February 19th, 2024

U.S. inflation slowed less than expected in January. Rather than declining as expected, headline CPI rose slightly to 3.1% and core CPI remained at 3.9% compared to December. The mixed news was a reassuring decrease in goods prices, offset by a disturbing increase in service prices. In response, interest rates rose as market expectations shifted to slower rate decreases from the Fed. The market has priced out any possibility of a Fed rate cut in March, and the current expectation is for the first cut by mid-year. Bond yields increased, with the 2-year Treasury yield rising by 18 bps and the 10-year by 13 bps since the week's start. Despite fluctuations, equities ended the week on a resilient note.

Takeaway:

- Speculation on fast rate cuts did not pan out.

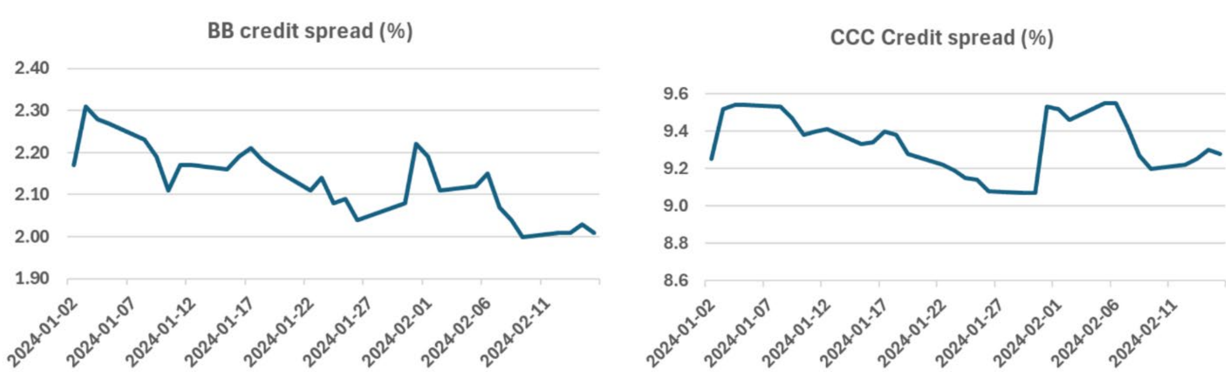
Source: CPI data is sourced from U.S. Bureau of Labor Statistics; Treasury yield data is sourced from U.S. Department of the Treasury

Default risk remains significant despite tighter headline/broad high yield credit spreads. Much of the falling spread in high yield is for the least risky high yield bonds. However, the spreads of the CCC rated junk bonds which are most likely to default, have not fallen. Relatively higher quality high yield bonds may be relatively low risk due to lower recession fears, but the lowest quality high yield bonds remain risky due to high refinancing costs in the near future.

Takeaway:

- The risk-return tradeoff for high yield bonds declined slightly (high yield bond risk has not declined as much as the credit spread has decreased).

The BB credit spread shrank while the CCC did not




*Source: FRED (ICE BofA BB US HY Index OAS & ICE BofA CCC US HY Index OAS)*

February 5th, 2024

**Macroeconomic data has been positive.** Q4 GDP grew at a surprisingly strong 3.3% and the January unemployment rate held steady at 3.7%. Inflation is also coming down through normalizing labor markets and healing supply chains—December's Core Personal Consumption Expenditures (PCE) inflation report marked 6 months at a 1.9% pace. Despite the good data, the Fed, as Powell said on Wednesday, needs more confidence that inflation is on target to start rate cuts. Bond markets responded modestly, with expectations for the first rate cut moving from March to May. Equity markets, however, have managed to stay largely positive in response to the good economic news. This is a good sign for investors as markets become less concerned about how economic data will affect Fed decisions and shift their analysis to how it will affect the strength of corporations.

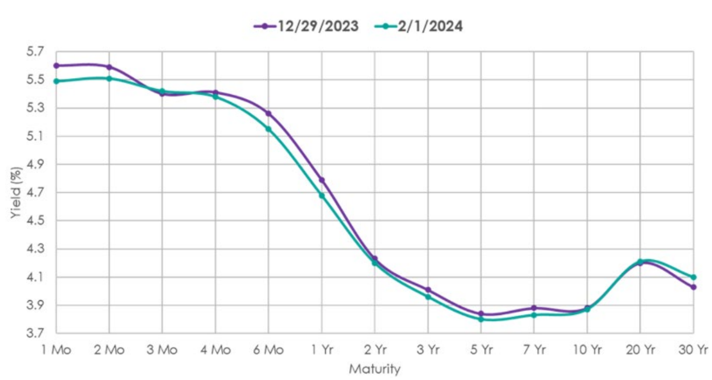
Takeaways:

- So long as the economy remains healthy, the Fed will need a strong inflation signal before cutting rates. Therefore, T-Bills and Floating Rate Notes remain attractive.
- As the economy continues to move closer to a soft landing, investors are gradually accepting good economic news as positive for stock markets.

**Yields are mostly unchanged this year.** Despite an abundance of news, both positive and negative, the entire yield curve is close to where it was at the start of the year. Notably, the 10-year rate moved from 3.88% on December 29, reached a peak of 4.18% on January 24, and subsequently returned to 3.87% on February 1. In contrast, the short end of the curve has witnessed limited changes, as the Federal Reserve held rates steady. The discrepancy between the Fed and the market is expected to keep fueling risks, but with an overall good economic picture, Powell is ready for markets to begin thinking on their own.

Takeaway:

- Overreacting to news leaves investors a step behind—the last month is another example of investors benefiting from a long-term perspective and a consistent approach to investing.




*Source: U.S. DEPARTMENT OF THE TREASURY*

NEW FRONTIER

**The outlook for international and U.S. markets** is difficult to forecast, even in the best of times. The U.S. clearly has earned its spot as the most valuable stock market in the world. However, its position as world leader in market capitalization presents some issues for investors. The U.S. market is already the largest by a factor of 10, comprising over 60% of global market capitalization compared to Japan's 6%. Despite concerns about concentration and valuation, the U.S.  has continued to lead in innovation and growth—and will likely continue to do so. On the other hand, with a 14 P/E ratio Europe is clearly cheaper than the U.S., where the S&P 500 has a P/E near 25. At some point, valuations matter because excess capital allocated leads to lower returns to capital—this makes a case for higher future returns for Europe and other international markets.

Takeaway:

- Too much reliance on return forecasting leads to concentration, and ultimately disappointment. Focusing on diversification and risk management is a more reliable approach to meet long-term investing goals.

*Sources: P/E for Europe ETF from Blackrock.com and S&P 500 from spdji.com*