MONTHLY FIXED INCOME MARKET UPDATE

VICTORY income investors
A VICTORY CAPITAL® INVESTMENT FRANCHISE

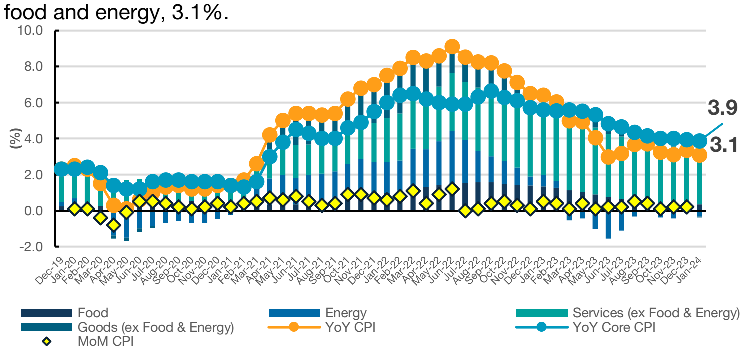
As of February 29, 2024

Key Takeaways

1. The yield curve rose throughout February, with the yield on the 10-year Treasury climbing 34 basis points (bps) to 4.25% from 3.91% on 1/31/24. Spreads for fixed income asset classes were largely unchanged month-over-month, apart from those for high yield bonds, which declined by 26 bps.
2. The Consumer Price Index and Personal Consumption Expenditure Index figures for February came in at or slightly above expectations. Unemployment remained stable and Nonfarm Payrolls increased.
3. The market's expectations for rate cuts steadily diminished, both in terms of how soon they would occur and how many instances across 2024. What began with January's inflation numbers in the first half of the month continued across the remainder in Federal Reserve Board (the Fed) governors' speeches emphasizing patience and certainty that inflation really was lower. At the start of the year, markets had expected a cut as soon as March; now, the consensus is that the first cut may not be until June.

The Month in Charts

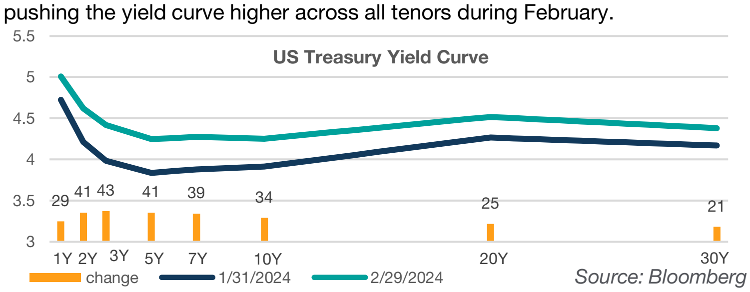
Year-over-year CPI prints for January, as reported February 13th, remained unchanged from December. Core CPI still stands at 3.9% and, including food and energy, 3.1%.



˙Basis point "bps" is 1/100th of a percentage point.

Source: Bloomberg

The Treasury yield curve rose throughout the month as consensus gradually settled on only a 20% chance of the first rate cut coming in May and June being far more likely. Many have come to believe that the Federal Reserve may not cut rates at all in 2024. This debate was in part responsible for pushing the yield curve higher across all tenors during February.



Source: Bloomberg

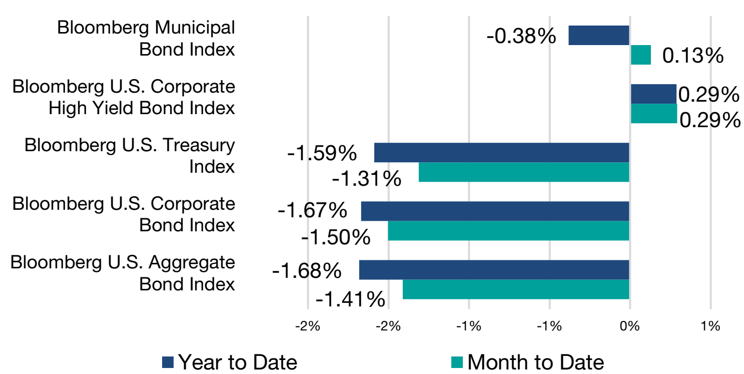
Credit spreads did not change month-over-month for most fixed income asset classes. Investment grade spreads, for example, were just 1 bps tighter. High yield spreads, though, tightened 26 bps on investors' rising confidence in the continued strength and resiliency of the US economy in the face of higher for longer interest rates.

				Quarter		Change		
Asset Class	Yield	Spread	Trend	Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	4.48							
U.S. MBS	5.14	50		44	57	3	-6	4
U.S. Corporate	5.42	95		88	106	-1	-9	-29
U.S. Corporate High Yield	8.02	317		307	376	-26	-54	-94
CMBS	5.47	105		104	137	-9	-30	2
ABS	5.24	55		54	77	-6	-16	0
A	5.29	82		76	93	-1	-8	-22
BBB	5.65	118		111	133	-1	-10	-33
BB	6.74	197		184	234	-16	-33	-71

Source: Bloomberg; Asset Classes represented by: ICE BofA US Treasury & Agency Index, Bloomberg US Agg Total Return Value Unhedged USD, ICE BofA US High Yield Index, ICE BofA US Fixed Rate CMBS Index, ICE BofA US Fixed Rate Asset Backed Securities Index, Bloomberg US Agg A Total Ret Index, Bloomberg US Agg Baa Total Ret Index, Bloomberg Ba US High Yield TR Index. MoM/QoQ/YoY as of 02/29/2024

The upwards shift in the Treasury curve combined with generally tight credit spreads resulted in mixed returns across all fixed income indices in February.

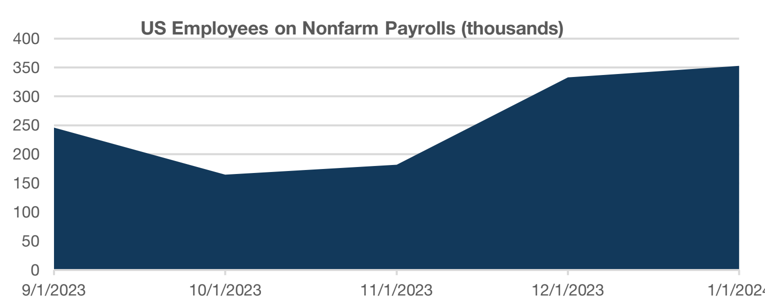
Returns (%) for Fixed Income Indices



Performance as of February 29, 2024

Past performance is no guarantee of future results. *Source: Bloomberg*

Nonfarm payrolls expanded by 353,000 in January (reported 2 February), far greater than estimates of 185,000. The unemployment rate held steady at 3.7%, unchanged since November of 2023. This surprisingly strong increase confirmed for many market watchers the resilience of the U.S. labor market. The same strength, however, underscores questions as to when the Federal Reserve will start cutting rates.



Source: Bloomberg

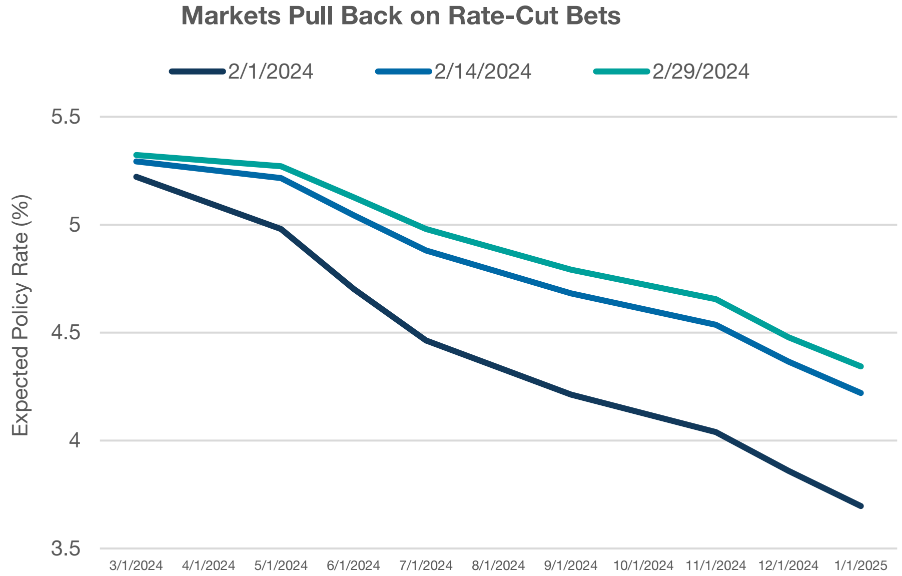
Bonding over Bonds
Our video series on the fixed income markets

In our #BondingOverBonds video series, experts discuss notable activity in the fixed income markets: [Watch Now]

Our Current Thinking

We do not believe we are out of the inflationary woods yet. We believe this period of stable but high interest rates with neither further hikes nor cuts could last longer than markets expect. Our positioning remains defensive across strategies due to lower than historically average credit spreads. Still, we believe this prolonged plateau offers a compelling opportunity for fixed income investors. While yields have dropped from the highs seen in October in 2023, on a historical basis they are still elevated. Starting yields have historically been a reliable indicator of prospective annualized returns and the pause following the Fed's hiking cycle is historically an excellent entry point for intermediate duration fixed income as seen in the quilt chart below.

The quilt chart displays the average annualized returns for each asset class for the 1-, 2-, and 3-year periods following the last rate hike for the last 7 hiking cycles. The average annualized returns indicate better performance for fixed income, with corporate bonds and the Agg ranking in the top half over the four different time periods. We believe that investors wanting to add fixed income or duration to their portfolios now have a longer time frame to do so.



Annualized Returns after Pause in Fed Rate Hikes

1st Year	2nd Year	3 Year	4 Year
Corp 14.9%	EAFE 12.6%	Corp 10.8%	Corp 9.6%
AGG 12.9%	Corp 12.5%	AGG 10.0%	HY 9.4%
Russell 2000 12.2%	AGG 11.7%	S&P 500 9.6%	AGG 8.8%
S&P 500 11.4%	S&P 500 11.0%	HY 8.8%	S&P 500 7.8%
HY 11.0%	Russell 2000 10.2%	Russell 2000 8.3%	Short Credit 7.6%
EAFE 10.9%	HY 9.3%	Short Credit 8.1%	Russell 2000 7.1%
Short Credit 10.0%	Short Credit 8.9%	EAFE 7.6%	EAFE 6.2%
Treasury 3-M 6.4%	Treasury 3-M 5.8%	Treasury 3-M 5.2%	Treasury 3-M 4.8%

KEY: S&P 500: S&P 500® Index; **EAFE:** MSCI EAFE Index; **Corp:** Bloomberg US Corporate Index; **Russell 2000:** Russell 2000® Index; **AGG:** Bloomberg U.S. Aggregate Bond Index; **Short Credit:** Bloomberg Municipal Bond Short 1-5 Year Index; **HY:** Bloomberg U.S. Corporate High Yield Bond Index; **Treasury 3-M:** U.S. 3-Month Treasury

Past performance is no guarantee of future results. Index performance includes reinvestment of dividends and other income but does not reflect management fees, transaction costs or expenses. One cannot invest directly in an index.

What We'll Be Watching in the Month Ahead

With the next FOMC meeting coming March 19 - 20, we will be watching the strength of the economy, inflation, and the following in the month to come:

- **March 8th, the next Non-Farm Payrolls release:** Together with accompanying revisions, this release will be one of the more important data points the market receives before the Fed's March meeting.
- **March 12th, the next CPI release:** this report will offer insight as to if inflation is still moderating towards the Fed's targeted 2% rate.
- **March 19th and 20th, the next FOMC Meeting:** We, like the market at large, do not expect a rate cut to come out of this meeting, but we expect the press conference to follow may offer further insight into what to expect from the Fed moving forward.

All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class. Interested parties are strongly encouraged to seek advice regarding the best options for their particular circumstances from qualified tax and financial experts.

The opinions are as of the date noted and are subject to change at any time due to changes in market or economic conditions.

Index returns are provided to represent the investment environment during the periods shown. Index performance includes reinvestment of dividends and other income. Index returns do not include transaction costs, management fees or other costs. Non-US indices are net of withholding taxes, if any.

Credit spread is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury. **The Treasury Yield Curve** shows the relationship between the US bond yield and the time to maturity. Yield and price have an inverse relationship. As the yield curve lowers, the price of bonds increase. **Tenor:** the length of time until a debt is due. **Core CPI:** CPI excluding food and energy. **Consumer Price Index (CPI),** a popular measure of inflation and deflation calculated by the Bureau of Labor Statistics, measures the monthly change in prices paid by U.S. consumers. **Personal Consumption Expenditure Price Index** is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services and is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

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