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Bond Market Update:
Despite U.S. Credit Downgrade, Yield Opportunities Remain Robust

By Bill Smith, Fixed Income Trader and Portfolio Manager

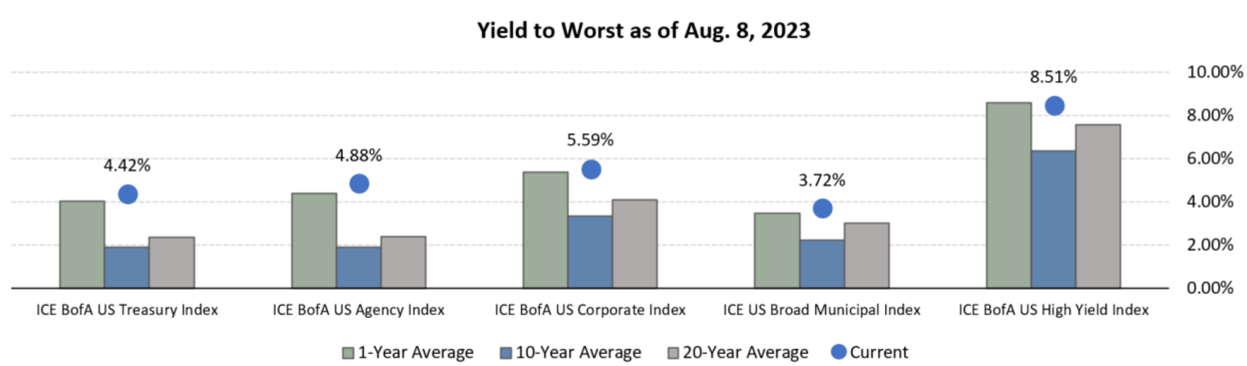
United States Credit Downgrade – A Brief Note

Citing rising debt levels and "repeated debt limit standoffs and last-minute resolutions," Fitch Ratings downgraded the United States credit rating from AAA to AA+ on August 1. Although the market's initial response was relative indifference, there was a subsequent increase in long Treasury yields in the days following the announcement. According to Bloomberg, the 30-year Treasury yield touched 4.32% on August 3, a rise of more than 30 basis points from the pre-downgrade lows observed on August 1.

This rise doesn't appear to be driven by changes in perceived credit risk and is instead a response to Treasury supply dynamics and continued strength in the labor market. A single-notch downgrade from Fitch doesn't change market fundamentals and is expected to have little effect on the enduring status of U.S. Treasury debt as a cornerstone of modern capital markets. Reminiscent of Standard & Poor's U.S. Treasury downgrade in 2011 from AAA to AA+, we expect this move will eventually fade from the news cycle as markets turn their attention elsewhere.

Yield Opportunities Remain Robust

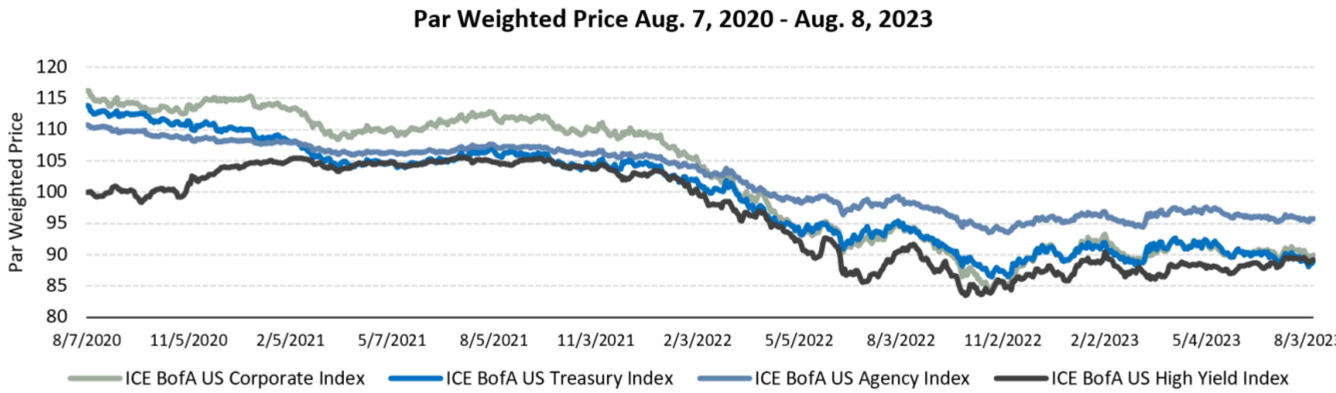
We believe the current rate environment offers a highly favorable opportunity to explore individual fixed income investments. See the chart, "Yield to Worst as of Aug. 8, 2023." Yields remain near multi-decade highs across sectors and maturities, giving investors the opportunity to secure compelling yields and gain more certainty around future cash flows and portfolio structure.



Source: ICE BofA Indexes/Bloomberg. Past performance is no guarantee of future results.

Room for Price Appreciation

While income has driven much of the bond market story this year, we believe structural conditions exist for compelling future price appreciation as well. See the chart on pg. 2, "Par Weighted Price Aug. 7, 2020 – Aug. 8, 2023." Since bonds typically mature at par, and major fixed income indexes are trading at discounts to par, higher total returns are possible as these price differentials close.



Source: Bloomberg 7/18/2023. Past performance is no guarantee of future results.

A prudent approach to fixed income investing calls for diversification across both credit and duration exposure. As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

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