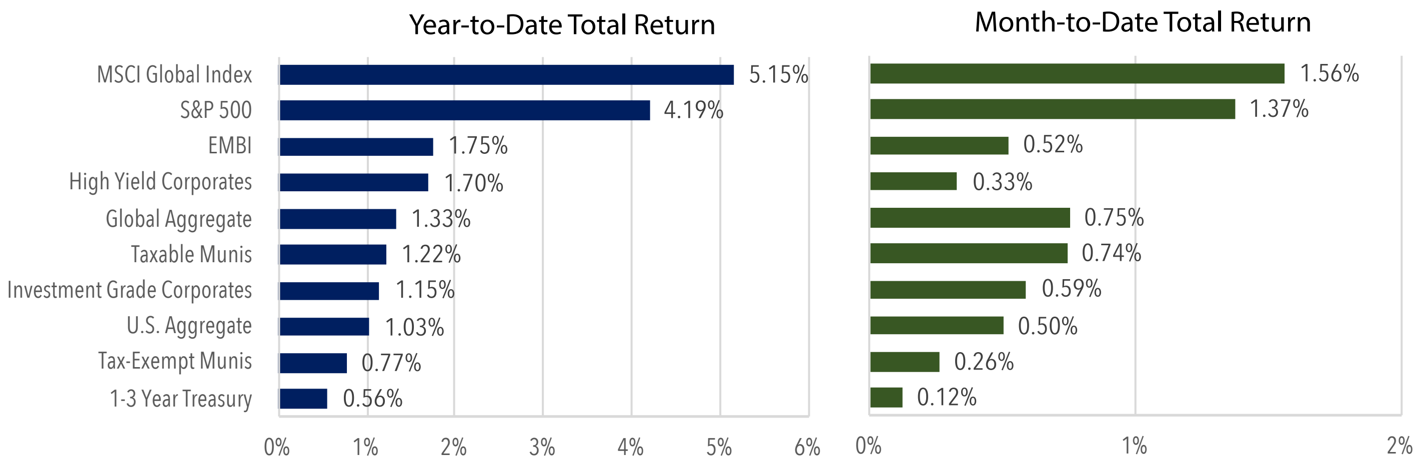
Week Ending: **February 21, 2025**

The Narrow Path

Economic Overview:

The Reserve Bank of Australia (RBA) reduced its main policy rate by 25 basis points this week from 4.35% to 4.10%, becoming the last major central bank to begin a rate-cutting cycle. With high pandemic-induced inflation worldwide, Australia adopted a different approach to combatting price pressures—a so-called "narrow path" aimed at preserving the gains in the labor market made during the pandemic while patiently bringing inflation back within its target band of 2-3%. In other words, the RBA kept its monetary policy significantly less restrictive than its global peers, which meant the RBA would be slower to cut. So far, it's a success story, with inflation moderating to 3.2% as of Q4 2024, near the RBA's 2-3% inflation target range. Meanwhile, the unemployment rate is near a record low at 4.1%, and the employment-to-population ratio registered its highest reading ever in January based on data out this week. Is the narrow path a model for other central banks to follow?

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: High-yield bonds are outperforming loans by almost +0.9% this year, but 80% of that result is attributable to lower interest rates. Falling rates benefit bond prices but have little near-term impact on loan prices. In the short term, we expect interest rate moves to account for most of the difference between loan and bond performance.

Municipals: Last week, LSEG Lipper inflows to municipal funds were positive for the 5th consecutive week. Net inflows totaled $546 million, driven entirely by $661 million of inflows into ETFs, offsetting the $115 million of outflows from mutual funds.

Equities: The U.S. equity market fell for the third time in four weeks due to growing concerns about an economic slowdown. Disappointing economic data and a surprise cut to Walmart's revenue outlook drove a flight-to-quality. Consumer discretionary, communication, and industrial sectors led markets lower, while energy, utilities, and healthcare were the best-performing sectors.

Securitized Products: While credit risk transfer (CRT) issuance remains relatively limited, as high mortgage rates restrict agency origination, the non-qualified mortgage (non-QM) sector continues to expand. January issuance in the space grew 40% year-over-year, implying that the mortgage market for borrowers underserved by government-sponsored enterprises (GSEs) (such as investors and those who are self-employed or credit-impaired) remains robust. Though non-QM delinquencies are elevated, resilient deal structures and embedded home price growth have kept losses minimal.