August 28, 2024

Bond Markets Demonstrate Increased Volatility, Lessened Correlation as Rate Cuts Likely to Create Favorable Conditions

Bond Market Update: Fed Likely to Cut Rates in September

The bond market has left investors feeling a bit whipsawed this month. After a weaker-than-expected jobs report, yields on the benchmark 10-year Treasury declined from 4% to 3.67%, only to retrace that move back to 4%—all within the first six trading days of the month.[1] The ICE BofA MOVE Index, a measure of bond market volatility that has averaged just 77 over the last decade, breached 120 on Aug. 5, and has remained above 100 throughout the first three weeks of this month. Amidst the volatility, Jerome Powell gave a dovish speech on Aug. 23, saying, "The time has come for policy to adjust."[2] This statement all but confirms a rate cut at the next Federal Open Market Committee meeting in September, and bonds have reacted accordingly. Yields on most major fixed income indices moved lower, and year-to-date performance is now solidly positive on the year. The charts below summarize the yield and performance of select fixed income indices and tenors as of Aug. 23.

U.S. Treasury Yield Curve

		Change (Basis Points)	
Maturity	Yield	Month-to-date	Year-to-date
2-year	3.894	-36.5	-35.9
5-year	3.629	-28.5	-22.1
10-year	3.787	-24.5	-9.3
30-year	4.083	-22.1	5.3

Source: Bloomberg, 26 August 2024 (US On/Off The Run Sovereign Curve)

U.S. Corporate (Investment Grade) Yield Curve

		Change (Basis Points)	
Maturity	Yield	Month-to-date	Year-to-date
2-year	4.648	-31	-34
5-year	4.522	-29	-22
10-year	4.941	-25.6	-12.6
30-year	5.267	-24.4	10.7

Source: Bloomberg, 23 August 2024 (USD US Corporate IG BVAL Yield Curve)

Municipal (AAA) Yield Curve

		Change (Basis Points)	
Maturity	Yield	Month-to-date	Year-to-date
2-year	2.495	-35.3	-0.9
5-year	2.49	-27.5	27.4
10-year	2.688	-8.7	41.9
30-year	3.645	-5.9	24.2

Source: Bloomberg, 23 August 2024 (BVAL Muni AAA Yield Curve)

Index Characteristics and Returns

			Returns (%)	
Index	Yield (Worst)	Modified Duration	Month-to-date	Year-to-date
U.S. Treasury	3.89	6.27	1.850	3.270
U.S. Agency	4.03	3.23	1.166	3.644
U.S. Corporate Investment Grade	4.88	6.78	2.083	4.534
U.S. Corporate High Yield	7.28	3.33	1.409	6.104
U.S. Mortgage Backed Securities	4.56	5.69	2.075	3.899
U.S. Broad Market	4.37	6.13	1.934	3.806
Global Broad Market	3.59	6.47	1.486	2.483
Emerging Market Corporate	5.77	4.96	1.616	6.274
Municipal Investment Grade	3.48	5.91	0.786	1.589
Municipal High Yield	4.99	5.53	0.959	6.779
Municipal Taxable	4.75	7.93	1.998	4.560

Source: ICE DATA INDICES, LLC ("ICE DATA"), 23 August 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 Meeting	31-Jul-24
Fed Funds Rate - Lower Bound	5.25	Next FOMC Meeting	18-Sep-24
Fed Funds Effective Rate	5.33		
Discount Rate	5.50		

Source: Bloomberg, 23 August 2024

Past performance is no guarantee of future results.

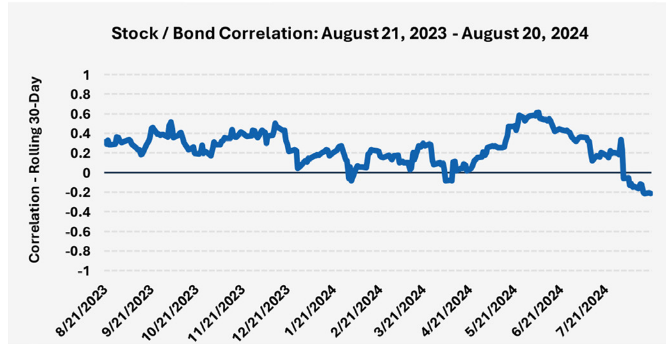
[1] *"Daily Treasury Long-Term Rates," U.S. Department of the Treasury, Aug. 22, 2024, https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_long_term_rate&field_tdr_date_value_month=202408*

[2] *"Speech: Review and Outlook," Board of Governors of the Federal Reserve System," Aug. 23, 2024, https://www.federalreserve.gov/newsevents/speech/powell20240823a.htm*

Stock/Bond Correlation

Stocks and bonds moved in opposite directions to start the month—a welcome relief for 60/40 portfolios after nearly two years of positive correlations. The S&P 500 index was down over 6% from 07/31 to 08/05, while the U.S. Treasury Index was up 1.80% during that same period

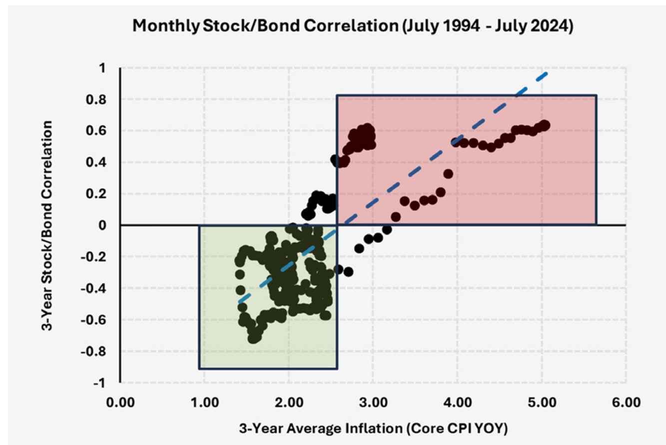
Source: Bloomberg, 22 August 2024. Rolling 30-day correlation between the S&P 500 Index and the Bloomberg US Treasury Index. Past performance is no guarantee of future results.



The correlation between stocks and bonds is often negative when inflation is well anchored.

With the year-over-year Consumer Price index (YOY CPI) declining from 9.1 to 2.9 over the last two years, and YOY Core CPI dropping from 6.6 to 3.2, there is reason to be optimistic that bonds will play an important role in diversifying stock volatility moving forward.[3] This is more likely to be the case if inflation continues on a sustainable path towards the Fed's 2% target.

Source: Bloomberg, Harmont calculations using the S&P 500 Index and the Bloomberg US Treasury Index. CPI data from the Bureau of Labor Statistics, 22 August 2024

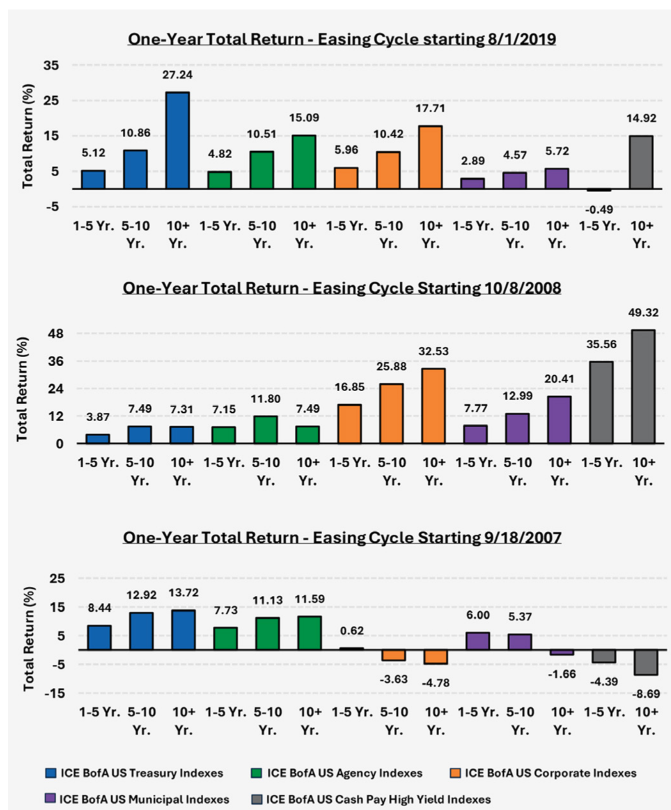


[3] *"Consumer Price Index—July 2024," U.S. Bureau of Labor Statistics, Aug. 14, 2024, https://www.bls.gov/news.release/pdf/cpi.pdf*

Historical Performance – Easing Cycles

Intermediate and long maturities have the potential to outperform short during easing cycles. The charts on the right look at the total returns for select bond indices at the beginning of the last three Fed easing cycles (March 2020 cuts excluded). While outperformance varied across fixed income sectors, maturity bands, and easing cycles, they illustrate the general tendency for intermediate and long maturities to outperform short when rates are falling.

With attractive yields still broadly available, and market expectations for future rate cuts increasing, extending duration should be an important consideration for most fixed income investors.



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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