Fourth Quarter 2024 Bond Market Review and Outlook

"I still see us on a downward policy rate path. Looking at everything before me now, I am not about to walk off this path, or turn around." (source: *Bloomberg* 1/9/25 Philadelphia Fed Reserve President Philip Harker)

The Friday, January 10 jobs report surprised on the upside following Thursday's stronger than expected job growth in the BLS's December employment report. The market reaction was a continued rise in longer term interest rates.

The 10-year Treasury pushed up to 4.77% (its highest yield since November 2023 (source: *Wall Street Journal* 1/12/25)). And the 30-year Treasury rose to 4.96%. (source: ibid). This has resulted in a positively sloped yield curve. The two year to five year portion of the yield curve is now positively sloped for the first time since 2022 (source: ibid).

However, the sell-off on the longer end of the curve has been much larger, resulting in a "bear steepening" trade. These are rare events following periods of yield curve inversions and this now past curve inversion was the longest in history.

The higher yields offered on 10-year and 30-year bonds is increasingly attractive to investors. The term premium offered on 10-year bonds is now 0.6% . While positive, it still is below the historical average of 1.5% (source: ibid). But, since the yield on the shorter 5-year bond is equal to the S&P 500 one-year forward earnings yield (see graph on page 3), the 5 to 10-year segment may be increasingly more attractive to asset allocation strategists (source: ibid). If equity valuations are stretched, bonds may be a safe haven, a way to protect and lock in equity market gains.

While the current consensus is that the economy is stronger than forecasted, there are some elements that bear scrutiny. The Institute for Supply Management reported that the manufacturing sector recorded its ninth straight month of contraction and its 25th month of contraction in the past 26 months. Also, residential and non-residential construction remain soft (source: *The View* by Value Line 1/13/25).

The fourth quarter's GDP expansion estimate of 2.4% results primarily from consumer spending (source: ibid). That consumer spending was financed with debt, at levels considered excessive. For the quarter ended September 30 credit card debt climbed to a record $1.17 trillion. Coincident with charge offs of over $46 billion in delinquent credit card balances, a 50% increase over the prior 12-months and the highest level since 2010 (source: ibid). A spending slowdown by consumers would lower GDP growth.

Another source of sluggish activity is the housing sector. Mortgage rates have risen in lock step with Treasury bonds. Mortgage rates have risen for a fourth week and as of 1/9/25 are 6.93% (source: *Bloomberg* 1/9/25). The result has been a sharp decline in new applications for home purchase loans (source: ibid). This drop in demand will probably result in slower growth in construction and GDP.

*(Continued on page 3)*

| Yields* on 12/31/2024 | Yield* |
| --- | --- |
| **CAM Broad Market (corporate core plus) Strategy** (6.2 year maturity; 4.9 duration) | **5.51%** |
| **CAM Investment Grade (100% corporate bonds) Strategy** (6.7 year maturity; 5.5 duration) | **5.18%** |
| **CAM High-Yield Strategy (only BA & B rated purchased)** (4.8 year maturity; 3.6 duration) | **6.16%** |
| **CAM Short Duration Strategy** (2.7 year maturity; 2.1 duration; 50% IG & 50% HY) | **5.30%** |
| **CAM Short Duration Investment Grade Strategy** (2.5 year maturity; 2.1 duration) | **4.74%** |
| **U.S. Treasury**** (10 year maturity) | **4.57%** |
| **U.S. Treasury**** (5 year maturity) | **4.38%** |
| **U.S. Treasury**** (2 year maturity) | **4.24%** |

* The lower of yield to maturity or yield to worst call date ** Source: Bloomberg

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## CAM's Key Strategic Elements

- Bottom-up credit analysis determines value and risk.
- Primary objective is preservation of capital.
- Larger, more liquid issues preferred.
- Target is always intermediate maturity.
- No interest rate forecasting.
- All clients benefit from institutional trading platform and multi-firm competitive bids and offers.

| CAM returns are after CAM's average management fee & all transaction costs but before any broker, custody or consulting fees. **The indices are unmanaged and do not take into account fees, expenses, and transaction costs.** | **Total Return (%)** | **Annualized Returns (%)** | | | | |
|---|---|---|---|---|---|---|
| | 4Q '24 | YTD | 1-YEAR | 3-YEARS | 5-YEARS | 10-YEARS |
| **CAM Broad Market Strategy—Net** 1/3 high yield, 2/3 investment grade | -1.53 | 3.90 | 3.90 | -0.66 | 1.22 | 2.46 |
| **CAM High Yield "Upper Tier" Strategy—Net** only purchase BB and B; no purchases of CCC & lower | 0.21 | 6.53 | 6.53 | **1.11** | 2.86 | 2.99 |
| Bloomberg US Corporate High Yield Index | 0.17 | 8.19 | 8.19 | 2.92 | 4.21 | 5.17 |
| **CAM Investment Grade Strategy—Net** 100% corporate bonds | -2.34 | 2.68 | 2.68 | -1.50 | 0.44 | 2.19 |
| Bloomberg US Corporate Index | -3.03 | 2.13 | 2.13 | -2.26 | 0.31 | 2.43 |
| **CAM Short Duration Strategy—Net** 1/2 investment grade, 1/2 high yield | 0.36 | 5.84 | 5.84 | 1.74 | 2.67 | 2.31 |
| **CAM Short Duration Investment Grade Strategy—Net** 100% corporate bonds | -0.14 | 4.47 | 4.47 | 0.74 | 1.34 | 1.95 |

**Relative Performance Review 12/31/2024**

CAM's **Investment Grade Strategy ("IG")** produced a gross total return of -2.28% in the quarter ended December 31, 2024, compared to -3.03% for the Bloomberg U.S. Corporate Index. CAM always positions a majority of the portfolio within intermediate maturities. Longer dated securities (10+ years) returned -6.20% for the period, widely underperforming the broader index. CAM's underweight in this duration bucket produced a +86 basis point contribution to excess return. Conversely, Shorter-dated securities (1-3 years) returned 0.19% for the period, outperforming the broader index. The allocation effect of CAM's underweight in that duration bucket was a -49 basis point contribution to excess return. CAM's positioning within the Electric Utilities industry was the largest positive impact to performance, with a +10 basis point contributions to excess return. Our positioning within the Banking industry was the largest negative contribution of -10 basis points. The YTD return for the CAM IG strategy was 2.92%, exceeding the Index return of 2.13%. CAM's positioning within the Airline industry was the largest positive impact to performance, with a +17 basis point contribution to excess return. Our positioning within the Banking industry was the largest negative contribution of -9 basis points.

The **High Yield Strategy ("HY")** delivered a gross total return of 0.29% in Q4 while the Bloomberg US Corporate High Yield Index returned 0.17%. CAM's overweight and security selection within the Banking industry had the largest positive impact on performance relative to the index with a +22 basis point contribution to excess return during the quarter. For negative impact relative to the index, CAM's positioning and security selection within the Technology sector was a -9 basis point contribution to excess return. CAM does not purchase securities rated CAA and lower, and this cohort's performance was significantly stronger than that of the higher quality portion of the Index. The result of CAM's underweight was a -25 basis point contribution to excess return during the fourth quarter. The HY YTD return was 6.84% while the Index returned 8.19%. CAM's overweight and security selection in the Banking industry had the biggest positive impact on performance relative to the index with a +53 basis point contribution to excess return. As far as negative impact relative to the index was concerned, CAM had no exposure to Wirelines, which was a -33 basis point impact to its performance relative to the Index.

Our **Broad Market Strategy ("BM")** – a 67%/33% blend of the IG and HY strategies above – produced a gross total return of -1.47% for the quarter compared to -1.97% for the Index, a similar blend of Bloomberg IG and HY corporates. At 12/31/2024 the modified duration of CAM's broad market portfolio was 4.95 while the modified duration of the Blended Benchmark was 5.76. Interest rates moved higher during the quarter which had a positive impact on CAM's performance relative to the index. The allocation effect of CAM's maturity profile served as a +62 basis point positive impact relative to the index during the quarter. The YTD return for the CAM Broad Market strategy was 4.17% compared to a blended Index return of 4.12%. CAM's overweight and security selection in the Consumer Cyclical Services industry had the biggest positive impact on performance relative to the index with a +12 basis point contribution to excess return. As far as negative impact relative to the index was concerned, CAM's positioning and security selection within the Pharmaceuticals and Technology industry groups yielded -17 and -10 basis point contributions to excess return, respectively.

**Bloomberg Bond Indices Returns vs. CAM Gross (annualized %)**

| Periods ended 12/31/2024 | 10-yrs | 20-yrs |
|---|---|---|
| **U.S. Aggregate** | **1.35** | **3.01** |
| **U.S. Corporate** | **2.43** | **3.97** |
| **CAM Investment Grade Strategy (gross)** | **2.43** | **4.06** |
| **CAM Investment Grade Strategy (net)** | **2.19** | **3.82** |

**Better Asset Allocation Might Result from More Exacting Analysis**

CAM looks to minimize the overall volatility of our High Yield strategy by focusing on the upper tier of High Yield credit (BA-B), as well as the conservative portion of a firm's capital structure. The chart to the right indicates 5, 10, and 20-year performance for the High Yield credit quality cohorts. While the CAA-rated cohort outperformed BA and B -rated bonds for the more recent 5 and 10-year periods, it underperformed higher quality BA-rated bonds over the longer 20-year period. Not shown in the table is the pronounced volatility that has characterized the CAA-rated and lower subsectors. For example, the CAA credit tier returned -20.55% in Q1-2020 (i.e. start of the COVID pandemic) versus -12.69% for the HY Index as a whole. In fact, over the 20-year period the standard deviation of the CAA credit tier has been approximately 60% greater than the broader Bloomberg US Corporate HY Index (16.54% versus 10.31%). This shows investors may not be rewarded for the additional volatility and risk of the CAA-rated and lower subsectors.

Upper tier High Yield credit (BA-B) has also outperformed the Bloomberg US Aggregate Index (the "Agg") for all periods, indicating these credit quality stripes have also kept better pace with inflation.

The above points suggest that upper tier High Yield bonds deserve consideration as a core holding over a complete market cycle.

**Total Return of High-Yield Bonds by Credit Quality**
(periods ended 12/31/2024) Source: Bloomberg US Corporate Indices **(annualized %)**

| High-Yield Bond Sectors | 5-years | 10-years | 20-years |
|---|---|---|---|
| **BA-rated bonds** | **4.05** | **5.11** | **6.53** |
| **B-rated bonds** | **3.75** | **4.81** | **5.72** |
| **CAA-rated bonds** | **5.09** | **5.58** | **6.29** |
| **CA & D-rated bonds** | **12.28** | **4.85** | **3.66** |

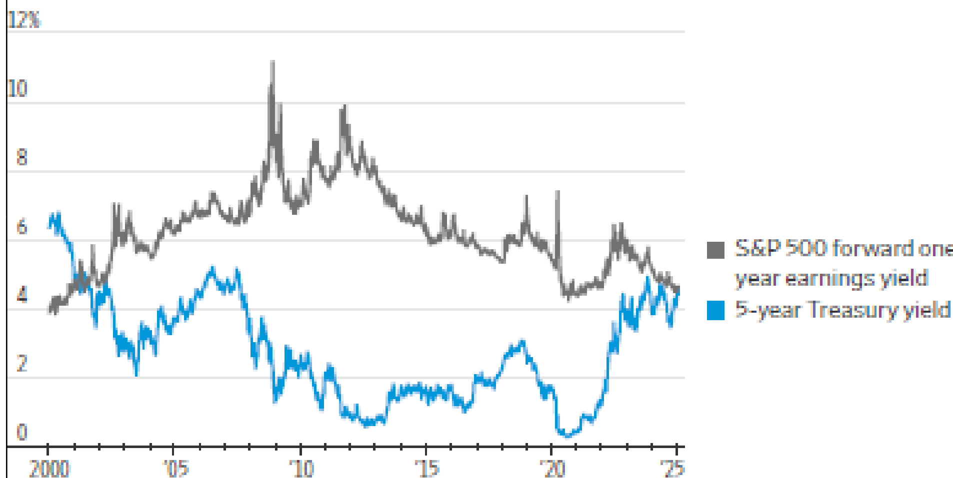
**Performance of Other Asset Classes**
**(periods ended 12/31/2024) Source: Bloomberg & Lipper**

| | | | |
|---|---|---|---|
| **S & P 500 Stocks** | **14.53** | **13.10** | **10.34** |
| **Bloomberg U.S. Aggregate** | **-0.33** | **1.35** | **3.01** |

The December 31 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 12/31/2024 all spread cohorts have tightened modestly versus 12/31/2023 while Treasury yields moved meaningfully higher. The 10-year U.S. Treasury closed out 2024 at 4.57%, a 69 basis point increase over the close of 2023.

We have a positive stance on the investment grade credit market for the year ahead. The "all-in" yield of the asset class continues to trade at much higher levels than recent history, providing a comfortable margin of safety for spread widening while still generating positive total returns.

| Credit Rating | 20-Year Average Spread (as of 12/31/24) | 12/31/24 | 12/31/23 | 12/31/22 | 12/31/21 | 12/31/20 | Tightest This Decade (as of 12/31/24) |
|---|---|---|---|---|---|---|---|
| A | 1.28% | 0.68% | 0.85% | 1.09% | 0.74% | 0.73% | 0.63% |
| BAA | 1.88% | 0.97% | 1.21% | 1.59% | 1.13% | 1.21% | 0.95% |
| BA | 3.51% | 1.79% | 2.01% | 2.95% | 1.94% | 2.64% | 1.58% |
| B | 4.88% | 2.77% | 3.10% | 4.89% | 3.13% | 3.79% | 2.54% |
| CAA | 8.95% | 7.03% | 8.09% | 11.54% | 5.96% | 7.15% | 4.91% |

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The unemployment report for December 2024 released January 10 headlined a much larger than expected increase in jobs. However, the industries that added the vast majority of jobs were those that benefit from government spending. Those were private education and health services and government. For December leisure and hospitality and retail posted slightly larger job growth than government. However, the 12-month data shown on the chart on page four shows the enormous impact of government spending on 2024 job growth (source: Bureau of Labor Statistics 1/10/25).

This follows the same distribution of job growth in 2023 which saw 2.7 million jobs created. Over 60% of jobs created in 2023 were in the government and health services sectors (source: Bureau of Labor Statistics 1/5/24). So a majority of job growth in 2024 and 2023 is the result of government spending.

Of note is the significant decline in employment in the manufacturing sector, which follows a year of no growth in 2023 (source: ibid). So how robust is the economy given the sources of job growth? Will it fade with the completion of the Biden Administration's massive spending bills? Employment concerns may once again become the prime consideration at the FED as it was this past August and the early fall, leading to an increasing number of interest rate cuts.

Recent reports detail that hiring is slowing and it is taking workers longer to find a new job. The number of unemployed workers searching for work for at least six months has risen 50% since the end of 2022 to more than 1.6 million workers (source: *Wall Street Journal* 1/5/25). The most difficult sectors are the high paying white collar jobs in tech, law and media (source: ibid).

There is now about one job posting per unemployed person down from a ratio of 2:1 in early 2022. A Conference Board survey of consumers in December showed 37% thought jobs were plentiful down

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## Footnotes and Disclosure

Advisory services are offered through Cincinnati Asset Management, Inc., ("CAM") an investment adviser registered with the U. S. Securities and Exchange Commission. The CAM High Yield, Investment Grade, Broad Market, Short Duration, and Short Duration-Investment Grade composites consist of all discretionary portfolios under management, including all securities and cash held in the portfolios, and have been appropriately weighted for the size of the account. All accounts are included after they are substantially invested.

Returns are calculated monthly in U.S. dollars and include reinvestment of dividends and interest. Figures for periods of less than one year are cumulative returns. All other figures represent annualized returns. Past performance is no guarantee of future results.

When compared to indices' performance, CAM results are after deduction of all transaction costs and CAM advisory fees. CAM advisory fees used are the actual composite averages. Accounts managed through brokerage firm programs usually will include additional fees. "Net of fees" herein refers only to CAM's management fee. The indices and information shown for comparative purposes are based on or derived from information generally available to the public from sources believed to be reliable. No representation is made to its accuracy or completeness. The Indices are referred to for informational purposes only and the composition of the Index is different from the composition of the accounts included in the performance shown above. Index returns do not reflect the deduction of fees, trading costs or other expenses.

This material was not intended or written to be used, and it cannot be used, by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

This information is intended solely to report on investment strategies and opportunities identified by CAM. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. This material is not intended as an offer or solicitation to buy, hold or sell of any financial instrument. References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

High yield bonds may not be suitable investments for all individuals. Before investing a thorough reading of all materials and consultation with an independent third party financial consultant may be appropriate. Fixed Income securities may be sensitive to changes in prevailing interest rates. When rates rise the value generally declines. For a depository institution, there is also risk that spread income will suffer because of a change in interest rates. Additional disclosures on the material risks and potential benefits of investing in corporate bonds are available on our website: https://www.cambonds.com/disclosure-statements/

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from 57% in mid 2022. Also, wage growth has fallen to about 4% in 2024 from about 6% a few years ago, symptomatic of a looser job market where employers are finding it easier to attract and retain workers (source: ibid).

A continuation of these trends could lead to job layoffs and a shrinking number of employed workers.

Inflation concerns in China, the world's second largest economy are the polar opposite of those in the USA. In China consumer prices grew just 0.2% in 2024. Recent inflation reports portend a drop in the GDP deflator, more extensive measure of economy wide prices, for a seventh straight quarter. Economists expect it to remain in negative territory through 2025 (source: *Bloomberg* 1/8/25). Given the share of China's economy in exports, this will have an impact on global prices for a number of goods.

Indicative of a weak economy with deflation in large sectors of the economy, such as housing, the 10-year Chinese government bond yield fell to 1.6% this month (source: *Wall Street Journal* 1/14/25). Economists expect more rate cuts by the central bank to provide more liquidity that will possibly spur consumer demand. The declining rates are lowering the yuan's exchange rate, further cheapening the price of Chinese goods sold abroad and exporting deflation.

The EU has reported low GDP growth. In November S&P Global projected 0.8% growth in 2024 and just 1.2% in 2025 (source: Euronews 1/14/25). The EU lowered rates 1% point in 2024, the same as in the USA and more cuts are expected in 2025 (source: *Wall Street Journal* 1/13/25).

So many macro economic elements point to a further decline in interest rates globally and in the USA. Given the steepening yield curve and the relationship to the S&P earnings yield, increasing 5-10 year maturity bond allocations may be opportunistic.

## Sharpe Ratios (risk & reward relative value) Inception-Q4 2024

**CAM Investment Grade Strategy 0.31**
Bloomberg U.S. Corp Bonds 0.28

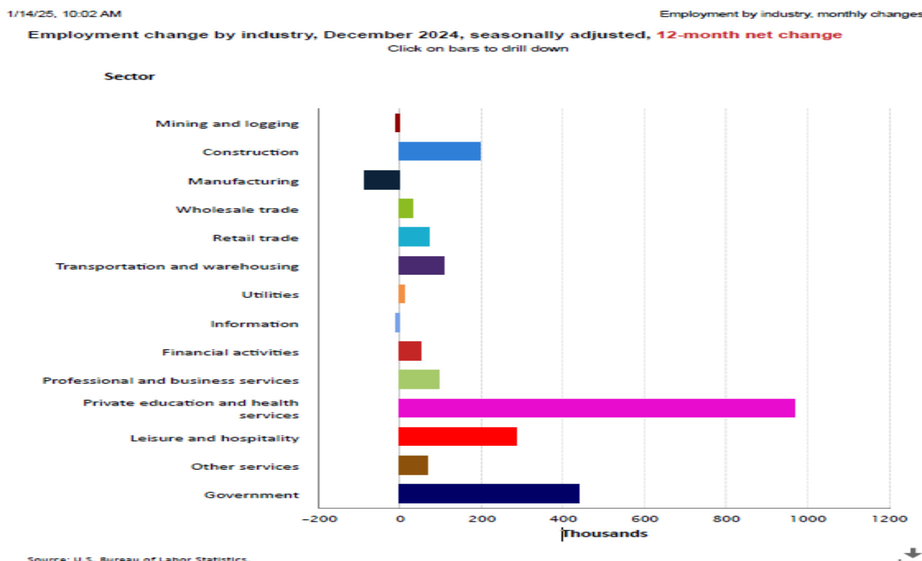
**CAM High Yield Strategy 0.47**
Bloomberg High Yield Corp Bonds 0.47

**CAM Short Duration 0.42**
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.51

**CAM Short Duration IG Strategy 0.74**
Bloomberg U.S. Corporate 1-5 Yr 0.76

**CAM Broad Market Strategy 0.52**
Bloomberg Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.54

An important objective for all Cincinnati Asset Management investment strategies is to deliver superior risk-weighted returns versus the benchmark. A quantitative indication of our success is the Sharpe Ratio that calculates total return per unit of risk. The data on the left indicates we have largely been successful. The Sharpe Ratio of the Investment Grade Strategy exceeded its respective benchmark by approximately 11%. The High Yield Sharpe Ratio approximated its benchmark, and the Short Duration Investment Grade and Broad Market strategies modestly fell short of their respective benchmarks (<4%).




| Rating | BA | B | CAA |
|---|---|---|---|
| **Avg Spread** | 351 | 506 | 945 |
| **Std. Dev.** | 165 | 220 | 406 |
| **12/31/2024** | **179** | **277** | **703** |
| **Lowest Spread** | 151 | 228 | 378 |

**Spreads to Treasuries by Credit Rating** show significantly lower risk of BA and B rated bonds. Source: Bloomberg, Barclays Research (12/31/99 to 12/31/2024)