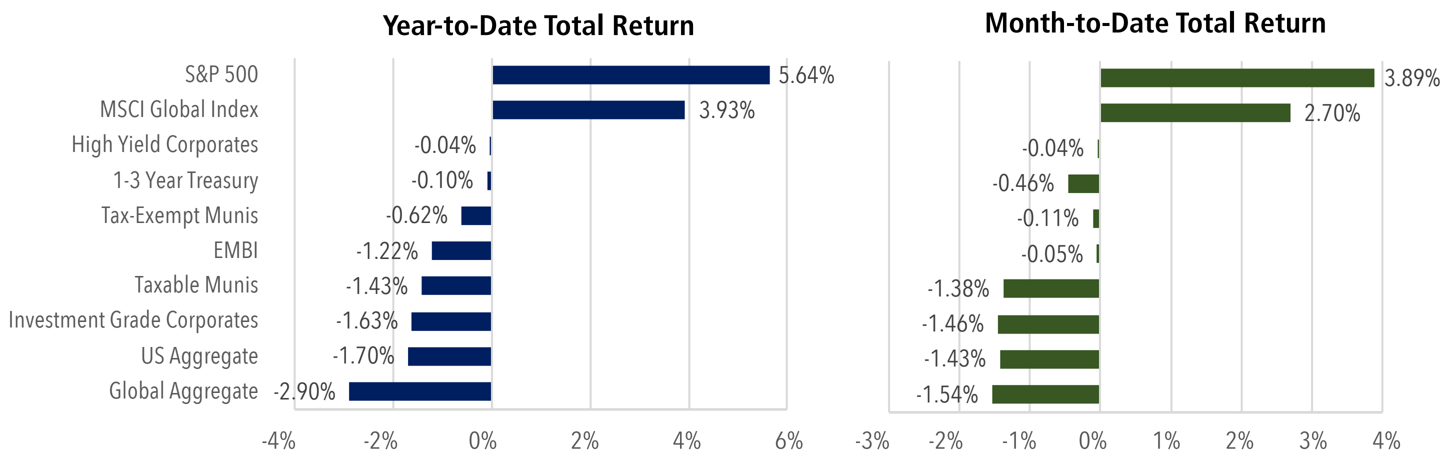
Week Ending: **February 16, 2024**

Blame Game

Economic Overview:

This week, January's Consumer Price Index (CPI) surprised investors, with core CPI, which excludes volatile food and energy prices, jumping 0.4% on the month and 3.9% versus a year ago. Bond investors quickly reassessed the timing and quantity of rate cuts, now anticipating four 0.25% rate cuts by year-end compared to seven when the year began. A blame game quickly got underway. Some investors lampooned the Fed for "pivoting prematurely." Others (ourselves included) blamed investors for setting themselves up for disappointment. After all, the Fed's December Summary of Economic Projections (SEP) suggested that even if inflation continued to cool, three cuts—not seven!—would be appropriate. Historically, neither investors nor policymakers excel at soothsaying. The 2022-2023 hiking cycle illustrates that reality often diverges from Fed and market expectations. What's the lesson? In Chair Powell's words, the economy can "evolve in many ways." Be prepared to be surprised again.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: High yield has held in reasonably well this year despite higher rates. While the yield on the 10-year treasury is +42 basis points higher, the total return for high yield is nearly flat (-0.08%) thanks to modest spread compression and healthy income generation. The ability to offset rate-induced price volatility is a key feature of high yield bonds, which makes them a good diversifier for more rate-sensitive fixed-income asset classes.

Corporates: While interest rates increased, investment-grade corporate spreads ground tighter to an option-adjusted spread of 92 basis points, back to the year-to-date tights. The strength in investment-grade corporates was partly due to the $6 billion in fund inflows to high-grade bonds on the week, showing continued demand for the asset class.

Municipals: Municipal issuance in January totaled $28 billion, coming in slightly above the 5-year average of $27 billion, with net issuance at $9 billion.

Equities: The U.S. equity market ended the week unchanged as mixed economic data increased the uncertainty surrounding the Fed's interest rate cuts. The best-performing sectors were energy and materials, which likely benefitted from increased inflation expectations. Conversely, technology, communications, and consumer discretionary gave back some year-to-date gains after ending the week lower.

Securitized Products: A weak retail sales number wasn’t enough to dampen the US ABS market this week, which saw over $8 billion in new issue supply. Year to date, we have seen a record $47 billion in new issues, compared to the historical average of $33 billion. Auto ABS has primarily dominated the issuance with consistent vehicle sales and new entrants utilizing the securitization market.

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