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Weekly Fixed Income Commentary

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Treasury yields decline as the Fed prepares for cuts

U.S. Treasury yields declined as the U.S. Federal Reserve leaned modestly dovish at the March meeting. The central bank remains on track for rate cuts later this year, and financial markets interpreted this decision positively.

HIGHLIGHTS

- **Total returns were positive across the board, led by investment grade corporates, taxable munis and MBS.**
- **Most spread sectors outperformed Treasuries, including preferreds, emerging markets and high yield corporates.**
- **Municipal bond yields rose slightly. New issue supply was $6.0B and fund inflows were $64M. This week's new issuance is expected to be $9.0B.**

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Watchlist

- *The 10-year U.S. Treasury yield fell last week, and we expect yields to decline slightly over the course of the year.*
- *Spread assets generally gained and outpaced the rally in Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

Rates have probably peaked for this cycle, as attention pivots toward rate cuts in response to softer growth and easing inflation.

The underlying growth outlook remains healthy thanks to strong consumer balance sheets and solid levels of business investment. This combination should keep corporate defaults low.

Risk premiums may widen further, with entry points for taxable fixed income likely to become more attractive over the coming quarters. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to continue moderating as expected, weighing on asset prices.
- Policymakers unsuccessfully juggle fighting inflation with supporting economies still struggling to gain traction.
- Geopolitical flare-ups intensify: Israel, China, Russia and Iran.

SPREAD ASSETS OUTPERFORMED ON THE HEELS OF THE FED

U.S. Treasury yields fell last week, as the Fed held rates steady and maintained its rate cut expectations for later this year despite increases in growth and inflation expectations. 10-year yields ended 11 basis points (bps) lower at 4.20%, while 2-year yields fell 14 bps to 4.59%. Markets interpreted the Fed news as modestly dovish and are now pricing in an 80% chance of a first rate cut by June. Global sovereign yields followed suit and were broadly lower, and the Swiss National Bank surprised markets with the first rate cut from a G-10 nation.

Investment grade corporates gained as yields fell and spreads tightened, returning 0.78% for the week. Spread assets in general outperformed on the heels of the Fed meeting, and the asset class outpaced similar-duration Treasuries by 6 bps. Inflows continued, though they decelerated, with $4.9 billion entering the asset class. The primary market continued to run hot as well, with $28.8 billion of new deals frontloaded early in the week ahead of the Fed meeting, surpassing weekly estimates calling for $20 to $25 billion. March supply now stands at $117 billion, pushing year-to-date supply to roughly 40% more than the same period in 2023.

High yield corporates performed well, returning 0.59% for the week and outperforming similar-duration Treasuries by 11 bps. Senior loans, which benefit from higher interest rates due to their floating-rate nature, returned 0.05%. High yield markets saw outflows of -$2 billion while loans experienced inflows of $157 million. The new issue market was active once again, with $4.7 billion and $28.5 billion entering high yield and loans, respectively. A significant portion of this year's new issuance has been refinancing, as companies take advantage of tight spread levels.

Emerging markets returned 1.10% for the week and outperformed similar-duration Treasuries by 44 bps. Spreads broadly tightened across sovereigns and corporates. Outflows of -$869 million were driven by hard currency funds. New issuance was relatively muted in advance of the Fed meeting, with $1.2 billion coming to market across several corporate deals.

DEMAND FOR MUNIS REMAINS STRONG

The municipal bond yield curve remained range bound last week, with yields rising slightly. Muni yields remain rich compared to Treasuries. Underwriters struggled to completely place some muni deals. Fund flows were positive for the fifth week in a row, despite exchange-traded fund outflows -$32 million. This week's new issue calendar is large once again, with more than half coming from three issuers: the state of California ($2.4 billion), New York City ($1.4 billion) and the state of Washington ($1 billion).

Municipal bond yields are coming under pressure due to outsized new issuance again this week. Even though muni yields remain rich compared to Treasuries, strong demand continues. This outsized muni new issue calendar gives institutional money managers an opportunity to get size allocations to retool bond funds to their stated mandates.

The New York Metropolitan Transportation Authority issued $1.2 billion transportation revenue bonds (rated A3/A-). Underwriters cheapened the deal slightly to get it sold.

High yield municipal demand remains strong, with fund inflows of $190 million last week. A $300 million new issue for a rare tribal gaming deal was 14x oversubscribed and traded 40+ bps tighter in the secondary market. New issuance is expected to be heavier this week, including two anchor deals: a $250 million deal for Miami World Center and a $100 million deal for Wisconsin-based senior living centers that continue a rapid pace of expansion.

More than half of this week's outsized muni new issuance of $9.0B comes from three issuers.

In focus

The Fed coalesces around cuts

Investors weren't expecting the Fed to lower borrowing costs last Wednesday, but instead to offer reassurance that easier policy was forthcoming. They weren't disappointed, and markets reacted accordingly.

The Fed kept its benchmark fed funds target rate at a 23-year high of 5.25%-5.50%, and its policy statement was little changed compared to January.

In his post-meeting press conference, Chair Jerome Powell explained the Fed's tricky balancing act, noting that "We're in a situation where if we ease too much or too soon, we could see inflation come back. If we ease too late, we could do unnecessary harm to employment." Nonetheless, he reinforced his belief that the Fed will reduce rates in 2024, but only when the central bank has seen evidence of inflation falling sustainably toward its 2% target.

Although the Fed's updated economic projections showed an uptick in core PCE inflation, most officials — via the dot plots — penciled in three 25 basis point cuts. Markets cheered this dovish stance. The S&P 500 Index hit yet another record high and U.S. Treasuries rallied by the end of the day, as the yields on the bellwether 10-year note and 2-year security, which closely tracks the outlook for near-term monetary policy, fell to 4.27% and 4.59%, respectively.

We agree that inflation will prove stickier than previously anticipated, and we continue to expect the Fed to begin cutting rates around midyear.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.59	-0.14	-0.03	0.34
5-year	4.18	-0.14	-0.06	0.34
10-year	4.20	-0.11	-0.05	0.32
30-year	4.38	-0.05	0.00	0.35

Source: Bloomberg L.P., 22 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.84	0.06	0.10	0.32
5-year	2.47	0.02	0.03	0.19
10-year	2.47	0.02	0.01	0.19
30-year	3.65	0.03	0.06	0.23

Source: Bloomberg L.P., 22 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	59
30-year AAA Municipal vs Treasury	83
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters, 22 Mar 2024. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg High Yield Corporate Index. **Performance data shown represents past performance and does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.44	–	6.07	-0.18	0.16	-0.22
High yield municipal	5.49	216[1]	6.92	0.05	1.08	1.41
Short duration high yield municipal[2]	5.13	268	3.61	0.13	0.70	1.97
Taxable municipal	5.02	64[3]	7.91	0.90	0.95	-0.24
U.S. aggregate bond	4.84	38[3]	6.22	0.73	0.70	-1.00
U.S. Treasury	4.42	–	6.04	0.67	0.42	-1.18
U.S. government related	4.89	44[3]	5.29	0.67	0.63	-0.49
U.S. corporate investment grade	5.29	88[3]	7.00	0.78	1.04	-0.64
U.S. mortgage-backed securities	5.05	48[3]	6.13	0.81	0.82	-1.28
U.S. commercial mortgage-backed securities	5.34	97[3]	4.31	0.72	0.74	0.68
U.S. asset-backed securities	5.16	54[3]	2.64	0.34	0.41	0.59
Preferred securities	6.27	140[3]	4.54	0.99	1.22	4.76
High yield 2% issuer capped	7.64	296[3]	3.14	0.59	1.08	1.37
Senior loans[4]	9.27	507	0.25	0.05	0.70	2.39
Global emerging markets	7.05	264[3]	6.07	1.10	1.52	1.33
Global aggregate (unhedged)	3.75	38[3]	6.67	0.15	0.40	-2.23

1 Yield difference between the Bloomberg High Yield Municipal Index and the 20-year AAA MMD scale. **2** Data is a subset of the S&P Short Duration Municipal Yield Index that is below investment grade/nonrated. Spread is the yield difference between this subset and the subset rated AAA. **3** Option-adjusted spread to Treasuries. **4** Spread refers to the 3-year discount margin. Duration is estimated based on the frequency of the reset date.

Source: Bloomberg L.P. and Credit Suisse, 22 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** Unless otherwise noted, the index is Bloomberg. All index returns are shown in U.S. dollars. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting. **Effective duration** (expressed in years) measures the price sensitivity of a fixed-income investment to a change in interest rates, considering that expected cash flows will fluctuate as interest rates change. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account.

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Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 22 Mar 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 20 Mar 2024.

Any reference to credit ratings refers to the highest rating given by one of the following national rating agencies: S&P, Moody's or Fitch. Credit ratings are subject to change. AAA, AA, A and BBB are investment grade ratings; BB, B, CCC, CC, C and D are below-investment grade ratings.

Representative indexes: municipal: Bloomberg Municipal Index; **high yield municipal:** Bloomberg High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; **U.S. government related:** Bloomberg U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Global Aggregate Unhedged Index.

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