NOVEMBER 2023

5 REASONS TO CONSIDER FIXED INCOME IN 2024

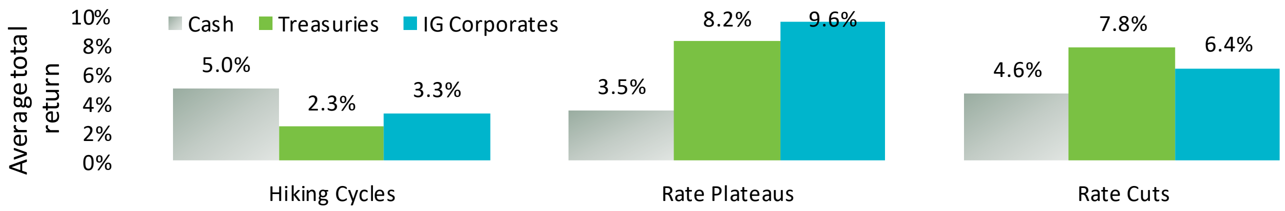
WE BELIEVE THE TIME FOR FIXED INCOME HAS ARRIVED – DON'T MISS OUT ON IT.

1) BEAT THE DASH FROM CASH

Cash typically beats fixed income when rates rise. That's no surprise. Historically, when central banks raise short-dated rates, longer-dated fixed income gets hit, while cash yields rise.

But once rates are done rising, fixed income generally reigns supreme (Figure 1). The curve tends to renormalize and locking in higher rates for longer has historically been the dominant strategy for many investors. We are at this transition now. In our view the Fed is done hiking, or at most has one hike left. It's the ideal time to move out the curve.

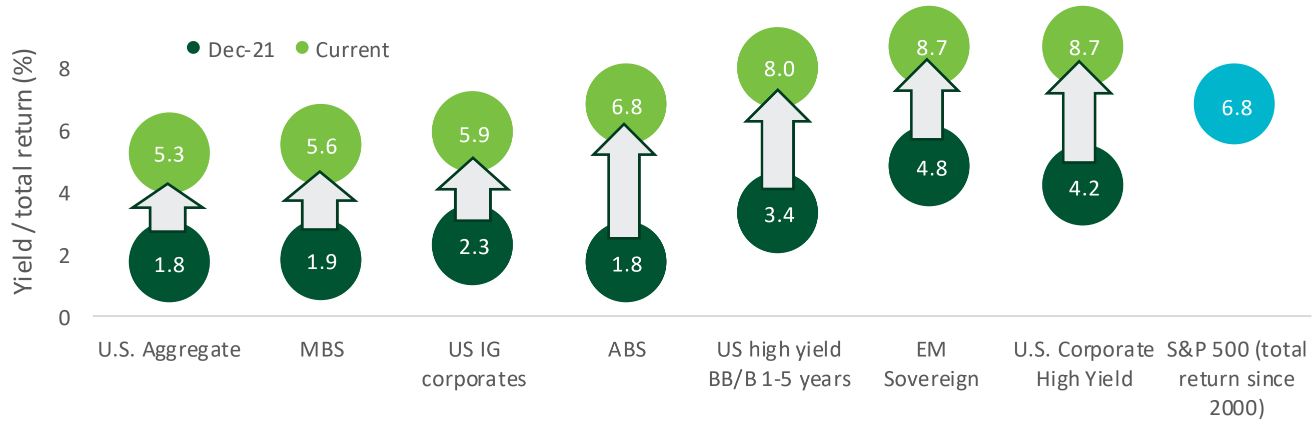
Figure 1: We believe it's the ideal time to move out the curve[1]



2) CURRENT YIELDS ARE SIMILAR TO LONG-TERM EQUITY RETURNS

There are rewards out the curve. Bond yields look equity-like (Figure 2) at a time that equity ironically might not. Volatility is a constant threat against a backdrop of high rates, quantitative tightening, and an economic slowdown. We think locking in returns through fixed income is a smart move.

Figure 2: Bond yields currently offer considerable income[1]



[1] Bloomberg, Insight calculations, November 16 2023. Cash: ICE BofA US 3-Month Treasury Bill Index. Treasuries: Bloomberg US Treasury Index, IG Corporates: Bloomberg US Corporate Investment Grade Index. See index descriptions at the back of the document.
Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

3) FIXED INCOME CAN BE A "WIN-WIN" FOR BOTH INVESTORS AND CORPORATES

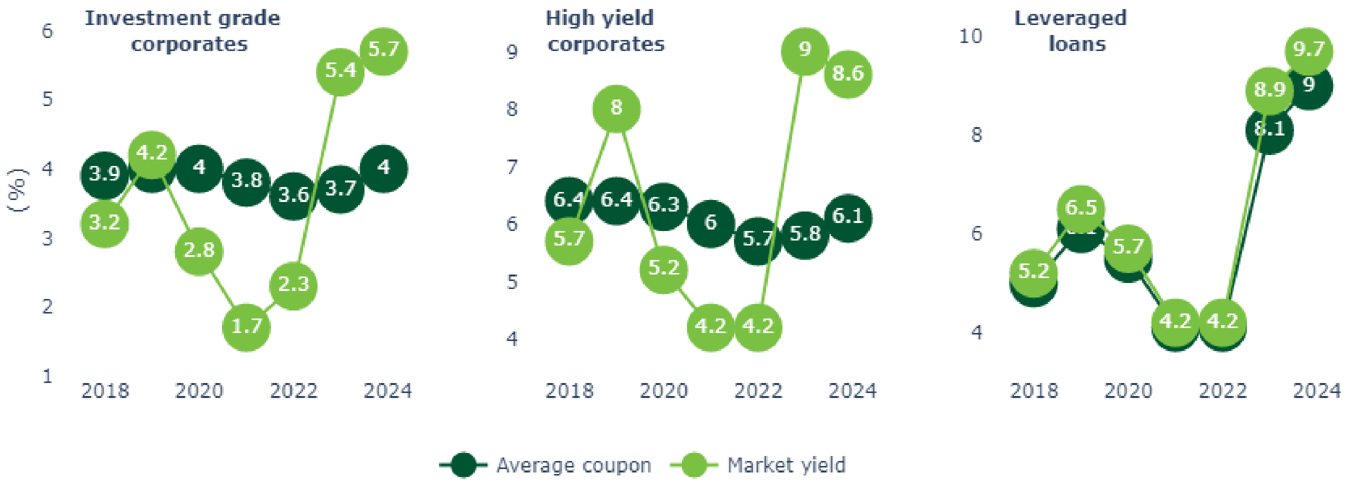
Q) What do corporates have in common with a pandemic-era homebuyer sitting on a 30-year fixed rate mortgage?

A) They're probably not feeling the pinch from rising rates.

Corporate bond yields started rising in 2021. But 75% of IG bonds and 80% of HY bonds were raised before 2021[2]. So, although yields are up, coupons generally aren't. Investors can secure higher yields and corporates don't have to pay them. In that case: win-win. US IG bonds have an average 10-year maturity, meaning it would take years for rates to materially impact funding costs.

Beware, though. In floating rate markets (like leverage loans) it's a different story – those coupons are rising with yields and could be a strain on the issuers (Figure 3).

Figure 3: Corporates with fixed coupons aren't feeling the pinch from higher yields, but beware of floating rate markets[3]

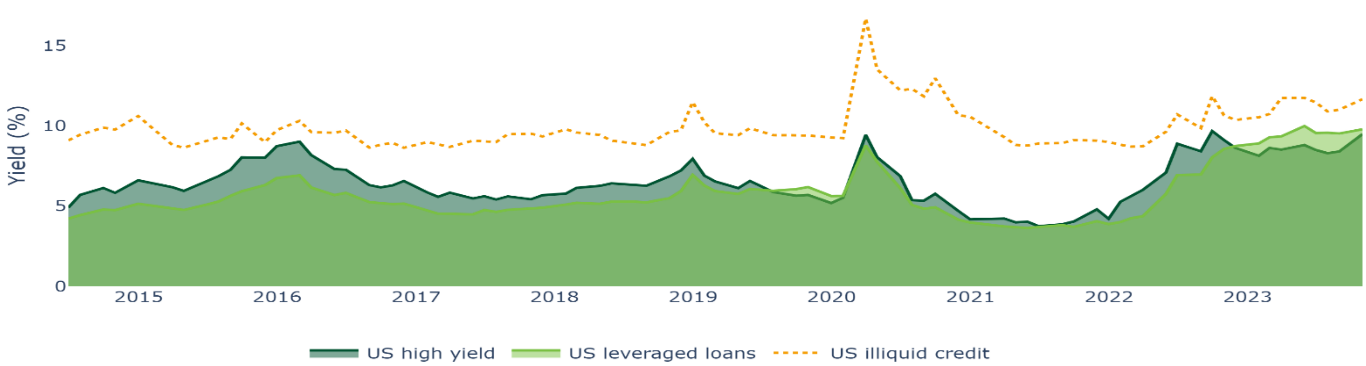


4) BEWARE THE INCREDIBLE SHRINKING ILLIQUIDITY PREMIUM

Speaking of floating rates, those tend to be the coupons of choice in private illiquid credit, too. That's one reason for pause.

But the major one is the evaporating "illiquidity premium." Private credit was certainly attractive when rates were zero, but now we believe it's time to pivot back to liquid fixed income (Figure 4).

Figure 4: As rates have risen, the illiquid premium from private debt has compressed[4]



[2] Bloomberg, Insight calculations, November 2023

[3] Bloomberg, Credit Suisse, November 2023, *Leveraged loan data as at October 31, 2023. IG Corporates: Bloomberg US Corporate Investment Grade Index. HY Corporates: Bloomberg US Corporate High Yield Index. Leverage loans: Credit Suisse Leveraged Loan Index. See index descriptions at the back of the document. **Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.**

[4] Bloomberg, S&P, November 2023. HY Corporates: Bloomberg US Corporate High Yield Index. Leverage loans: Credit Suisse Leveraged Loan Index. Illiquid credit: MarketVectorTM US Business Development Companies. See index descriptions at the back of the document.

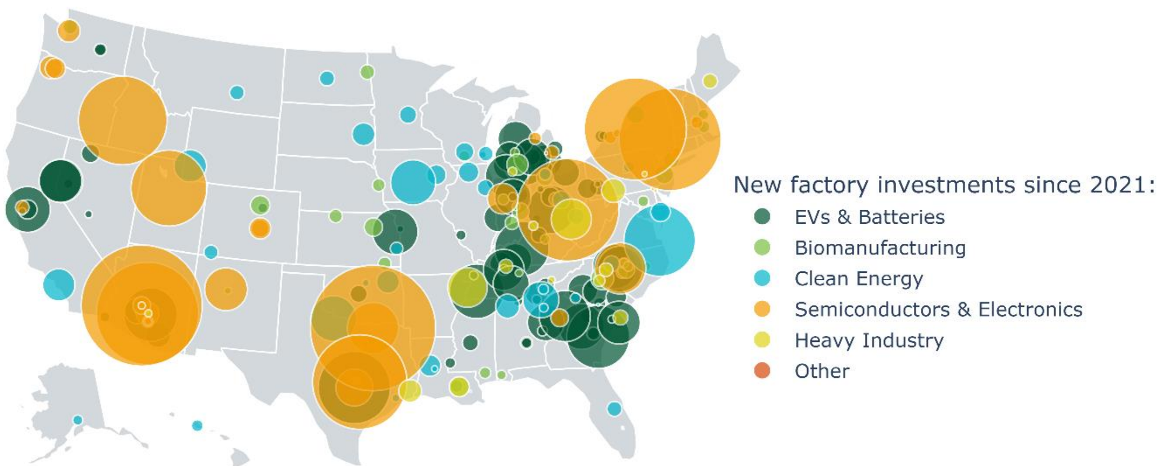
5) STAY ACTIVE, IT'S A BOND-PICKER'S MARKET

Looking ahead, we think investors need to be intentional about the fixed income risks they seek and stay nimble.

Be an opportunist

A capex supercycle may be kicking off as manufacturing returns to the US at breakneck pace due to federal incentives. New manufacturing plants have been the leading lights of business investment in the latest GDP reports. Compelling opportunities may arise for opportunists – as long as you stay nimble. So far, we have seen value in some of the large, established bond issuers in the auto, semiconductor and electronics, and biomanufacturing businesses that have opened new factories. We believe this may add diversification benefits and help insulate reshorers from political risk.

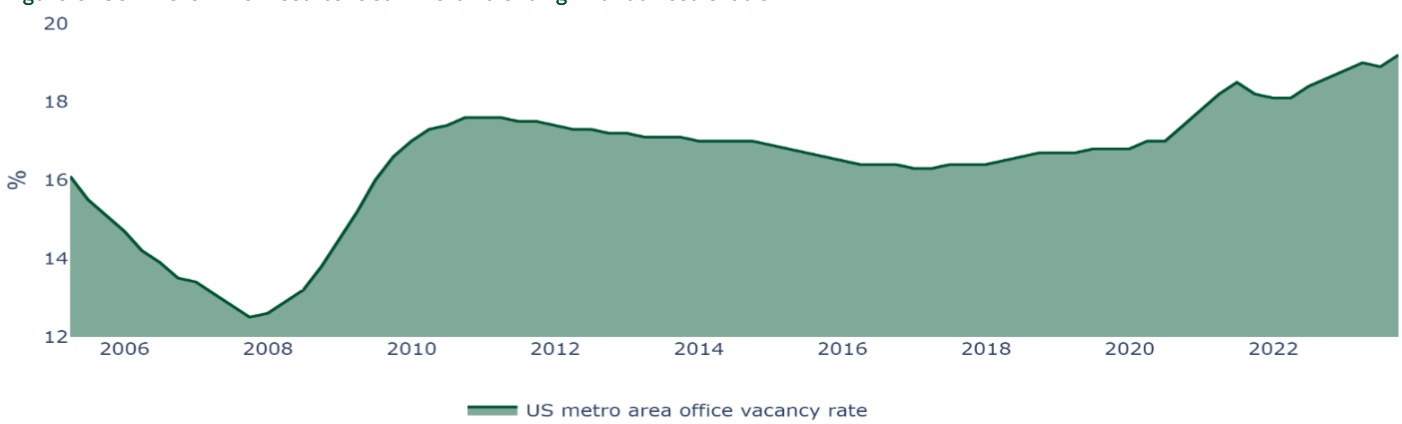
Figure 5: A capex supercycle could directly or indirectly create opportunities in credit[5]



Careful – some things could still break

As we saw with the banking crisis early in 2023, rising rates can break things. An area that still looks dicey to us is commercial real estate, which still has not recovered from the pandemic and deserves utmost caution (Figure 6).

Figure 6: Commercial real estate is still worth treating with utmost caution[6]



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[5] The White House, November 2023

[6] Bloomberg, November 2023

High quality credit looks particularly attractive, for now

We think we are entering a fixed income golden age[7].

High quality debt alone currently offers plenty of yield and should be the backbone of any fixed income allocation. We particularly like investment grade pipelines, utilities, and large money center banks. Off the beaten path, we also see value in the complexity premium from quality senior structured credit, particularly CLOs.

Elsewhere, in high yield, a short-dated approach can be attractive given compelling cashflow visibility over short timeframes. Broad high yield also offers value if you can maximize diversification and liquidity.

FIND OUT MORE

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The ICE BofA US 3-Month Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue.

The Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting.

The Bloomberg US Corporate Investment Grade Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

The Credit Suisse Leveraged Loan Index tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+.

The MarketVectorTM US Business Development Companies Liquid Index covers the largest and most liquid companies which are classified as Business Development Company in the US. The index is reviewed on a quarterly basis, modified float market capitalization weighted, and the maximum component weight is 20%.