Market Commentary Blog

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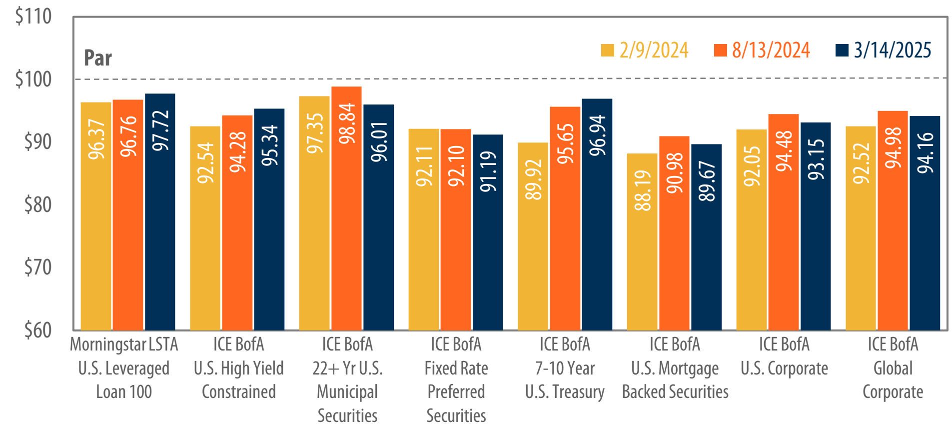
A Snapshot of Bond Valuations

Par Weighted Price of Bond/Income Indices



Source: Bloomberg, Bank of America. **Past Performance is no guarantee of future results.**

View from the Observation Deck

Today's blog post is intended to provide insight into the movement of bond prices relative to changes in interest rates. For comparative purposes, the dates in the chart are from prior posts we've written on this topic. Click here to view our last post in this series.

Five of the eight bond indices we track saw prices decline since our last post. That said, prices for six of the eight indices increased above their time series lows from February 2024.

Notably, these price declines occurred despite the Federal Reserve ("Fed") announcing three rate cuts totaling 100 basis points (bps) at the end of 2024. As this data is atypical (fixed income prices and yields generally move in opposite directions), several explanations warrant investigating. First, fixed income markets are forward looking. We believe the increase in fixed income prices between our posts on 2/9/24 and 8/13/24 reflect that. At that time, interest rate cuts were just a rumor, but investors felt increasingly certain that rate reductions were forthcoming. Prices increased as a result. That certainty has been whittled away in recent months amidst growing threats of recession, resurgent inflation, tariffs, and geopolitical strife, in our opinion. Second, as interest rates fall, companies often become more profitable, which can increase their attractiveness relative to fixed income. Case-in-point, the S&P 500 Index increased by 4.60% (total return) between 8/13/24 and 3/14/25.

A few notes on inflation.

While down significantly from its most recent high, inflation, as measured by the trailing 12-month rate of change in the consumer price index (CPI) stood at 2.8% in February 2025, above the Fed's target of 2.0%. The CPI is also above its most recent low of 2.4% (September 2024). For comparison, the CPI averaged 3.8% over the 50-year period ended December 2024.

Takeaway

Valuations improved for just three of the eight fixed income indices in today's chart between 8/13/24 and 3/14/25. This is particularly noteworthy given the Fed's year-end policy rate reductions, which would typically lead to price increases. We believe falling bond valuations reflect reduced certainty permeating the current investment climate. Future Fed policy decisions are looming unknowns, as are the dichotomous (to interest rate policy) threats of resurgent inflation and a potential U.S. recession. At 2.8%, the CPI remains stubbornly above the Fed's target rate, which could limit its ability to reduce rates in the face of an economic slowdown. We will continue to update this post throughout the year.

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 Morningstar LSTA U.S. Leveraged Loan 100 Index is a market value-weighted index designed to measure the performance of the largest segment of the U.S. syndicated leveraged loan market. 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 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 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 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 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 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 Global Corporate Index tracks the performance of investment grade corporate debt publicly issued in the major domestic and Eurobond markets.

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