Dynamic
Wealth Advisors

Dec. 20, 2023

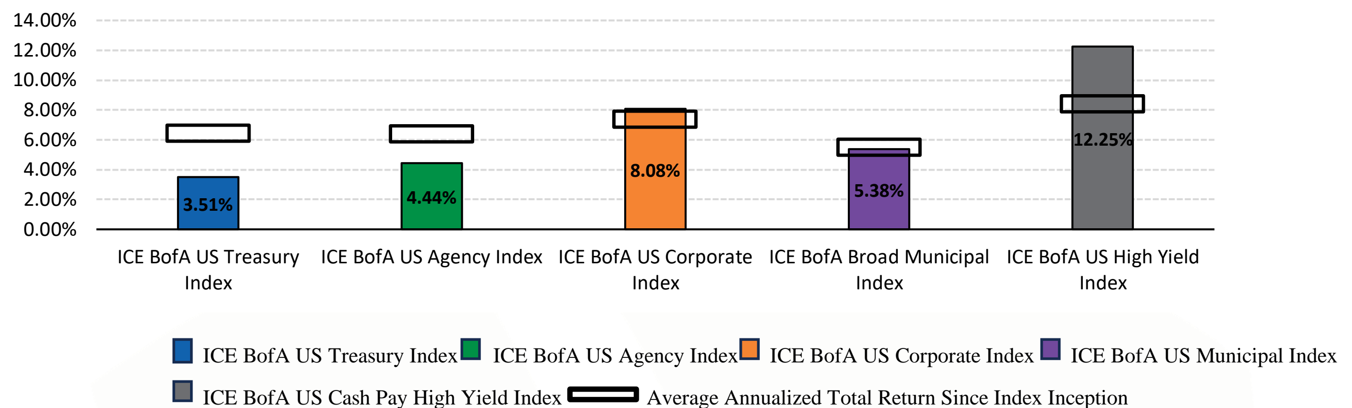
Bond Market Update: December Brings Good Tidings for Bond Investors

By Bill Smith, Fixed Income Trader and Portfolio Manager

Strong Year-End for Bonds

Yields continued to decline this month, gifting bond investors one of the strongest year-end rallies since the early 1980s. While most major fixed income indices are positive on the year, high yield and investment grade corporate returns have been particularly strong and are the only indices in the "YTD Total Return" chart below that have outperformed their average annualized total return since inception. With just under two weeks remaining in 2023, fixed income sentiment remains high, and any lingering fears of a third consecutive year of poor bond performance have diminished.

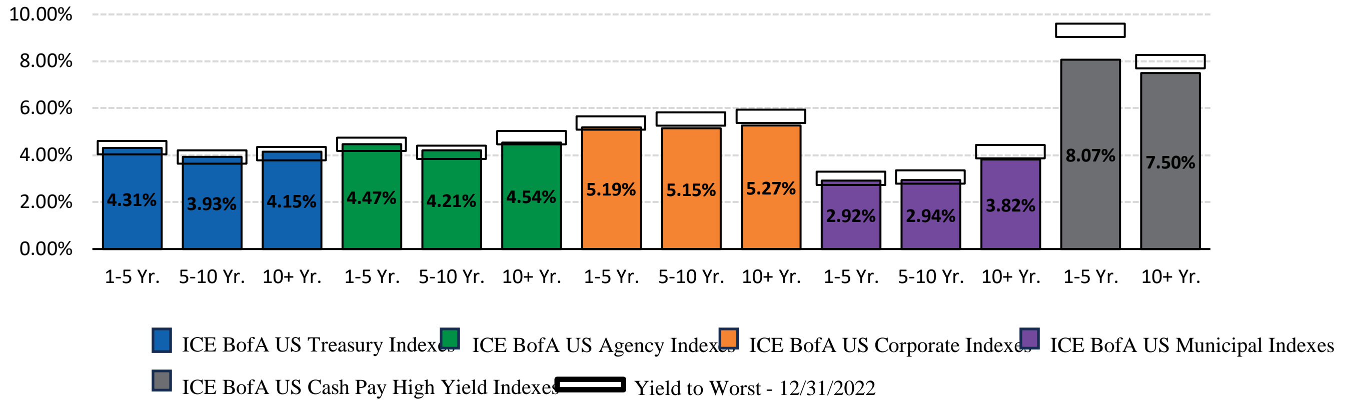
YTD Total Return Dec. 15, 2023



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

The Yield Window is Still Open

Despite a significant decline over the last two months, fixed income yields are relatively unchanged in 2023 and remain near decade highs. Importantly, many of the factors that initially drove rates higher, including elevated inflation and interest rate uncertainty, have eased considerably. Year-over-year Consumer Price Index (CPI), for instance, has dropped from 6.40% to 3.10%, while expectations that rate cuts may be on the horizon have increased dramatically. The Fed's "Dot Plot" now calls for three interest rate cuts in 2024, while Bloomberg's interest rate probability model now estimates at least five.



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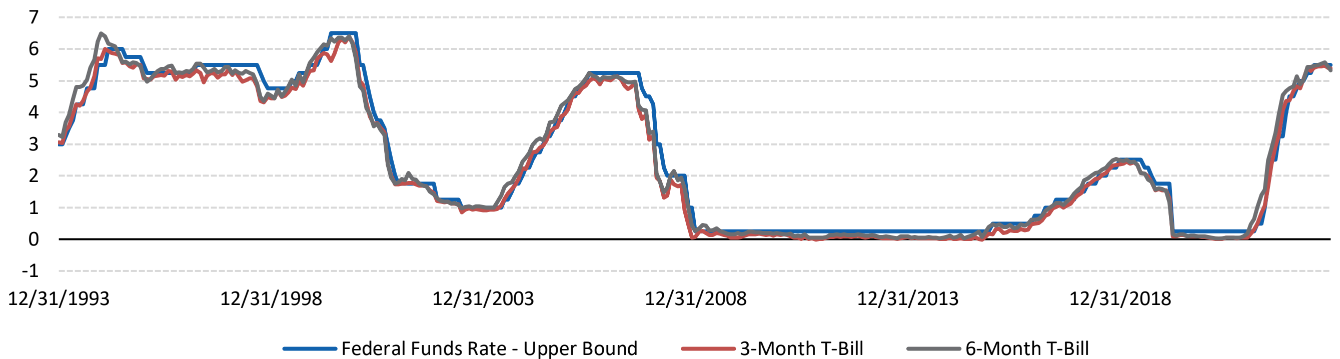
Short Rates Remain Attractive but Can Decline Quickly

One of the best performing bond strategies of 2023 was to stay short. Not only did this reduce volatility, but also the inverted nature of most fixed income yield curves meant shorter bonds yielded more than long. While it may seem tempting to replicate this strategy in 2024, as most yield curves remain inverted, we believe a more diversified approach to maturity selection is prudent. Short maturities carry the highest reinvestment risk, and tend to track the Federal Funds rate closely, as demonstrated in the "Short Treasury Yields vs. Federal Funds Rate" chart below. With both the Fed and futures market telegraphing potential rate cuts in 2024, the yields available today might not be here tomorrow.



Source: Bloomberg. Past performance is no guarantee of future results.

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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.

Bill Smith serves as president, Portfolio Management & Trading, of Harmont Fixed Income in Phoenix.

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