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December 31, 2023

Fourth Quarter Fixed Income Letter to Clients

The bond market underwent a major reversal from high yields/low prices to significantly lower yields/higher prices in the fourth quarter. Based on the Federal Reserve's economic indicators, inflation pressures are softening, and the Fed's Chairman, Jerome Powell, has indicated that they feel they are near the end of its rate hiking cycle. While growth is expected to slow from very strong levels in the third quarter, the US economy is projected to grow at slower levels in 2024.

Although the US bond market, including the tax-free municipal bond sector, saw positive performance last year, most of which occurred in the past two months, we believe that the current environment is an attractive range to invest in bonds. We expect municipal bond credit quality to remain firm, for interest rate volatility to decline, and for the municipal bond market to remain resilient. It's worth noting that municipal issuer credit-rating upgrades outpaced downgrades overall in 2023, and we expect municipal credit defaults to remain very low and isolated to the riskiest sectors of the high yield market.

Even after the major bond market rally at the end of 2023, bond yields are still at elevated levels not seen since 2013. The municipal bond market's common bellwether, the S&P Municipal Bond Index's total return was +6.99% for the fourth quarter, and +5.86% for 2023.

For comparison's sake, the taxable Bloomberg US Corporate Bond Index posted a total return of +8.52% for 2023. And in the US Treasury Market the 10-year treasury bond ended the year with a 3.88% yield.

Our fixed-income investment strategy is for investors to capture relatively higher current returns than have been available over the past decade. We see attractive opportunities to earn income in investment grade credits on intermediate-term bonds.

Evan Slater
Fixed Income Portfolio Manager