

Fed Rate Cuts Likely in 2024 as Real Yields Remain Attractive

July Bond Market Update: Lower Inflation, Cooling Labor Market Set the Stage for the FedMid-Year Review

Markets are pricing in significant rate cuts in 2024. Bloomberg’s interest rate probability model estimates two U.S. Federal Reserve (Fed) cuts by November, with a 66% chance of a third by December.* Fixed income markets have responded accordingly, with positive monthly performance seen broadly across most fixed income indices. Long Treasury investors breathed a sigh of relief, at least for now, as the year-to-date performance of the ICE BofA Treasury index turned positive in July. In line with the theme from last month, high-yield municipal, high-yield U.S. corporate and emerging market bonds have continued to outperform this year. The charts, shown below, summarize the yield changes and performance of select fixed income tenors and indices as of July 24.

* “Traders Add to Bets on Three Fed Rate Cuts in 2024,” Bloomberg.com, July 15, 2024, <https://www.bloomberg.com/news/articles/2024-07-15/traders-add-to-bets-on-fed-rate-cuts-after-goldman-sachs-view?embedded-checkout=true>

U.S. Treasury Yield Curve

Maturity	Yield	Change (Basis Points)	
		Month-to-date	Year-to-date
2-year	4.433	-32.2	18.2
5-year	4.173	-20.4	32.5
10-year	4.285	-11.2	40.5
30-year	4.543	-1.6	51.4

Source: Bloomberg, 24 July 2024 (US On/Off The Run Sovereign Curve)

U.S. Corporate (Investment Grade) Yield Curve

Maturity	Yield	Change (Basis Points)	
		Month-to-date	Year-to-date
2-year	5.135	-22.9	14.8
5-year	5.034	-17.4	29.1
10-year	5.374	-16.7	30.7
30-year	5.619	-7.4	46.0

Source: Bloomberg, 24 July 2024 (USD US Corporate IG BVAL Yield Curve)

Municipal (AAA) Yield Curve

Maturity	Yield	Change (Basis Points)	
		Month-to-date	Year-to-date
2-year	2.904	-23.6	40.1
5-year	2.825	-13.1	60.9
10-year	2.804	-5.8	53.6
30-year	3.732	-6.0	32.9

Source: Bloomberg, 24 July 2024 (BVAL Muni AAA Yield Curve)

Index Characteristics and Returns

Index	Yield (Worst)	Modified Duration	Returns (%)	
			Month-to-date	Year-to-date
U.S. Treasury	4.40	6.15	1.010	0.181
U.S. Agency	4.63	3.32	0.822	1.735
U.S. Corporate Investment Grade	5.32	6.64	1.295	1.333
U.S. Corporate High Yield	7.58	3.42	1.681	4.341
U.S. Mortgage Backed Securities	5.03	5.84	1.387	0.537
U.S. Broad Market	4.85	6.06	1.162	0.689
Global Broad Market	3.97	6.38	0.982	0.033
Emerging Market Corporate	6.13	4.83	1.049	3.964
Municipal Investment Grade	3.63	5.93	0.735	0.670
Municipal High Yield	5.03	5.86	0.808	5.561
Municipal Taxable	5.14	7.84	1.188	1.239

Source: ICE DATA/INDICES, LLC (“ICE DATA”), 23 July 2024. Past performance is no guarantee of future results. U.S. Treasury = ICE BofA US Treasury Index, U.S. Agency = ICE BofA US Agency Index, U.S. Corporate Investment Grade = ICE BofA US Corporate Index, U.S. Corporate High Yield = ICE BofA US High Yield Index, U.S. Mortgage Backed Securities = ICE BofA US Mortgage Backed Securities Index, U.S. Broad Market = ICE BofA US Broad Market Index March 2020 Regular Rebalance, Global Broad Market = ICE BofA Global Broad Market Index, Emerging Market Corporate = ICE BofA Emerging Markets Corporate Plus Index, Municipal Investment Grade = ICE BofA US Municipal Securities Index, Municipal High Yield = ICE US High Yield & Non-Rated Municipal Securities Index, Municipal Taxable = ICE BofA Broad US Taxable Municipal Securities Index.

Federal Open Market Committee (FOMC)

Fed Funds Rate - Upper Bound	5.50	Last FOMC Decision	12-Jun-24
Fed Funds Rate - Lower Bound	5.25	Next FOMC Decision	31-Jul-24
Fed Funds Effective Rate	5.33		
Discount Rate	5.50		

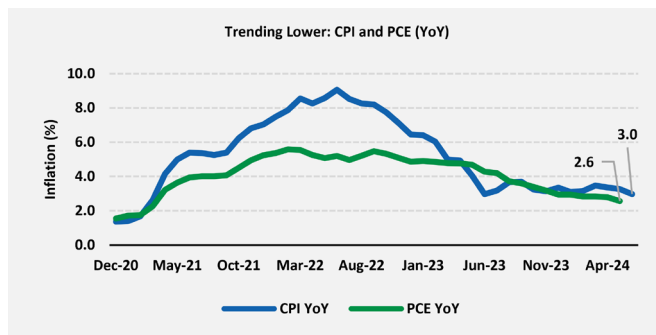
Source: Bloomberg, 24 July 2024

Past performance is no guarantee of future results.

Inflation / Labor Market Snapshot

Inflation is trending lower. On July 15, Jerome Powell reiterated, “If you wait until inflation gets all the way down to 2%, you’ve probably waited too long.” With the consumer price and personal consumption indexes nearing the Fed’s 2% target, the odds of policy easing in the last half of the year are increasing.

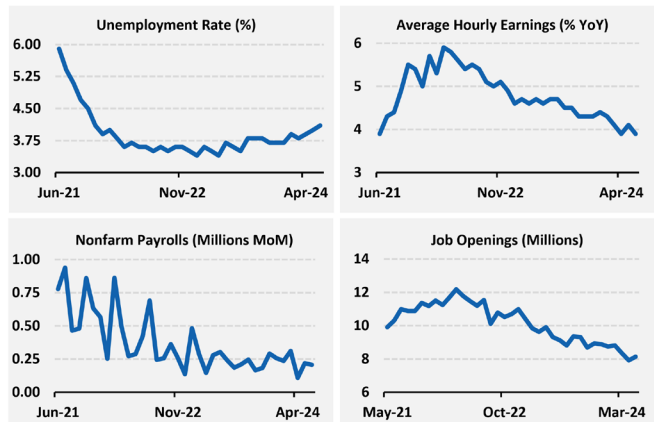
Source: Bureau of Labor Statistics, Bureau of Economic Analysis, 25 June 2024. Past performance is no guarantee of future results.



The labor market has softened.

Numerous indicators across the job market have weakened in 2024, further bolstering the case for potential rate cuts. Jerome Powell recently noted, “Now that inflation has come down and the labor market has indeed cooled off, we’re going to be looking at both mandates.” Employment data will likely play a larger role in the timing and magnitude of potential rate cuts moving forward.

Source: Bureau of Labor Statistics, 24 July 2024 and Bloomberg News, “Fed Prepares for September Cut as Powell Shifts Focus to Jobs” by Craig Torres and Amara Omeokwe, 17 July 2024.

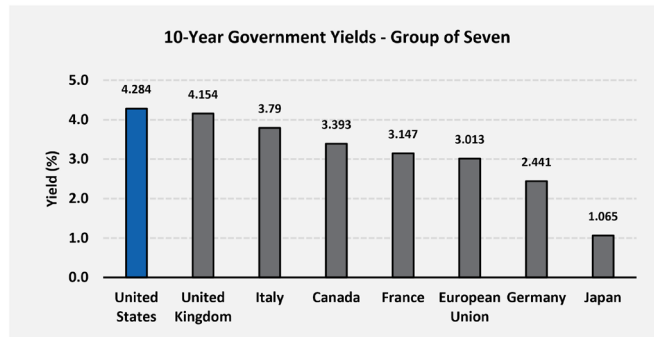


U.S. Yield Snapshot

Yields remain high in the world’s largest government bond market.

Even after declining 11 basis points this month, U.S. Treasury yields are still running higher than the debt of every member of the Group of Seven (G-7) across 10-year maturities.

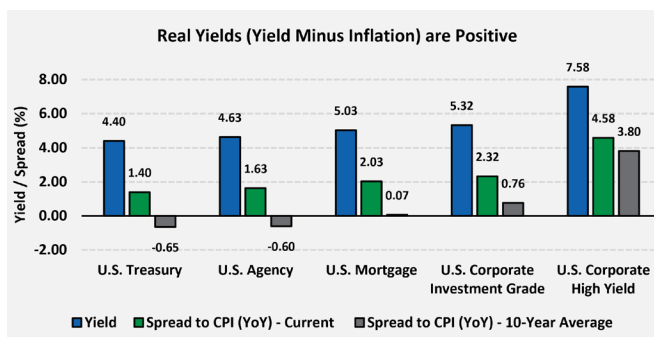
Source: Bloomberg, 24 July 2024. Past performance is no guarantee of future results.



Real yields appear attractive.

Yields across major U.S. fixed income indices are now well above the inflation rate. For example, the ICE BofA Treasury Index yields 4.40%, which is 1.40% above last month’s YoY CPI print and 2.00% above the ten-year average of -0.65%.

Source: ICE DATA INDICES, LLC (“ICE DATA”), 24 July 2024. Ten-year average from 06/2014 to 06/2024. 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.

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

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