Fixed Income Quarterly Commentary

Growth Through Stability

Q4 ▪ 2024

Market Update

The fourth quarter saw diverging trends in yields across the Treasury curve. Following a 50-basis-point Federal Funds rate cut in September, the Fed implemented additional 25-basis-point cuts in November and December. This total of 100 basis points of short-term rate cuts follows the peak of 5.25% in July 2023. These reductions were driven by slowing inflation and moderating U.S. economic growth. However, in December, the Fed projected that further cuts might be limited as inflation and the economy have remained stronger than initially expected.

The market has responded by selling longer-term Treasury bonds, which are more sensitive to inflation. Intermediate and long-term Treasury yields have risen by more than 75 basis points since the Fed's September cut. This shift is due to stronger economic data and the impact of the November election. With campaign promises from President Trump likely to increase the deficit, the bond market faces additional pressure following four years of large deficit spending under President Biden. This ongoing supply-and-demand imbalance will likely push Treasury yields higher, regardless of the Fed's actions.

The rise in yields during the fourth quarter negatively impacted returns across most fixed-income assets. For the year, returns remain modest compared to equities but are still positive for most bond sectors. With higher yields, bond portfolios are better positioned to weather interest rate volatility. At AMI, we anticipate continued bond market volatility in the coming year, as the market navigates competing forces: a new presidential administration and a slowing economy. As a result, we've adopted a defensive stance, avoiding the more cyclical sectors of the market.

Core Taxable Fixed Income

Core taxable accounts posted negative returns in the fourth quarter, largely mirroring the index's -1.54%[1] decline. However, for the full year, returns were modestly positive, and AMI clients generally outperformed the benchmark. Rising Treasury yields negatively impacted taxable municipal bonds, high-quality corporates, and intermediate Treasuries in the fourth quarter, with only shorter-duration bonds posting positive returns. For the year, all three of our core bond asset classes showed positive performance. Corporate bonds were the largest contributor to the outperformance, while taxable municipal bonds outperformed other government bond types. As we enter 2025, we will maintain a more cautious allocation in Core portfolios, favoring intermediate Treasuries over corporate bonds, which currently offer historically low additional compensation.

Municipal Bonds

Municipal accounts posted negative returns in the fourth quarter, generally in line with the benchmark which fell -0.95%[2]. Rising yields led to negative returns across the municipal bond curve, while the presidential election also weighed on returns. The potential extension of income tax cuts, which are set to expire next year under President Trump, dampened demand. Higher tax rates typically drive increased demand for municipal bonds, a trend we're unlikely to see in the next four years. For the year, AMI municipal accounts posted modestly positive returns and generally outperformed the benchmark, thanks in part to our strategy of holding longer-maturity bonds with shorter calls. At AMI, our focus remains on essential service sectors, such as water, sewer, and electric utilities, as well as Mello-Roos bonds backed by stable property tax revenues and minimal pension liabilities.

High Yield Fixed Income

High Yield accounts posted negative returns in the fourth quarter and underperformed the index, which declined by -0.14%[4]. This underperformance was mainly due to an overweight position in higher-rated corporate bonds, reflecting our cautious stance on the economy. For the year, AMI High Yield accounts showed positive returns but still lagged the benchmark. Our cautious approach in portfolio construction for 2024, which favored higher-rated bonds, proved less effective as the lowest-rated bonds in the asset class delivered the best performance. With additional compensation for corporate bonds at an all-time low, our focus remains on higher-quality bonds that we believe will be more resilient to economic pressures.

Disclosures

AMI Asset Management (AMI) is an independent investment management firm registered with the Securities and Exchange Commission since 1994. Registration does not imply a certain level of skill or training. AMI provides discretionary asset management services to institutional and individual clients through separately managed accounts using seven equity and fixed income strategies.

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To receive a complete list of composite descriptions, GIPS® Reports, or the latest copy of our ADV Part 2 contact Katharine Kim at (424) 320-4003 or write AMI Asset Management Corporation, 10866 Wilshire Boulevard Suite 770, Los Angeles, California 90024, or Katharine@amiassetmanagement.com.

1. Figures presented on page one are from the ICE BofAML 1-10 Year US Corp and Government Index as of 9/30/24

2. Figures presented on page one are from the ICE BofAML 3-7 Year US Municipal Securities Index as of 9/30/24

3. Figures presented on page two are from the ICE BofAML 1-10 Year US High Yield BB-B Index as of 9/30/24