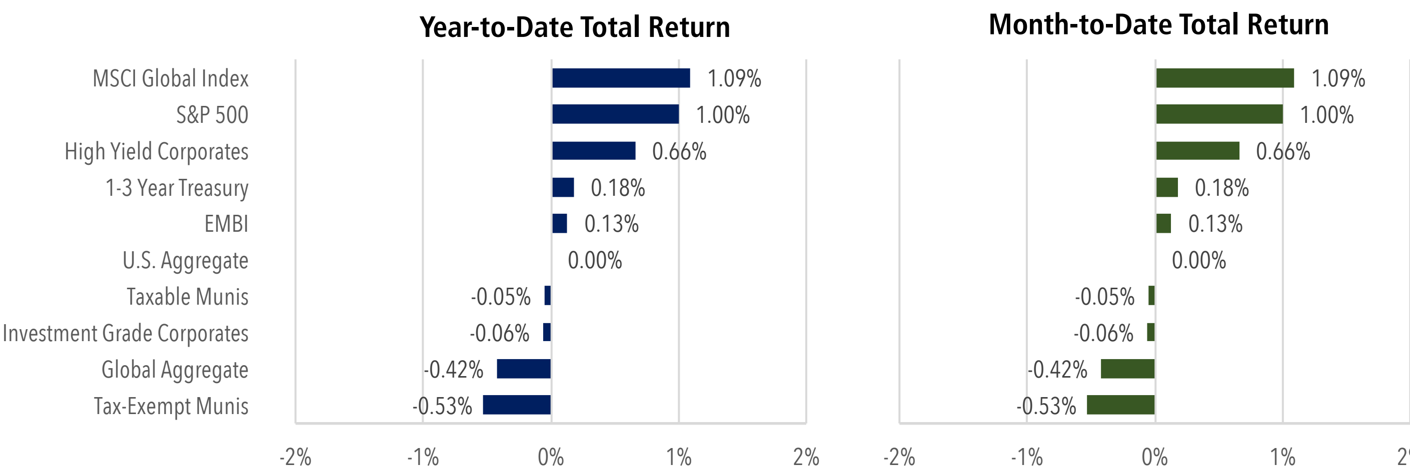
Week Ending: **January 17, 2025**

Bond Oddity

Economic Overview:

In theory, bond yields convey the collective wisdom of how markets see the present and future of a country. The 30-year Chinese government bond yield recently dipped below the 30-year Japanese government bond. The occurrence is remarkable on two counts. First, Japan has languished near deflation for 20 years, so rising yields reflect some chance that the economy is turning the corner. Second, China has been teetering on the cusp of deflation (e.g., CPI near 0% for 18 months). Investors have also become pessimistic about Chinese growth, with the property market downturn weighing on activity, suggesting China may follow the path tread by Japan after its 1980s boom and bust. A Chinese growth slump would be bad news as China's real per capita GDP is only half of Japan's and only 60% of Japan's level in the 1990s. The good news? This week, China reported that Q4 GDP was up 5.4% compared to a year ago. Another takeaway from the chart is that with lower yields, it may be an opportunity for China to take advantage of lower borrowing costs and issue more longer-term government debt.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: Loan funds have seen $10.5 billion in inflows over the past three months, compared to a $1.5 billion outflow for high-yield bond funds. The changing outlook for rates likely drives investor preference for loans. Markets are pricing in a higher-for-longer rates environment that would benefit floating-rate assets like loans.

Corporates: Investment grade (IG) issuance was bolstered this week by the big six banks (Bank of America, Citibank, Goldman Sachs, JP Morgan, Morgan Stanley, and Wells Fargo), pushing weekly totals to almost $55 billion and resulting in $135 billion in supply month to date. This was the first time since January 2018 that we saw all six banks issue in the same week. Expectations for next week range from $10-25 billion.

Municipals: LSEG Lipper reported $251 million in outflows last week, of which $168 million left ETFs and the remaining $83 million came from mutual funds.

Equities: The U.S. equity market posted strong returns for the week as softer inflation data and a better-than-expected start to the corporate earnings season boosted market sentiment. All sectors posted gains, with energy, materials, and financials up by more than +5%, while communications, consumer staples, and healthcare were the market laggards.

Securitized Products: Mortgage rates have risen back above 7%, casting into doubt consensus calls for a more active housing market in 2025. Delinquencies have increased across mortgage products, but this has not led to higher losses, given the substantial embedded home price appreciation. The devastating wildfires in Los Angeles are not expected to flow through to material losses, given the presence of insurance coverage coupled with relatively low exposure to heavily damaged areas.