

Cash Flow and Carey



Robert Carey, CFA
Chief Market Strategist

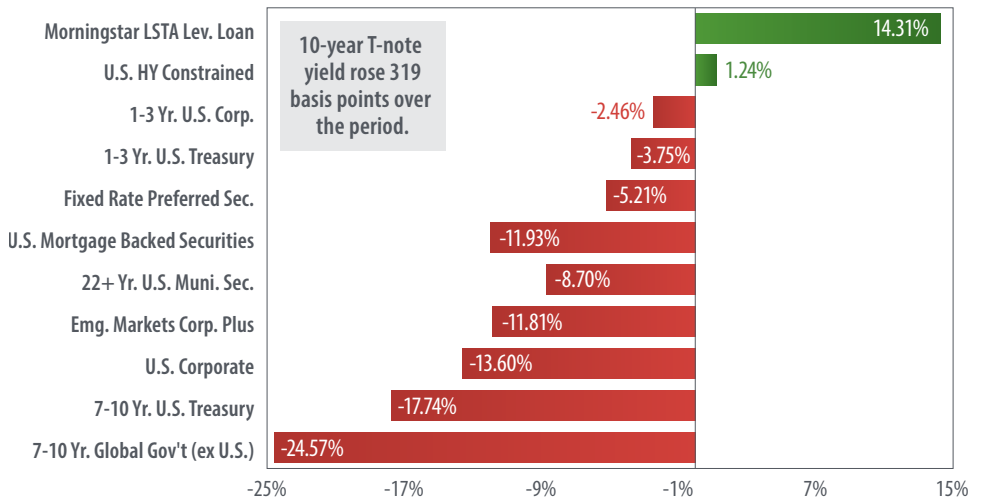
3/14/23

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The ICE BofA U.S. High Yield Constrained Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. The Morningstar LSTA U.S. Leveraged Loan Index is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market. The ICE BofA Emerging Markets Corporate Plus Index tracks the performance of U.S. dollar and euro denominated emerging markets non-sovereign debt publicly issued in the major domestic and eurobond markets. The ICE BofA Fixed Rate Preferred Securities Index tracks the performance of investment grade fixed rate U.S. dollar denominated preferred securities issued in the U.S. domestic market. The ICE BofA U.S. Mortgage Backed Securities Index tracks the performance of U.S. dollar denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. domestic market. The ICE BofA 1-3 Year U.S. Corporate Index is a subset of the ICE BofA U.S. Corporate Index including all securities with a remaining term to maturity of less than 3 years. The ICE BofA 1-3 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government with a remaining term to maturity of less than 3 years. The ICE BofA 22+ Year U.S. Municipal Securities Index tracks the performance of U.S. dollar denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions with a remaining term to maturity greater than or equal to 22 years. The ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market. The ICE BofA 7-10 Year Global Government (ex U.S.) Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency with a remaining term to maturity between 7 to 10 years, excluding those denominated in U.S. dollars. The ICE BofA 7-10 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government with a remaining term to maturity between 7 to 10 years.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial advisors are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

How Bonds Have Fared Since 8/4/20

Bond Index Total Returns (8/4/20 - 3/10/23)



Source: Bloomberg. *Past performance is no guarantee of future results.*
Index returns reflect the performance of ICE BofA Indices.

View from the Observation Deck

On 8/4/20, the yield on the 10-year Treasury note (T-note) closed at an all-time low of 0.51%, according to Bloomberg. Since then, the yield on the 10-year T-note rose by 319 basis points (bps), settling at 3.70% as of 3/10/23. To view the last post we did on this topic, [click here](#).

Per the chart above, the 319 bps increase in the 10-year T-note coincided with a dramatic sell-off in longer duration fixed income categories.

As many investors may be aware, bond yields typically move in the opposite direction of bond prices. Notably, only two of the 11 debt categories represented in today's chart are in positive territory. They are leveraged loans (senior loans), which are floating-rate speculative-grade securities, and U.S. high-yield bonds, commonly known as "junk" bonds because of their lower credit quality. Both categories are also known for their shorter duration profiles, a feature which may have helped them to weather the recent interest rate climate more effectively, in our opinion.

Inflation, as measured by the trailing 12-month rate of change in the Consumer Price Index (CPI), is at a level not seen since 1990, according to data from the Bureau of Labor Statistics (excluding October 2021, when it was trending towards its June 2022 peak of 9.1%).

We want to acknowledge that inflation, as measured by the CPI, has been trending downward since peaking at 9.1% in June 2022. That said, February's CPI rate of 6.0% represents the highest level we have seen since 1990. In response to surging inflation, the Federal Reserve ("Fed") has raised the federal funds target rate (upper bound) at a rapid pace. As of 02/28/23, the federal funds target rate (upper bound) stood at 4.75%, up from 0.25% on 2/28/22. We will be watching to see if the Fed continues to push interest rates higher over the next few meetings.

Emerging market bonds and intermediate-term global government bonds were deep into negative territory for the period captured in the chart.

The strength in the U.S. dollar definitely had a negative impact on the performance of foreign bonds, in our opinion. The U.S. Dollar Index (DXY) rose by 11.99% over the period indicated in today's chart, according to Bloomberg. The U.S. Dollar Index stood at 104.58 as of the close of trading on 3/10/23. The index has closed above the 100 mark in every trading session since 4/13/22, according to data from Bloomberg.

Takeaway

Today's chart reveals the impact tighter monetary policy can have on fixed income securities. This begs the question: what is the Fed's next move? On one hand, inflation remains stubbornly high, and the U.S. consumer and labor market appear to be relatively strong ([Click Here](#) to view "The Consumer Gets Some Love"). These factors could be a signal to the Fed that further monetary tightening is necessary. On the other hand, the U.S. just experienced its second-largest bank failure of all-time. Brian Wesbury, Chief Economist at First Trust Portfolios LP noted that last week's news about Silicon Valley Bank makes a 50 basis point hike unlikely. The situation is changing rapidly, and the yield on the 10-year T-note has been volatile, shedding an additional 12 basis points on 3/13/23 to settle at 3.58% as of market close. We will keep monitoring the data and report back on this topic as warranted.