Fixed Income Quarterly

Market Perspectives from Fixed Income Solutions

The Economic Cycle Moves On

There is little doubt about our love of spending money. As long as we hold jobs, there are products and services waiting to be consumed. The U.S. has enjoyed an economy that has outperformed and outspent and just won't slow down — until now. Surface cracks have begun to spread as consumers may be tapped out. Surplus savings have been wiped out, and it appears spending for a large percentage of consumers has turned to doing so on credit. In addition, the healthy employment levels that have been the foundation of this expansion are also stumbling.

Before we get all doom and gloom, it's not yet time to take your ball and go home. The stock market is displaying uncertainty and volatility yet persevering in its bull run even as signs of an economic slowdown begin to surface. Let's not ignore the income opportunities that also persist as interest rates remain relatively high. Investors maintain an opportunity to preserve the wealth accumulating in growth assets such as stocks with individual bonds that offer productive levels of income. Locking into this preserving asset while producing income remains desirable. We will suggest ideas on how to do this.

> "Let's not ignore the income opportunities that also persist as interest rates remain relatively high."

This quarterly examines the yield curve, the opportunities it affords, and how it is playing out in this economic cycle. It then isolates specific product types with directions on what characteristics to consider when optimizing your fixed income strategy. Economic cycles take time to play out, but history tells us that the cycle will eventually complete itself.

FIXED INCOME QUARTERLY CONTRIBUTING STRATEGISTS

DOUG DRABIK

DREW O'NEIL

ROB TAYLOE

KEITH PARRISH

IN THIS REPORT

Digging Into Statistics, Facts, Figures, Curves, Data Points (pg 2)

- Expansionary/Recessionary Periods (pg 2)
- Inverted Curve (pg 3)
- Today's Inverted Curve (pg 4)
- The Future Treasury Curve (pg 6)
- The Next Issue – Government Debt? (pg 7)

Corporate Bonds (pg 8)

Municipal Bonds (pg 10)

Be Prepared (Muni) (pg 12)

Tax Loss & Other Swaps (pg 14)

Know What You Can Own (pg 16)

Strategy Resources (pg 17)

DIGGING INTO STATISTICS, FACTS, FIGURES, CURVES, DATA POINTS

Investment strategies can be traced back to utilizing combinations of facts, narratives, and history. Economic and market opinions cover a wide spectrum thought and theories, which may contribute to market volatility. For much of the year, the market focus has been on inflation and geopolitical upheaval, but recently, it has turned to employment data and the upcoming U.S. federal elections. No magic formula exists to forecast the future of rates or credits, and thus, planning a fixed income strategy is part rational, part mathematical, and part personal insight. However, information is key, and although even factual data is open to interpretation, patterns or trends can support developing an optimal long-term fixed income strategy. The following statistics, facts, figures, curves, and data points are intended to do just that.

EXPANSIONARY AND RECESSIONARY PERIODS

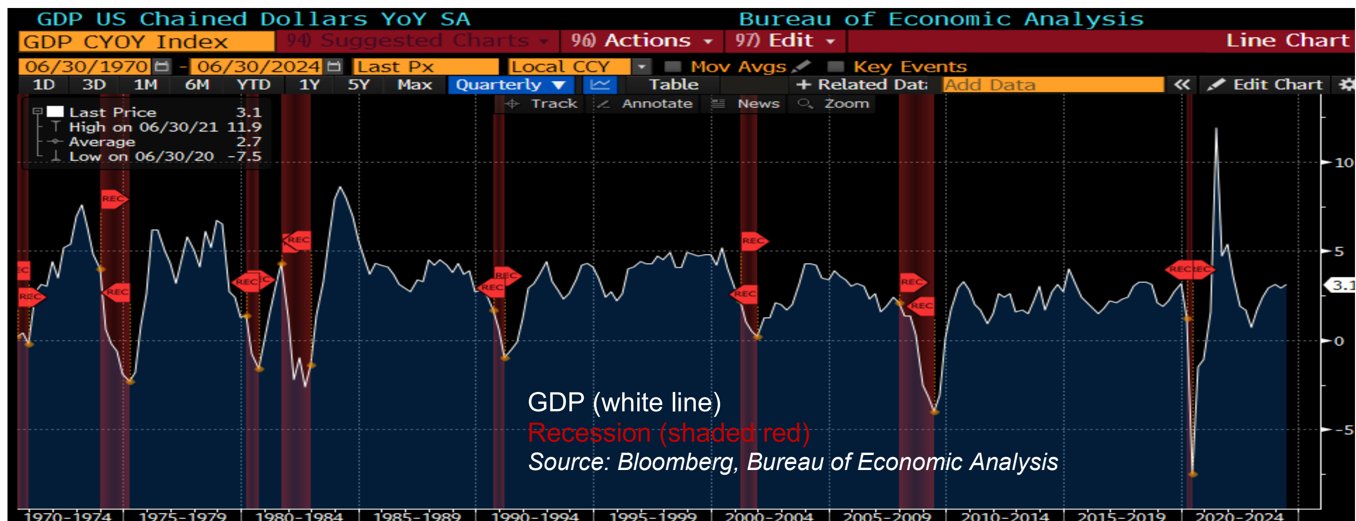
The economic cycle is either in expansion or recession. In other words, the economy is either growing or regressing. Fortunately, the economy has historically grown for longer periods of time than it has retracted. Over the last hundred-plus years, the average recessionary period is 0.9 years, whereas the average expansionary period is 5.2 years.

----------Recession----------			----------Expansion----------		
Date Range		Years	Date Range		Years
2/1/2020	4/30/2020	0.2	5/1/2020	8/14/2024	4.3
12/1/2007	6/30/2009	1.6	7/1/2009	1/31/2020	10.6
3/1/2001	11/30/2001	0.8	12/1/2001	11/30/2007	6.0
7/1/1990	3/31/1991	0.7	4/1/1991	2/28/2001	9.9
7/1/1981	11/30/1982	1.4	12/1/1982	6/30/1990	7.6
1/1/1980	7/31/1980	0.6	8/1/1980	6/30/1981	0.9
11/1/1973	3/31/1975	1.4	4/1/1975	12/31/1979	4.8
12/1/1969	11/30/1970	1.0	12/1/1970	10/31/1973	2.9
4/1/1960	2/28/1961	0.9	3/1/1961	11/30/1969	8.8
8/1/1957	4/30/1958	0.7	5/1/1958	3/31/1960	1.9
7/1/1953	5/31/1954	0.9	6/1/1954	7/31/1957	3.2
11/1/1948	10/31/1949	1.0	11/1/1949	6/30/1953	3.7
2/1/1945	10/31/1945	0.7	11/1/1945	10/31/1948	3.0
	Avg	0.9		Avg	5.2

Sources: Bloomberg, Raymond James

Interestingly, when the last four cycles are isolated, the average recessionary period continues to be 0.9 years; however, the last four expansionary periods average 7.7 years. How has the U.S. been able to extend the expansionary periods? Is it a good thing? Has it come at a cost? This is where independent judgments may begin to influence autonomous and/or market behaviors.

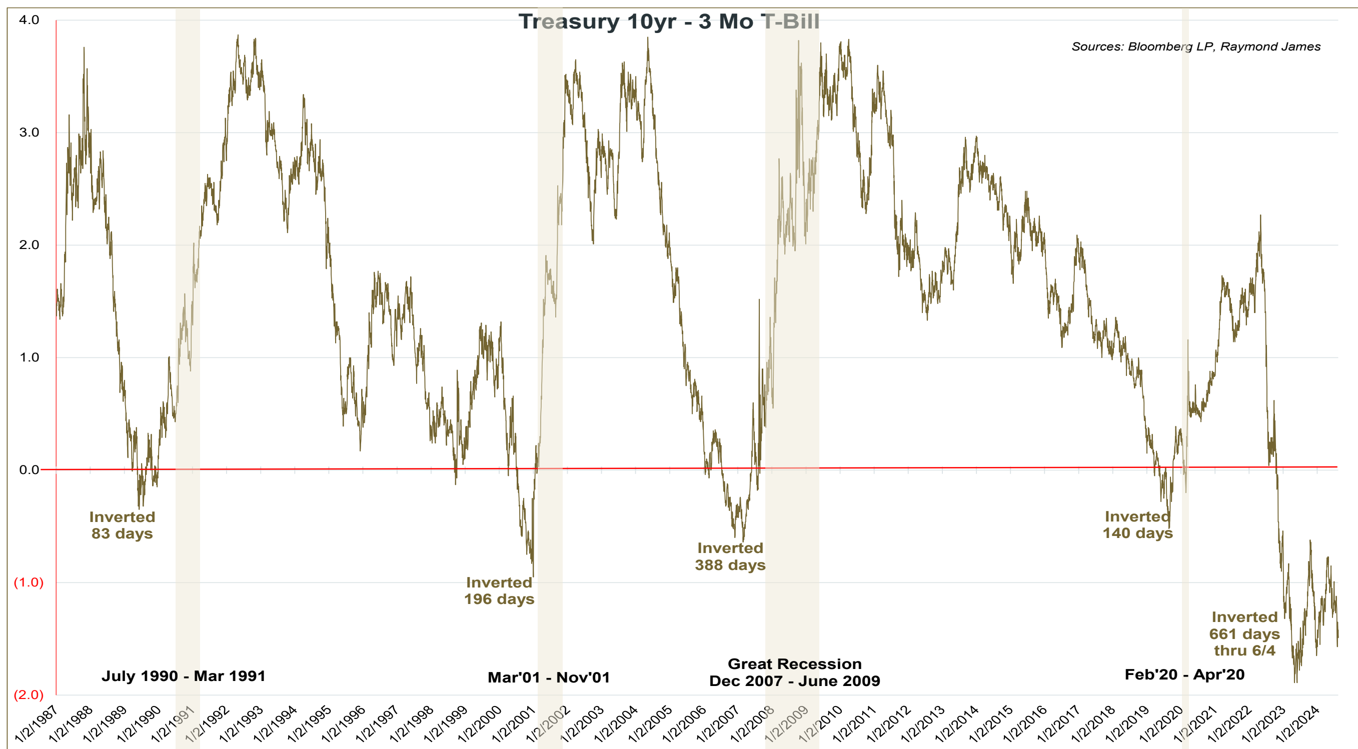
The average Gross Domestic Product (GDP), which could be argued as a measure of the nation's economic health, averaged 0.06% during the recessionary periods and 3.6% during the expansionary periods. Again, if we isolate the last four periods, GDP remains 0.6% (versus 0.6% over 100+ years), but the last four periods of GDP returned 3.1% in expansion (versus 3.6% over 100+ years).



INVERTED CURVE

Inverted curves have been credited with predicting recessions. Numerous articles both support and refute this claim. Some suggest that not all inverted curves lead to a recession, but it may be a matter of isolating a specific time range or incorporating extended periods of time where the curve is inverted. In a bigger picture view, when considering time spans that are governed by inverted periods, a recession has always followed. The following graph illustrates this. Anytime the Treasury curve returns to a normal upward slope *(10yr-3mo dark line returns above the horizontal red line)*, a recession follows within the next year.

Others argue that tight credit and rising short-term rates can increase the chance of or trigger a recession. When monetary policy is too tight for too long, aging expansionary periods, and combinations of all the above have been flagged as potential causes of a recession.



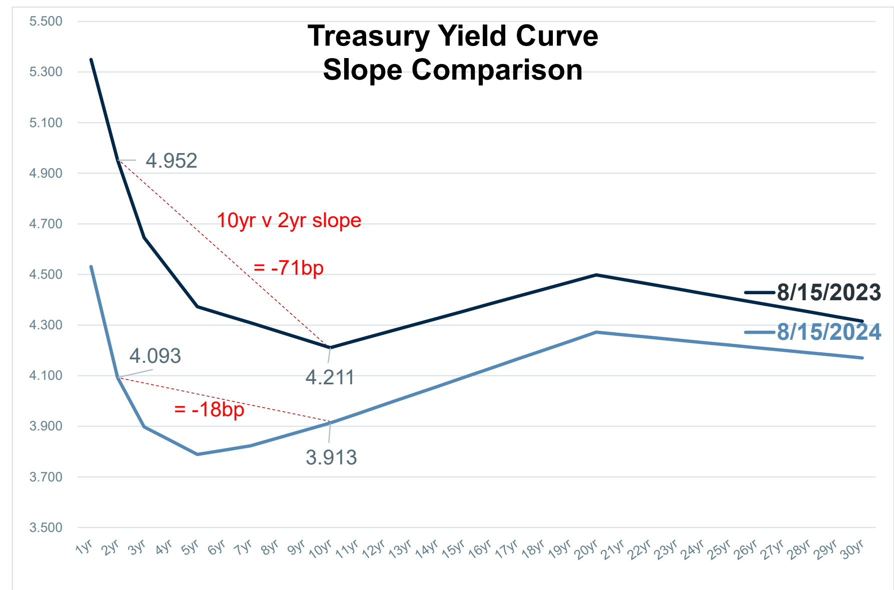
In practice, many of these events are linked and interconnected. When the Fed policy puts interest rates near zero, the ensuing low interest rates spur investment. When policy puts money in the hands of consumers, it stimulates spending, which generates business orders and spurs increases in supply. When demand outreaches supply, prices begin to inflate. The Fed, in turn, raises rates to slow down inflation.

If the Fed keeps monetary policy tight *(high rates)* for too long, the high borrowing costs can stress credit markets. Banks decrease lending when they are forced to pay higher rates than they receive by lending money out. Thus, it becomes harder to get a loan. When there are high levels of distressed debt, it also can trigger a credit event. The Great Recession serves as an example. Credit standards were loose until substantial lending turned into excessive loan defaults. The events succession leads institutions to swing in the opposite direction, lending only to those with the highest ratings.

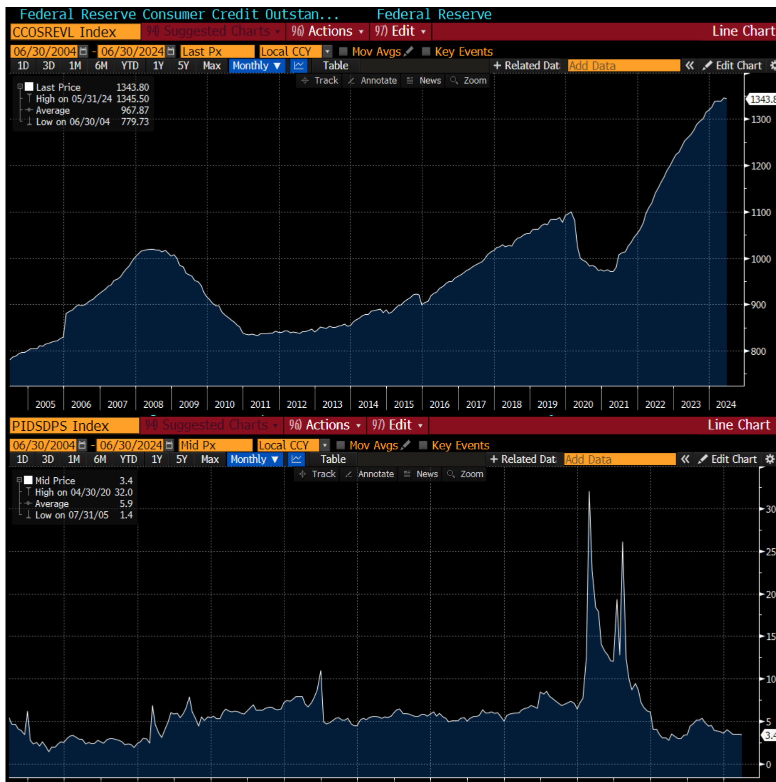
And the cycle repeats itself. A period in expansion lives through its peak where it eventually overheats the economy and must be slowed to allow consumers and pricing to catch back up.

TODAY'S INVERTED CURVE

The current yield curve is experiencing a deep and long inversion compared to previous inversions. The 10-year Treasury versus the 3-month T-Bill has been inverted for 661 days as of this writing. Similarly, the 10-year versus the 2-year Treasury has been inverted for over 2 years. Recently, short-term Treasury yields have fallen faster than long-term yields, narrowing the curve's inversion. The 10-year and 2-year have flirted with being flat. During 2024, the market and pundits have been focused on inflation; however, recently, investors have turned their worries toward a recession. The catalyst has been weakening . Inflation has been a major focus since peaking at 9.2% in mid-2022. The Fed is determined to bring it closer to its 2% target. Inflation has dropped dramatically, but despite the improvement, Personal Consumption Expenditure (PCE) sits at 2.63%, and Consumer Price Index (CPI) sits at 3%; both data points are well above the ultimate target level.



Source: Bloomberg, Raymond James



Although patience appears to be at a premium, economic cycles take time to unfold. Keep in mind the central bank's intervention and the copious amounts of money added to the money supply. It is no wonder that an economic downtrend has been delayed, consumer spending stretched, corporate earnings drawn out, and inflation has been sticky.

Have consumers tapped out? Savings accumulated during COVID-19 have been depleted and then some. The average household savings is well below 20- or 30-year averages despite peaking at highs in 2020. In addition, revolving debt is topping all-time highs. It appears consumers continue to spend, but they do so on borrowed funds.

Why do we look at the Treasury yield curve for insight? The yield curve does not “cause” things to happen. As already observed, the length of an expansionary period, the depth, or the span of an inversion do not appear to forecast the timing of an economic cycle’s end.

This is not an exact science as recessions are often announced well after the fact – sometimes months after the actual recession started. The curve is shaped as a result of an economic event (i.e., credit crunch, geopolitical event, etc.) or monetary policy position.

An inverted curve acts as a market signal, educating investors about economic conditions and potentially forewarning future policy events that will reshape the curve itself. These signals assist in laying out long-term strategies.

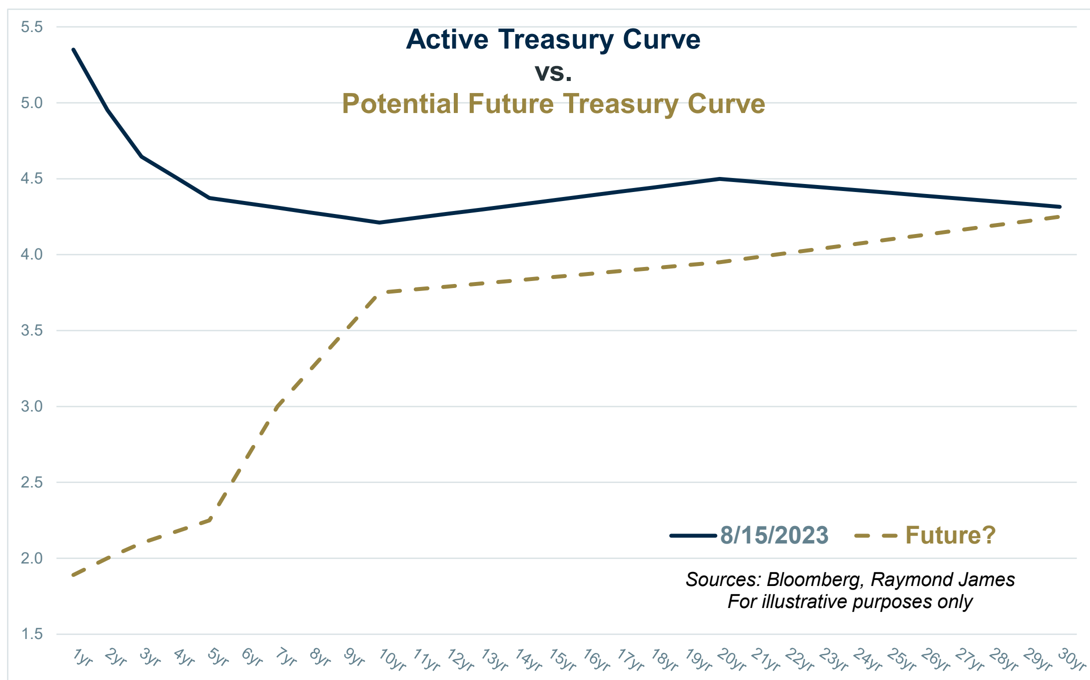
Several situations held constant during the previous four recessionary periods. In each case, the yield curve was inverted prior to the recession. In addition, it was not until the yield curve showed a positive slope *(long-term rates being higher than short-term rates)* that a recession surfaced. The time span between the Treasury curve becoming positively sloped and a recession has ranged from 2 to 8 months. Today’s Treasury curve is still inverted.

Sources: Bloomberg LP, Raymond James

THE FUTURE TREASURY CURVE

Long-term prognosticating about the future shape of the yield curve can be very difficult due to the abundance of variables that affect it. By examining trends and data, educated deductions may help identify short-term direction and appropriate investment choices. Analysis provides investors with the knowledge to create strategies that help maximize personal goals and returns.

For example, the economic data releases suggest that the economy is, at the very least, slowing down. It also suggests that employment trends are downward and inflation, although having trended down, is sticky. The Treasury yield curve's negative slope is clearly compressing and trending toward a more normal shape. Should these events continue to track in this manner, it is plausible that the Treasury yield curve could look much like the potential future Treasury curve depicted in the graph. In this hypothetical scenario the inflated short-term rates of today will be gone. It may benefit investors to lock into yields for longer (extend maturities) while the market provides relatively high intermediate and long-term returns.

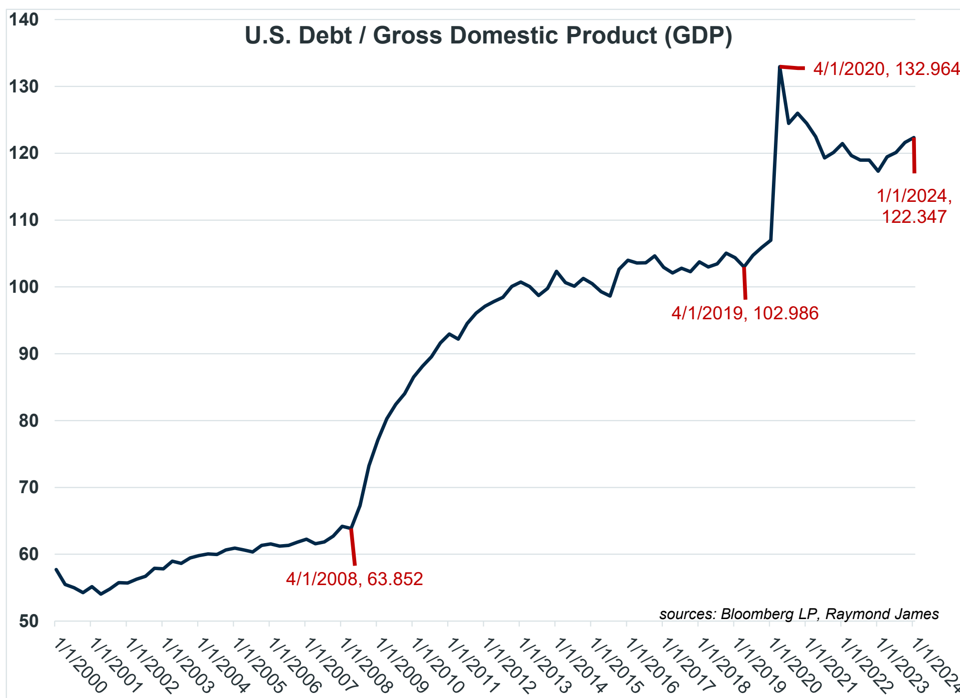


THE NEXT ISSUE – GOVERNMENT DEBT?

The Gross Domestic Product paints a picture of a nation's financial health, however, that is only part of the picture. Carrying a $5,000 credit card balance is not necessarily an issue for an individual with a $20,000 monthly income. But it might be for an individual with a $3,000 monthly income. The same holds true for our government, although the consequences are quite different. When the government runs a deficit, they are spending more in expenses than they are receiving in revenue such as through taxes collected. To pay the bills the government can sell Treasury bills and notes (borrow money) to meet their debt obligations. Although this arrangement may work for a period, continued deficits can reach a level that even the government cannot handle. The higher the debt to GDP, the harder it becomes to repay.

The government must pay interest on outstanding debt, much like individuals pay interest on credit card balances. According to FiscalData, as of July, the government was paying nearly $1 trillion in interest, which represents ~17% of the total federal spending for 2024.

Deficits are caused by various issues: an increase in government spending, a decrease in tax revenue, funding a war, pandemics, and economic catastrophes such as the Great Depression. To reduce the debt ratio, the government could reduce major expenditures, such as healthcare, social security, or defense spending. Of course, these aren't popular choices publicly.



This serious issue will continue to intensify over time. Although we raise the red flag, there is more to be analyzed and to unfold over the upcoming months. How our political landscape changes after this year's election may have a lot to say about our government deficits and growing national debt.

CORPORATE BONDS

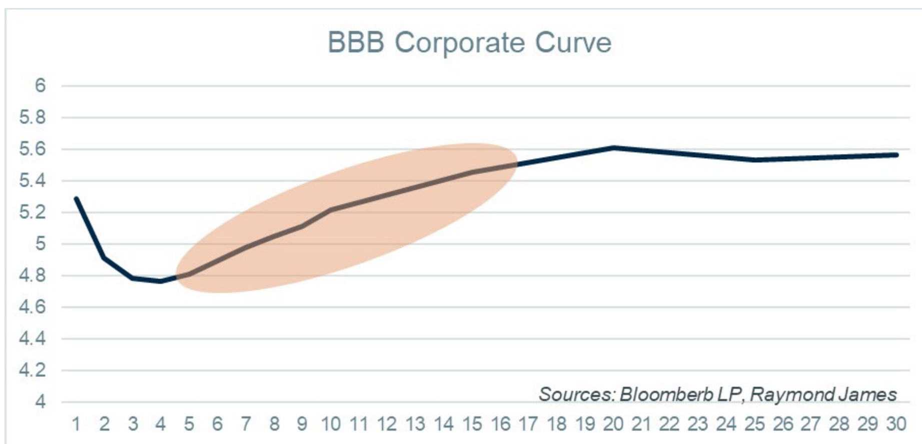
The corporate bond market is offering yields at some of the most attractive levels of the past 15+ years. Current market conditions have some investors unsure about how to strategically choose or position investments and how to best take advantage of the current opportunities. The following information attempts to provide some clarity on investing in the corporate bond market.

CURVE POSITIONING

The corporate curve is currently inverted out to about 4 years, meaning that yields get progressively lower from 3 months to 4 years. Around 4 years, the curve normalizes and is positively sloped. The steepest part of the curve is the 5 to 10-year range, while the 10 to 15-year window still provides a decent slope. It is often viewed as advantageous to invest in steeper parts of the curve to maximize the risk/reward relationship, where "risk" is the increased duration that comes with longer maturity bonds. "Reward" is the additional yield that can be earned.

Another important factor when considering where on the curve to position is the direction that interest rates are expected to move in the future. The future direction of yields is unknown, so the "input" into this side of the equation might be different from investor to investor. In general, if an investor thinks that yields are likely to head higher, shorter-term investments will likely make sense, as short-term bonds mature sooner and allow for reinvestment into the higher-yielding environment. If an investor thinks yields are going to move lower, investing in longer-term bonds will make sense to reduce the need to reinvest maturing bond proceeds into lower-yielding bonds in the near future. Investing in longer-maturity bonds locks in currently available yields for a longer period.

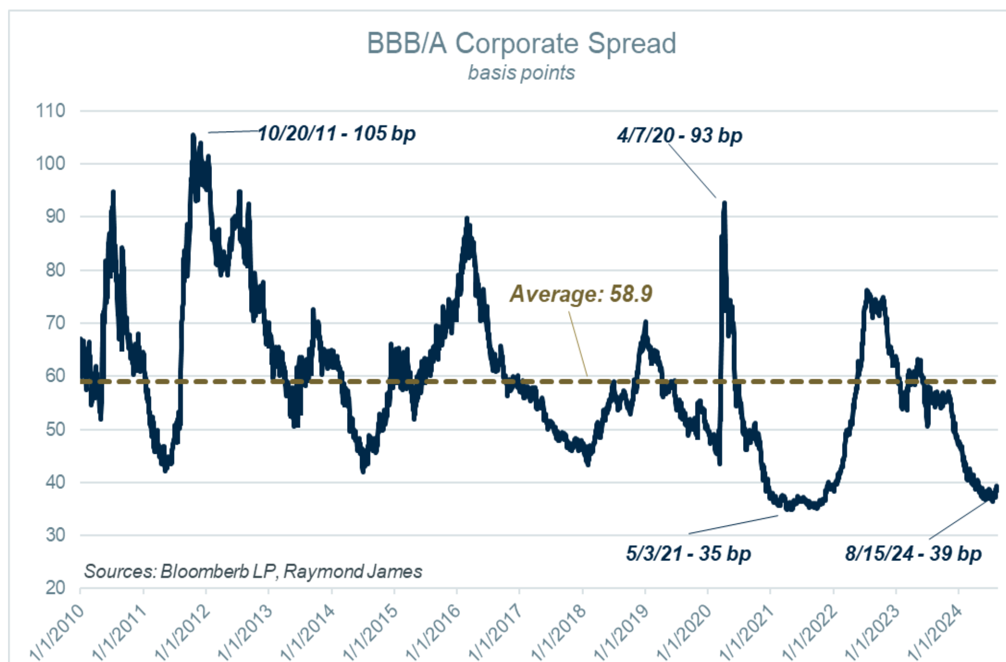
Taking these factors into consideration provides a good roadmap for how to think about where to position corporate bond portfolios in the current environment. Assuming that an investor is of the opinion that yields are trending lower, investing in an intermediate-term portfolio is likely an optimal choice. By extending out beyond the short end of the curve, near-term reinvestment risk is reduced, and the investor is taking advantage of the steepest part of the curve. This is highlighted in the adjacent yield curve graph by the shaded oval. By purchasing longer maturity bonds, the attractive yields that are currently available can be locked in for a longer period.



CREDIT QUALITY

The vast majority of the investment-grade corporate bond market is rated between the A and BBB-rated categories. Many core corporate bond portfolios are positioned primarily in the BBB-rated space, which, for most investors, provides a good balance of earning attractive yields while remaining in high-quality investments. For more conservative investors, jumping up from a BBB-rated portfolio to an A-rated portfolio can reduce the overall credit risk at the cost of a lower-yielding portfolio.

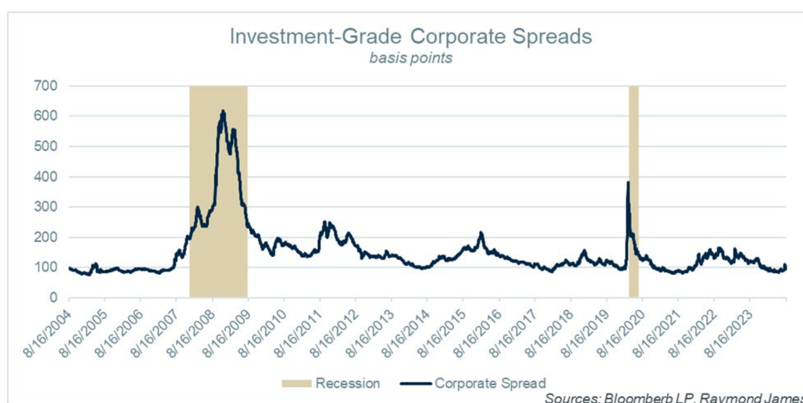
In a slowing economy with a potential recession, increasing portfolio credit quality will provide a wider credit quality cushion to investors. During economic slowdowns, it is commonplace to experience credit downgrades when corporate financial metrics tend to slip. Although downgrades do not mean default, raising credit ratings by a notch or two could provide confidence at this point in the economic cycle. Currently, the difference between A and BBB-rated yields is near its lowest level over the past 15 years. While levels will vary from bond to bond, at the index level, the yield difference between the two rating categories at 10-years is only ~40 basis points. This means that, on average, moving from a BBB-rated bond to an A-rated will only reduce the yield by 40 basis points. For some investors, sacrificing 40 basis points of annual yield to increase the credit quality could make sense.



SPREADS

Investment-grade corporate spreads are near some of their tightest levels over the past 20 years. Historically, as the economy slows and/or enters a recession, spreads tend to widen (increase) as uncertainty about credit quality and a flight to quality takes hold in the market. At the same time, the Federal Open Market Committee policy decisions and the flight to quality tend to push Treasury yields lower. Even in the face of lower Treasury yields, corporate yields have historically risen during these times of economic uncertainty, as spreads widen by larger margins than Treasury yields fall.

As an investor, it is important to understand the potential implications that this might have on fixed income portfolios. As corporate bond yields rise, prices will fall. These spikes in spreads (and corresponding yield increases) are often temporary and bounce back relatively quickly. For long-term investment allocations by buy-and-hold investors, anticipating this price volatility and positioning to weather the storm can mitigate yield and price risks during economic uncertainty. Remember, if bonds are held to maturity, interim price movement does not affect the income or cash flow on bonds held.



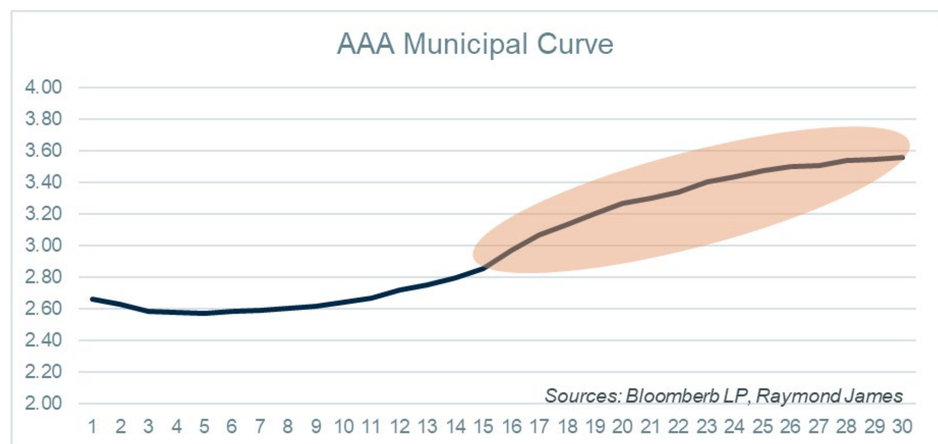
MUNICIPAL BONDS

Similar to the corporate bond market, yields in the municipal space remain at attractive levels. Extending out in maturity likely makes sense for many investors, as the long part of the curve currently offers the best value for higher tax bracket investors. This section discusses some of the aspects of the municipal bond market and considerations that investors should take when constructing portfolios or analyzing current portfolios in this market environment.

CURVE POSITIONING

The municipal curve is slightly inverted on the short end to about 3 years and then remains relatively flat for about 15 years. While there is some moderate slope, the AAA-rated yield increase from 4 to 15 years in maturity is about 30 basis points in total. Although extending in this range may have marginal yield benefits, any extension locks yield in for longer and reduces reinvestment risk.

Around 15 years, the curve steepens significantly, providing investors with increased yield opportunities for each incremental year as maturity increases.



When considering appropriate curve positioning for a municipal bond portfolio, the final bond maturity provides only a portion of strategic consideration. Most municipal bonds that are issued with maturity dates longer than 10 years come with a call option - usually at 10 years from the original issue date, although this can vary. This call option is a date when the issuer has the option to redeem the bond. For example, a bond might be issued with a final maturity in 2044 but with a call option in 2034, meaning that the issuer could potentially redeem this bond in 2034 instead of letting it remain outstanding until its final maturity date. It is advantageous for an issuer to execute a call option if they can re-issue new debt at a lower cost. Therefore, call structure is an important municipal consideration in strategic planning.

LADDERED APPROACH

The current economic outlook includes the potential for a lower interest rate environment. At the same time, available rates are attractively high. Utilizing bonds with no or long call dates will reduce near-term reinvestment risk. In addition, taking advantage of the steep part of the curve (15+ maturities) may optimize income while locking in for longer. It is conceivable to obtain a longer-laddered maturity range along with a longer-laddered call date range between 5 and 10 years. The laddered structure reduces risk by mitigating concentrated reinvestments in any single year down the road, regardless of whether all/some of the bonds get called at their initial call dates or if they remain outstanding until their maturity dates.

CREDIT QUALITY

For an in-depth discussion on credit quality considerations and expectations in the face of a potentially slowing economy, see the *Be Prepared* section on the following page.

COUPONS

Coupon choice determines an investor's cash flow. In the case of municipal bonds, it generally creates tax-exempt cash flow. The coupon, combined with the call date, is a big determinant as to whether a bond is likely to get called. This can have a big effect on the overall yield and duration of a portfolio as well as its longer-term performance.

In general, the higher the coupon, the higher the likelihood that a bond will get called (all else being equal). For example, a bond with a 20-year maturity that is callable in 10 years will have a higher probability of being called in 10 years if it has a 5% coupon versus a 3% coupon. For this reason, choosing the appropriate coupon/call date/maturity date combination for each bond in a portfolio is important to ensure that the overall portfolio comes together as intended.

Today, 4% coupon bonds provide healthy cash flows with a lower probability of being called versus 5% coupon bonds. In the current market, purchasing higher coupon (4 to 5%) bonds on the longer end of the curve with call dates in the intermediate range allows investors to take advantage of the attractive value opportunities in longer maturities while maintaining a higher likelihood that at least some of the bonds will get called in the next 10 years. This would provide nearer-term liquidity while keeping duration lower than a similar portfolio of low-coupon bonds. If these bonds are not called and remain outstanding until maturity, the investor will continue to earn an attractive return for the life of the bond.

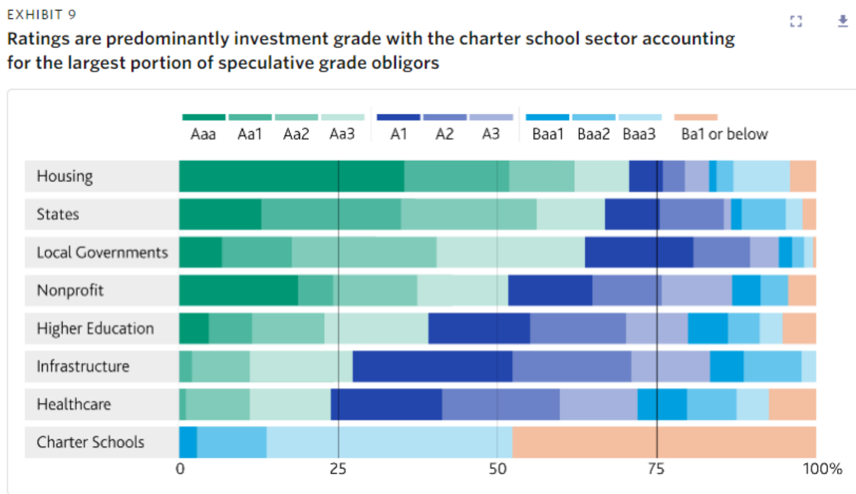
BE PREPARED *(by Ted Ruddock, Managing Director, Head of Fixed Income Private Wealth and Gina Fay, Director, Fixed Income Private Wealth)*

As our colleagues and clients along the southern coastal region know only too well, we are in the heart of hurricane season. More than a worthy slogan for scouts, "Be Prepared" is common sense advice that may help avert disaster --- or save a life --- should a blockbuster storm hit.

Being prepared is also important in our investing corner of the world. The markets have been in some stormy conditions recently as speculators, traders, and investors try to anticipate the economy's direction (and speed) along with the Federal Reserve. We've been talking about a slowing economy for some time, but the markets (over) reacted in early August in response to a more dovish tone from the FOMC with a weaker jobs report for July. The R-word was no longer being whispered but rather shouted out loud. In a matter of days, Treasuries yield plunged 20 – 40 basis points at various points along the yield curve, while the equity markets took a nosedive. As expected, markets have retraced some of that ground. But recession talk is now everywhere.

IS YOUR PORTFOLIO PREPARED FOR A RECESSION? While we don't know when a recession will come, we know it will: the business cycle isn't dead yet.

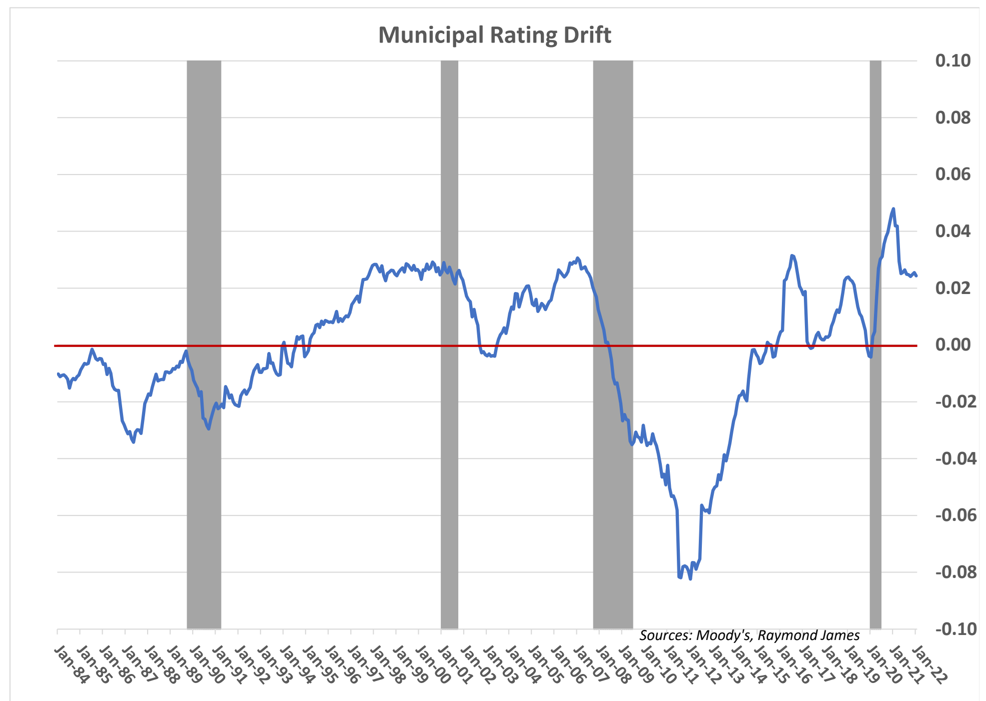
Recessions can wreak havoc on a portfolio, particularly on risk assets. Municipal investors know that municipal bonds are a resilient asset class that can focus on wealth preservation. See the chart below that highlights the high-quality ratings of municipal bonds by sectors at the end of 2023. At the end of 2022, about 90% of Moody's rated municipal credits were in the A category or higher. The median rating is Aa3, just three notches below Aaa. **But just how resilient are municipal bonds during times of economic uncertainty**?



One way of measuring resiliency is by looking at ratings and changes in ratings over time. Moody's, which rates more than 10,000 investment-grade municipal issuers, has tracked rating changes over the past 50 years and looked at rating changes (transitions, both year-over-year and multi-year), including during recessions. Each year, Moody's summarizes the number of rating changes, up and down, along with the number of "notches" in movement. A "notch" represents an assigned level in Moody's credit rating, e.g., Aa1, Aa2, Aa3. Aa1 represents a slightly better credit rating than Aa2, which is a slightly better rating than Aa3 and so on. If a municipal bond rated Aa2 was downgraded one notch, the rating would change to Aa3. Likewise, even moving across rating categories, if that same Aa2-rated bond was downgraded two notches, it would move to A1. Typically, rating changes involve only one notch in movement up or down. Multi-notch rating changes are unusual, but they do occur.

The chart below summarizes Moody's rating change data over the past 40 years, through four recessions. The recessions are indicated by the gray bars. *(It should be noted that typically ~90% of investment-grade municipal credits have no rating change from one year to the next, reflecting the overall stability of ratings.)* The blue line in the chart depicts the number of notches in ratings changes per 100 ratings. The most recent data for 2022 shows that the rating changes were 2 notches (up, above zero) per 100 credits. On average about 90 out of 100 ratings remained stable. The 10% that moved had very minor changes. Downgrades occur alongside upgrades, the net amount reflected 2 notches positive per 100 ratings. Below the red line reflects periods where downgrades were more prevalent than upgrades and/or the movement was greater. The worst period after the Great Recession in 2011 saw rating changes that were 8 notches (down) per 100 credits. Most Moody's investment-grade municipal credits saw no rating change that year. **The key takeaway from the chart is that even during recessions, municipal ratings are remarkably stable. A downgrade is not a default and often reflects that one of the financial metrics or ratios slipped down a category. Downgrades are often manageable within a well-diversified portfolio.**

Past performance does not guarantee future results. That said, the ratings consistency of municipal bonds over the past 40 years, including four major recessions, is the hallmark of this resilient asset class.



TAX LOSS & OTHER SWAPS

Typically, investors wait until the end of the year to contemplate swaps for tax loss purposes or to reposition their portfolios. It is not too early to consider how this year's investments and repositioning may benefit your tax situation. The 10-year Treasury yield has covered a lot of ground in the last 4+ years. Since January 1, 2020, the yield has been as low as 0.50% and as high as 5%. This volatility has created an opportunity to rebalance portfolios, whether looking for gains or losses in portfolios. Harvesting tax losses/gains is typically just one part of an investment decision: what will you do with the sale proceeds?

WHEN TO CONSIDER A SWAP

In simple terms, a bond swap is when an investor chooses to sell one bond and subsequently purchase another, using the proceeds from the sale to take advantage of the current market environment. Investors may choose to swap a bond for a wide variety of reasons, including:

- Anticipation of a Change in Interest Rates
- Extend or Shorten Maturity
- Alter Call Protection
- Capture a Premium
- Alter Credit Quality or Change Industries
- Tax Bracket Change (Federal or State)

IS IT TIME FOR A BOND SWAP?

The versatility of bond-swapping methods provides ample opportunities for investors to improve their bond portfolios (credit quality, sector, yield) or to opportunistically position for an anticipated change in market conditions (modify extension, duration, call protection, tax-swaps). Professional advice can be a key element of successful financial planning. Financial advisors assist investors in creating diversified fixed income portfolios designed to perform well in volatile and unpredictable market environments while addressing the investors' specific objectives for level income and principal preservation. As investors reevaluate their bond portfolios, they should consider a list of questions to help determine if it is the right time to consider a bond swap.

1. Is the investor trying to capture a gain or realize a tax loss?
2. Would the investor like to improve the credit quality of their portfolio?
3. Does the investor wish to increase yield or income?
4. Would the investor like to have more call protection?
5. Has a tax status changed?
6. What is the current tax bracket?
7. What are the general investment parameters, and have they changed?

Does the outlook for the economy and/or interest rates encourage repositioning?

Implementing a swap is not always a clear solution; there is almost always a "give up," so investors need to determine their goal and prioritize needs based on the potential outcome. There are many types of swaps investors can deploy based on individual circumstances. Here are some of the more common swaps.

- **Extension Swaps:** liquidate money market funds or sell shorter maturities to purchase longer-dated securities with longer call dates. Why would an investor want to do this? The investor believes interest rates will be progressing lower and wants to avoid reinvestment risk on the shorter maturities and lock in available yield levels for longer.

- **Credit Swaps:** Investors liquidate riskier investments and purchase improved credits to improve the credit quality of their portfolios.
- **Tax Loss Swaps:** liquidate positions with unrealized losses to use against portfolio gains. Why would an investor want to do this? Offsetting gains improves tax situations and allows losses to be carried forward. Often investors will purchase longer maturities to increase or maintain yield levels. Note: Short vs. long-term losses receive different tax treatment for tax purposes.
- **Change in Tax-Bracket:** liquidates one asset class for another depending on an investor's current Federal tax bracket. Why would an investor want to do this? If investors are in a higher federal tax bracket, they may want to swap out taxable securities and reposition them into tax-exempt securities or vice versa.
- **Geographic Swap:** liquidates some or all municipal securities because of state relocation. Why would an investor want to do this? Depending on where an investor relocates, it may be more tax-efficient to purchase in-state bonds. If an investor was living in a high-tax state and moved to a state with no income tax, they may be able to sell their bonds at a premium and replace them with a national portfolio.

Raymond James is not a tax advisor and does not give tax advice. Please consult a tax professional prior to making any investment decisions.

KNOW WHAT YOU CAN OWN

Most individual bonds provide investors with a few prominent features that are difficult to find in other product types, most notably: known cash flow for the life of the security, known income (yield) at the time of purchase, and a known date when the principal will be returned. While most individual bonds provide these benefits to investors, there are many types of individual bonds, each having different features and applications within a portfolio. As an investor, sometimes it's difficult to know which product is most appropriate for a particular situation. Below are listed attributes that may illustrate how various products might work within a portfolio. Identify acceptable risk factors.

- ✓ Define desired income.
- ✓ Create required cash flow.
- ✓ Identify the requisite redemption period.
- ✓ Create needed liquidity.
- ✓ Isolate personal biases.
- ✓ Use appropriate asset mix.
- ✓ Diversify.
- ✓ Rebalance when applicable.

	PRODUCT ATTRIBUTES	HOW DOES THIS FIT?	ADDITIONAL CONSIDERATIONS
TREASURY	Minimal credit risk. State and local tax exempt.	Can I benefit from the state tax exemption? Am I seeking safety and liquidity over maximizing yield?	Although credit risk is minimal, market risk increases with lengthening maturity.
CERTIFICATES OF DEPOSIT BROKERED	FDIC insured. Ability to diversify with multiple issuers.	Do I need more principal assurance? Typically more attractive yield versus Treasuries.	$250,000 per issuer per tax ID maximum size for insurance. Sales prior to maturity subject to interest rate risk and liquidity risk.
MUNICIPAL TAX-EXEMPT	Tax exempt income with favorable long-term credit standing.	The higher the tax bracket, the greater the tax benefit. The high credit quality is often viewed favorably.	Diversification can be attainable yet the liquidity is lesser versus other alternatives due to limited issue sizes. Subject to credit and interest rate risk.
MUNICIPAL TAXABLE	High quality, taxable alternative.	High credit quality alternative taxable investment. Investors in a lower tax bracket not benefitting from tax-exemption but still seeking the high quality and diversification offered by municipal bonds.	Diversification can be attainable yet the liquidity is lesser versus other alternatives due to limited issue sizes. Subject to credit and interest rate risk.
INVESTMENT GRADE CORPORATES	High quality, relatively good liquidity and competitive yields.	The breadth of the corporate market can allow for extensive diversification from credit ratings to multiple sectors. Generally liquid. Flexibility to create desired cash flow and income levels.	Wide range of issuers with various degrees of credit risk. Credit risks can fluctuate during holding period although this will not alter designated cash flow, income or redemption periods.
PREFERRED SECURITIES	Appeal to investors seeking higher yields and/or high cash flow	This may benefit the portfolio as a higher yielding component with more risk versus true fixed income alternatives.	Preferred's are subordinate to debt securities but placed ahead of common stock in the corporate structure. Being perpetual or very long dated exposes them to increased price volatility. Not a hold-to-maturity alternative.

FIXED INCOME STRATEGY RESOURCES

Doug Drabik - Sr. Fixed Income Strategist
Drew O'Neil - Fixed Income Strategist
Rob Tayloe - Fixed Income Strategist
Keith Parrish– Jr. Fixed Income Strategist

The Fixed Income Strategy Group provides market commentary, portfolio analysis, and strategy to Raymond James financial advisors for the benefit of their clients and prospects. We are part of the larger 14-person Fixed Income Solutions group within the Raymond James' Fixed Income Capital Markets Group's 43 fixed income locations with more than 500 fixed income professionals including trading and public finance specialists nationwide. This publication does not constitute Fixed Income research, but rather it represents commentary from a trading perspective.

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- Fixed Income Weekly Primer
- Municipal Bond Investor Weekly
- Weekly Interest Rate Monitor

INVESTMENT TYPES/EXPERTISE INCLUDE

- Treasuries/Agencies
- Brokered CDs
- Corporate bonds
- MBS/CMOs
- Tax-exempt municipals
- Taxable municipal bonds
- Preferred securities

RAYMOND JAMES August 12, 2024

Bond Market Commentary

Fixed Income Solutions

Long-Term Strategic Fixed Income Allocation

DOUG DRABIK
Managing Director, Fixed Income Strategist

Market investors have a multitude of reasons for the strategic allocation of their portfolios. This is no surprise as everyone's financial situation is unique, ranging from sources of income to necessities, to uses of discretionary funds. The flexibility offered through individual bonds translates well for tailoring individual financial goals and needs. On a higher level, many investors' fixed income allocations carry the primary goal of preserving capital or keeping individuals wealthy when they typically have retired from their primary source of income.

Over the last couple of years, bond market yields have elevated to levels not seen in almost 17 years. Unfortunately, the opportunity to benefit from these higher rates of return is not guaranteed to be available in the future. For well over a year, the Treasury rate curve has been inverted. When the economy gets overheated and pricing inflates, the Fed raises Fed Funds to slow things down. Long term rates can decline when investors feel this could cause a slowdown in the economy. An inverted curve naturally attracts investors to short term investments since a higher rate of return is offered on short maturing bonds versus longer maturing bonds. The Investment Company Institute (ICI) reports that money market assets have climbed to a staggering $6.19 trillion.

Sources: ICI, Bloomberg LP

A recent third-party Harris Poll conducted for the Guardian showed that nearly 3 in 5 respondents felt the U.S. was in a recession. Whether we are officially in one or not may not matter if the majority of Americans are feeling less sure about their financial security or how the current markets will affect their financial position.

If the economy is indeed slowing down and employment data is weakening, it is not farfetched to rationalize interest rates will continue to fall. The green line in the graph shows current interest rates and the higher levels associated with short holdings. The red line *(for illustrative purposes)* depicts how the future yield curve could look if employment and economic data continue to decline. This is the dilemma

Source: Bloomberg; For illustrative purposes only.

U.S. Treasury securities are guaranteed by the U.S. government and, if held to maturity, generally offer a fixed rate of return and guaranteed principal value. Fixed-income securities (or "bonds") are exposed to various risks including but not limited to credit (risk of default or principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise. Short-term bonds with maturities of three years or less will generally have lower yields than long term bonds which are more susceptible to interest rate risk. Credit risk includes the creditworthiness of the issuer or insurer, and possible prepayments of principal and interest. Bonds may receive credit ratings from a number of agencies however, Standard & Poor's ratings range from AAA to D, with any bond with a rating BBB or higher considered to be investment grade. Individual investor's results will vary. Moody's rates more than 10,000 investment-grade municipal issuers, has tracked rating changes over the past 50 years and looked at rating changes (transitions, both year-over-year and multi-year). Each year, Moody's summarizes the number of rating changes, up and down, along with the number of notches in movement.

The Personal Consumption Expenditures Price Index (PCE) is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Price Index (CPI) is a price index representing a weighted average market basket of consumer goods and services purchased by households. Changes in measured CPI track changes in prices over time.
A credit rating of a security is not a recommendation to buy, sell or hold the security and may be subject to review, revision, suspension, reduction or withdrawal at any time by the assigning Rating Agency. Ratings and insurance do not remove market risk since they do not guarantee the market value of the bond.

VIX Index: financial benchmark designed to be an up-to-the-minute index estimate of the expected volatility of the S&P 500 Index, and is calculated by using the midpoint of real-time S&P Index (SPX)) option bid/ask quotes.

MOVE Index: this is a yield curve weighted index of the normalized implied volatility on 1-month Treasury options. It is the weighted average volatilities on the CT2, CT5, CT10 and CT30. (weighted average of 1m2y, 1m5y, 1m10yand 1m30y Treasury implied vols with weights 0.2/0.2/0.4/0.2, respectively).

S&P Index: is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

U.S. Bloomberg Aggregate Bond Index (U.S. Corporate Investment Grade/LUACTRUU): Measures the investment grade, taxable corporate bond market. It includes USD demoninated securities publicly issued by US and non-US industrial, utility and financial issuers.

Duration is the measure of a bond's price sensitivity relative to interest rate fluctuations. Rebalancing a non-retirement account could be a taxable event that may increase your tax liability.

Diversification and strategic asset allocation do not ensure a profit or protect against a loss. Investments are subject to market risk, including possible loss of principal. The process of rebalancing may carry tax consequences.

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Prior to transacting in any security, please discuss the suitability, potential returns, and associated risks of the transactions(s) with your Raymond James Financial Advisor.

The value of fixed income securities fluctuates and investors may receive more or less than their original investments if sold prior to maturity. Bonds are subject to price change and availability. Investments in debt securities involve a variety of risks, including credit risk, interest rate risk, and liquidity risk. Investments in debt securities rated below investment grade (commonly referred to as "junk bonds") may be subject to greater levels of credit and liquidity risk than investments in investment grade securities. Investors who own fixed income securities should be aware of the relationship between interest rates and the price of those securities.

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Investment products are: not deposits, not FDIC/NCUA insured, not insured by any government agency, not bank guaranteed, subject to risk and may lose value.

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Investing involves risk and you may incur a profit or loss regardless of the strategy selected.

Bond ladders: time-honored investment technique, in which an investor blends several bonds with differing maturities, provides the benefit of blending higher long-term rates with short-term liquidity. Should interest rates remain unchanged, increase, or even decline, a laddered approach to fixed income investing may help reduce risk, improve yields, provide reinvestment flexibility, and provide shorter-term liquidity. Risks include, but are not limited to, changes in interest rates, liquidity, credit quality, volatility, and duration.

Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary.

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863 // RAYMONDJAMES.COM

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Ref. M24-578924 until 8/22/2025