, has kept inflation above the Fed's target.

Investors now anticipate a pause as we enter 2025. Policy uncertainty will make for a more volatile bond market in 2025. Higher yields one year in the future wouldn't surprise us. A flight-to-quality event or a deterioration in employment data are the most likely causes of a rally in IG. There are a multitude of sources that may pressure Treasury rates higher: an increased deficit/increased Treasury issuance, mass deportation, lower income and corporate taxes, possible trade tariffs, and an increased inflation risk premium.

With the recent suspension of the debt ceiling, we anticipate a sizable increase in both Federal spending/tax cuts, and Treasury issuance. We also expect less demand from investors for maturities longer than intermediate maturities.

Economic growth remained solid this past year despite uncertainty around a presidential election, elevated interest rates, and a cooling labor market.

PORTFOLIO REVIEW

Treasuries

Yields increased steadily during the 4th quarter, with the 10-year Treasury starting at 3.73% and as of this writing, is 4.53%. Recent economic releases in conjunction with a more hawkish Fed, have altered the previous path of interest rates. Weakness at the long of the curve is attributable to the Fed's hawkishness and technical impact of the anticipated increase in Treasury supply away from Treasury Bills.

Corporates

With less primary issuance and investors clamoring for supply, spreads will start 2025 at razor thin levels. Buyers in general care more about the all-in YTM as the Treasury market has sold off significantly over the previous months.

We are also seeing compression between the different credit levels, so the pick-up at the BBB level is significantly less than A-rated level on a historical basis (source: Bloomberg).

Performance has been strong for the sector, but we do not see much more room for additional spread contraction. If/when an increase in volatility occurs, we will see a decrease in demand, spreads will increase, and the sector will underperform. Also, a slowdown in the U.S. economy would undermine borrowers' ability to repay their outstanding obligations.

Municipals

State and local governments rushed to raise very large sums of funding as pandemic relief dwindled and inflation remained sticky, forcing them to sell additional debt for more expensive infrastructure projects. Rising construction costs (raw material & labor) in addition to elevated interest rates mean the cost to service bonds will eat up more of state local governments budgets.

The municipal bond market has followed the Treasury market higher in rates over the quarter, while at the same time the muni curve has steepened. Most importantly, the muni/Tsy ratios have cheapened as supply increases. January issuance is expected also to be high. Muni funds have experienced outflows/redemptions to end the period, adding to supply.

Oil

The price of crude oil ends the year with bullish sentiment as the prospect of sanctions on Iran and Russian oil decrease supply, and fiscal stimulus measures in China escalate global demand. China is importing more oil from Iran, Russia, and Venezuela this year as it fell to the sixth largest buyer of U.S. crude from second last year (source: Bloomberg).

Domestically, stockpiles decreased to end the year. West Texas Intermediate crude futures mostly traded between $66 and $72 over the quarter ($71.39 as of this writing). The reduced supply from OPEC+ will counter projections for a supply glut in 2025. This small concession on price should be another tailwind to the U.S. consumer's wallet.

Housing

The housing market continued to struggle under the weight of higher borrowing costs. Mortgage rates, which fell to a two-year low in September, have been approaching 7% again on expectations that the Fed will take longer to cut rates. Home builders continued to offer incentives to lure buyers, including mortgage buydowns and payments on their behalf, as well as occasional price cuts.

While sales have stabilized somewhat this year, they remain below pre-pandemic levels. In the resale market — which accounts for a majority of home purchases — the National Association of Realtors anticipates the 2024 sales pace came in even lower than last year, which was already the worst since 1995.

PORTFOLIO OUTLOOK

Consumer spending should remain strong as we enter 2025. Low jobless claims, strong wage growth, high stock prices, and higher household wealth all help U.S. consumer spending and thus the economy.

Looking forward, the challenge confronting policymakers is how to slow growth in the service sector without completely extinguishing it and without keeping policy too restrictive for manufacturing, housing, and other rate-sensitive parts of the economy. We see a limited outlook for rate cuts by the Fed in the year ahead.

If investors reallocate away from equities to lower the risk in their portfolios, we could see another source of demand into fixed income.

Final thought on global trade…East Coast dockworkers threaten (rethreaten?) to strike on January 15 if their labor contract doesn't include anti-automation language. Tariffs and potential strikes at the ports in addition to slowing global growth and geopolitical fragmentation are new headwinds to trade. Hope we have some viable solutions well before our next commentary.

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.***

Fixed income securities are subject to

increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

U.S. TREASURY YIELDS	12/31/2023	3/31/2024	6/30/2024	9/30/2024	12/31/2024	YTD Change
2 YR	4.25%	4.62%	4.72%	3.64%	4.24%	0.01%
3 YR	4.01%	4.41%	4.52%	3.56%	4.28%	-0.27%
5 YR	3.85%	4.22%	4.34%	3.57%	4.38%	-0.53%
7 YR	3.88%	4.21%	4.34%	3.66%	4.48%	-0.60%
10 YR	3.88%	4.20%	4.37%	3.79%	4.57%	-0.69%
20 YR	4.19%	4.45%	4.54%	4.18%	4.86%	-0.67%
30 YR	4.70%	4.34%	4.64%	4.13%	4.78%	-0.08%
10S MINUS 2S	-37.0bps	-42.0bps	-35.0bps	14.5bps	32.9bps	

Source: FactSet