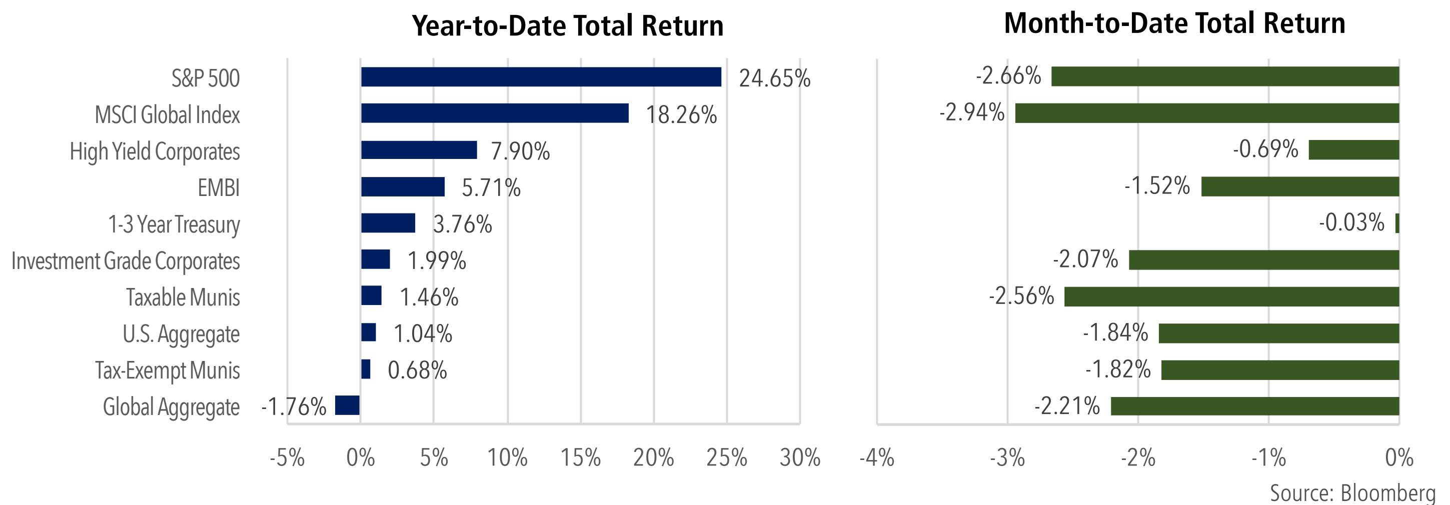
Week Ending: **December 20, 2024**

Risk & Reward

Economic Overview:

Risk and reward have gone hand in hand all year. Year-to-date, the riskiest assets, U.S. equities and global equities, have returned 25% and 19% respectively, while U.S. high yield bonds returned 8.4%. What explains the stellar year? Another year of good economic news. As Fed Chair Jerome Powell remarked this week, "The economy is strong overall and has made significant progress toward our goals over the past two years." Looking ahead, we find plausible a scenario in which the Fed's preferred inflation gauge, the core PCE price index, drifts back down to 2%. Meanwhile, the unemployment rate could edge higher, reaching 4.3% by year-end, which would still be quite low compared to the long-run average of 5.5%. With that backdrop, we expect the Fed to continue to cut the fed funds rate to support the labor market as inflation fades, albeit at a slightly slower pace in 2025 compared to 2024. In turn, rate cuts for a still-growing economy might bode well for the same risk assets next year, too. Enjoy the holiday season and see you back here in 2025!

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: High yield has returned 7.66% year-to-date, which compares to a starting yield of 7.65% on 12/31/2023. Analysts consider many variables when projecting future returns, but yield's track record as a return estimator remains robust. With a yield of 7.47% as of yesterday, our outlook remains positive on performance for next year.

Corporates: The week kicked off with headlines of a Honda and Nissan merger, causing Nissan bond spreads to tighten sharply on investor optimism. However, after Wednesday's Fed meeting, the rest of the investment grade (IG) market did not follow suit, as rates and credit spreads sold off modestly. Spreads on the broad IG index widened four basis points (bps) this week to an option-adjusted spread (OAS) of 79, though just five bps wide of the year-to-date tight of 74 bps.

Municipals: 2024 has been a memorable year for the muni market due to issuance levels near historical highs and increased policy uncertainty stemming from the aftermath of the red sweep in this year's elections. Recent FOMC meetings in November and December signaling fear of sticky inflation offset the optimism our market felt at the beginning of the year that we were likely on a steady path to 2% inflation and lower interest rates, threatening to wipe out our 0.68% gain so far this year.

Equities: The U.S. equity market posted strong returns for 2024. Despite macro concerns throughout the year, fundamentals proved to be strong, with the U.S. economy and corporate earnings posting better-than-expected growth. At the same time, the Fed shifted to a more accommodative stance. This year, all sectors posted gains, with growth-oriented sectors such as communications, technology, and consumer discretionary leading markets higher, while materials, health care, and energy were the market laggards.

Securitized Products: The collateralized loan obligation (CLO) market brushed off equity volatility this week and ended with tighter spreads and a firm tone. The holiday season has done little to slow the pace of new issuance in the CLO market, even as other securitized sectors have slowed down. Year-to-date CLO spreads are between 50 and 200 bps tighter and, combined with an elevated 3-month benchmark rate, have resulted in healthy total returns.

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