

Fourth Quarter Fixed Income Letter to Clients

The U.S. fixed income markets navigated a complex landscape in the fourth quarter of 2024, shaped by cooling inflation, the Federal Reserve's policy pivot earlier in the year, and persistent concerns about economic growth. Against this backdrop, the municipal bond market continued to shine as a stable and attractive option for yield-seeking and tax-conscious investors.

Following its 50-basis point rate cut in Q3, the Federal Reserve maintained a pause during Q4, adopting a "wait-and-see" approach. Policymakers emphasized data dependency, monitoring economic indicators closely to assess the effectiveness of their earlier actions. This steady policy stance contributed to relative stability in interest rates, with the yield curve maintaining a modestly steepened shape after significant adjustments in previous quarters.

Short-term Treasury yields remained anchored at lower levels, reflecting the Fed's accommodative stance. Longer-dated yields, however, fluctuated as market participants weighed the potential for further monetary easing against lingering concerns over long-term economic growth, fiscal pressures, and inflation.

Inflation showed continued signs of moderation, with core inflation edging closer to the Fed's 2% target. Cooling consumer spending, softening labor markets, and stabilized commodity prices all contributed to this trend. However, structural inflationary pressures, particularly in services and wages, persisted, underscoring the delicate balance the Fed must maintain in supporting economic stability without reigniting inflation.

The broader U.S. economy exhibited resilience, though growth slowed in key areas such as business investment and consumer spending. These conditions amplified the appeal of high-quality fixed income assets, including municipal bonds, as investors sought to de-risk portfolios in anticipation of potential economic softness in 2025.

Municipal bonds outperformed many other fixed income sectors during Q4, offering a combination of strong credit fundamentals, attractive tax-advantaged yields, and relative stability. Demand for municipals remained robust, driven by heightened investor focus on quality and the sector's defensive characteristics amid economic uncertainty.

Credit quality across the municipal market continued to strengthen, supported by sound fiscal management at the state and local levels. Higher-than-expected tax revenues, combined with prudent budgetary practices, enabled many issuers to maintain or improve their credit ratings. Infrastructure spending tied to federal initiatives also provided a

tailwind, with revenue bonds benefiting from increased investment activity in transportation, utilities, and public works projects.

As we enter 2025, the fixed income markets are poised for a delicate balancing act between economic resilience, potential fiscal challenges, and the Fed's evolving monetary policy. Municipal bonds are well-positioned to remain a cornerstone of fixed income portfolios, offering tax efficiency, stability, and strong credit fundamentals.

Our focus in managing client bond portfolios is to remain cautious, focusing on investment grade rated bonds and carefully managing duration exposure.

Evan Slater

Fixed Income Portfolio Manager