Fixed Income Quarterly Commentary

Growth Through Stability

Q4 ▪ 2023

Market Update

The Federal Reserve signaled in Q4 that rate hikes were done and that it is looking at rate cuts in 2024. With inflation trending lower and the end of rate hikes, interest rates on intermediate and longer maturity treasuries declined significantly during the fourth quarter as bonds rallied. Despite that decline, the yield on the 10-year treasury was roughly back to where it started in 2023. The bond market has been anticipating a recession for over a year now, as evidenced by the inverted yield curve predicting rate cuts in 2024. The bond market is also wrestling with a supply and demand mismatch in Treasuries, driven by Federal Government issuance to fund deficit spending and weaker demand due to the Fed tapering asset purchases. These two cross currents will likely make Treasury yields more volatile in 2024. At AMI, we are somewhat skeptical of the "soft landing" scenario where the economy avoids a recession. With the fixed income markets reflecting this hopeful outcome, we are underweighting the higher cyclical portions of the bond market.

Core Taxable Fixed Income

Core accounts finished with positive returns in the fourth quarter and generally outperformed the index that returned 4.41%[1]. The outperformance was primarily driven by taxable municipal bonds, which outperformed other government bonds during the quarter. Portfolios also benefited from outperformance in corporate bonds, which were buoyed by some of the stronger economic data points in the fourth quarter.

Municipal Bonds

Municipal accounts were up in the fourth quarter, generally outperforming the index that was up 5.25%[2]. The rapid decline in Treasury yields helped all municipal bonds, with the longer maturity bonds outperforming shorter bonds, a reversal of last quarter. Callable bonds with longer maturities drove the outperformance relative to the index. At AMI, we continue to focus on essential services (water, sewer, and electric) and Mello-Roos bonds (backed by property taxes) with clear cash flows and low pension liabilities.

High Yield Fixed Income

High Yield accounts posted positive returns during the fourth quarter but underperformed the index that was up 6.96%[3]. The primary driver of the underperformance was due to being overweight floating rate bonds, convertible notes, and high-quality issuers. We remain cautious on the economy and are positioned for an economic slowdown with a focus on higher quality bonds that should be less sensitive to the economy.

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Disclosures

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1. Figures presented on page one are from the ICE BofAML 1-10 Year US Corp and Government Index as of 12/31/23

2. Figures presented on page one are from the ICE BofAML 3-7 Year US Municipal Securities Index as of 12/31/23

3. Figures presented on page one are from the ICE BofAML 1-10 Year US High Yield BB-B Index as of 12/31/23