NDR
NED DAVIS RESEARCH

Fixed Income Allocation Strategy

MAY 2024

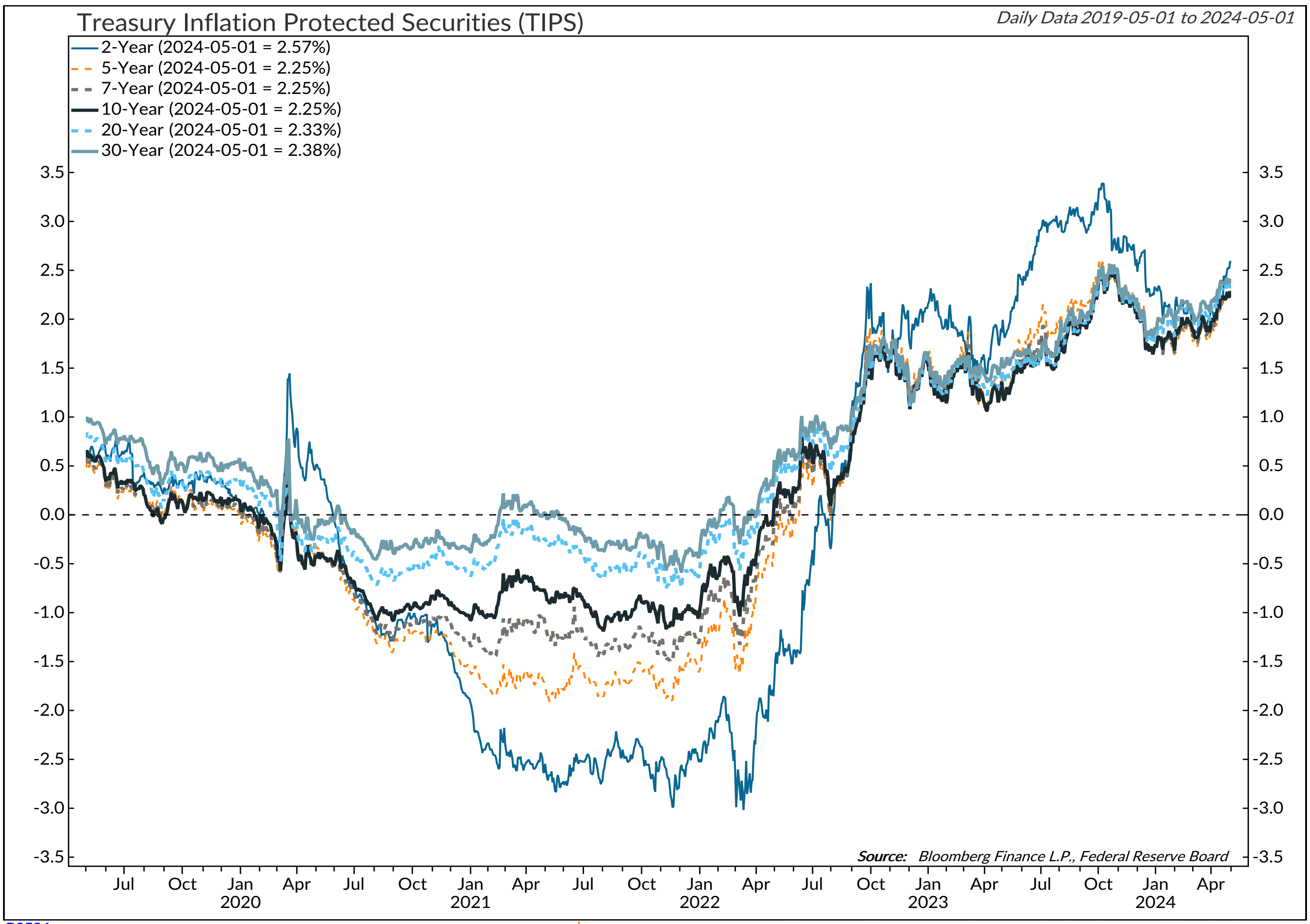
Fixed Income Market Update

The Bloomberg Barclays U.S. Aggregate Bond Total Return Index weakened in April with a return of about -2.5%. Breadth deteriorated sharply—seven of nine fixed income sectors we track posted negative returns for the month. U.S. Long-Term Treasurys were the weakest at -6.4%, driving down the aggregate.

Due to sticky inflation and robust jobs market, the FOMC kept the fed funds target range at 5.25% to 5.50% for the sixth consecutive meeting this month. The Fed noted the "lack of further progress toward the Committee's 2% inflation objective." We believe that means fewer rate cuts this year than what was expected in March.

The big debate in the market and in the press is if policy is restrictive. If you're the Fed and you look at the real policy rate, the answer is yes. Real rates from the TIPS market are at or near their October cycle highs, leading to a higher cost of capital. In fact, the last time we saw real rates this high was during the GFC (chart below).

As a result, entering May, the fixed income allocation strategy's sector positioning favors an inflationary environment. The model is overweight U.S. Floating Rate Notes, U.S. High Yield, and International Investment Grade. The model is underweight U.S. Mortgage-Backed Securities, U.S. Long-Term Treasurys, U.S. Investment Grade Corporate, and Emerging Market bonds.



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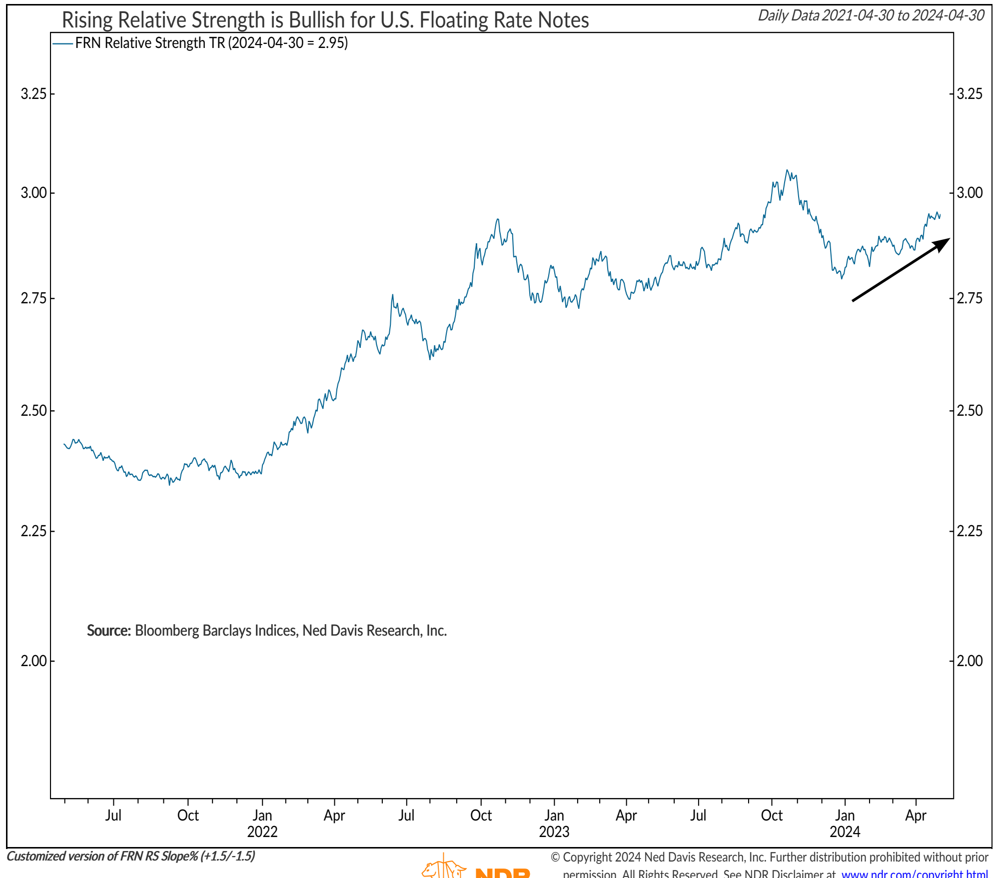
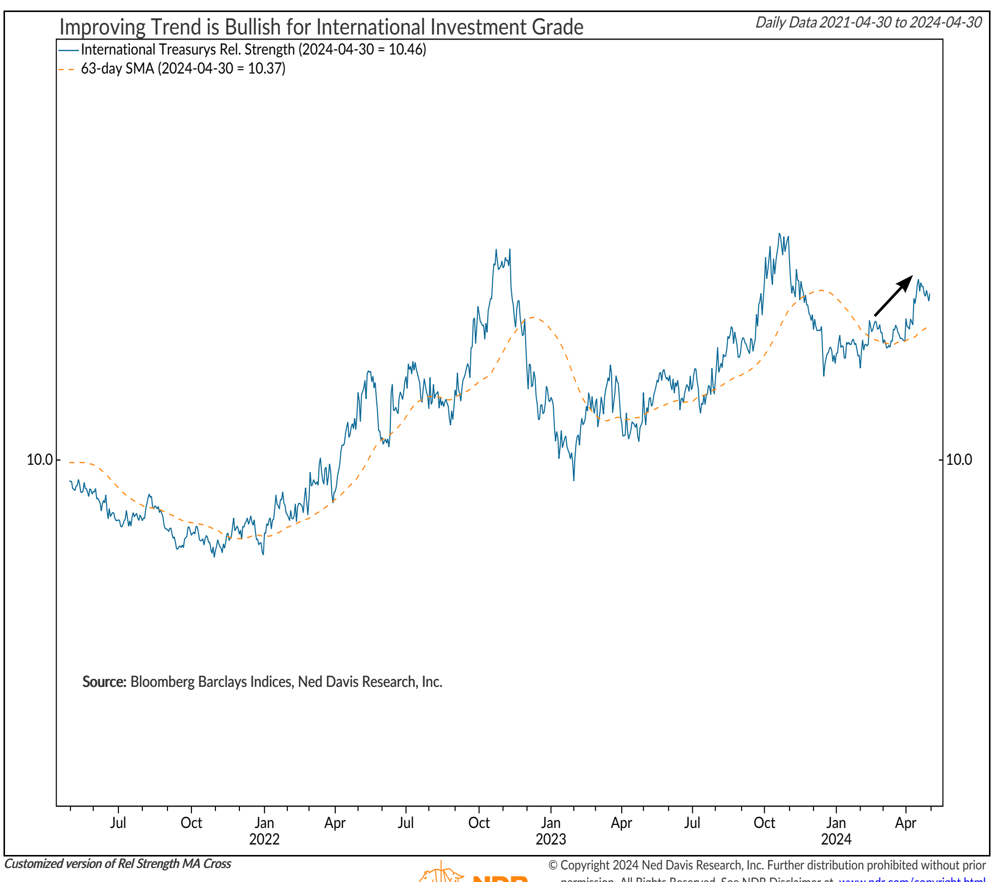
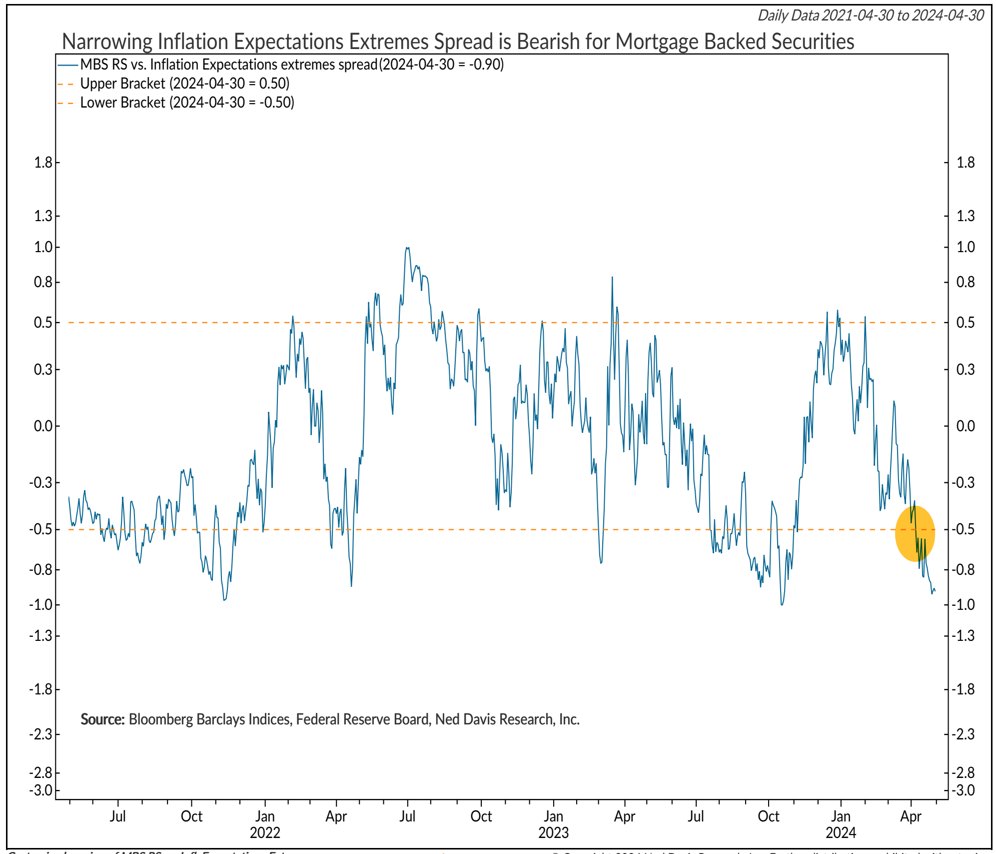
U.S. Floating Rate Notes' allocation improved sharply and is now the largest overweight. Four of five indicators are now bullish for the sector. During the month, market volatility (as measured by the VIX) moved neutral for U.S. Floating Rate Notes. Technicals improved—the sector had new bullish signals from a momentum indicator and slope indicator (chart right).



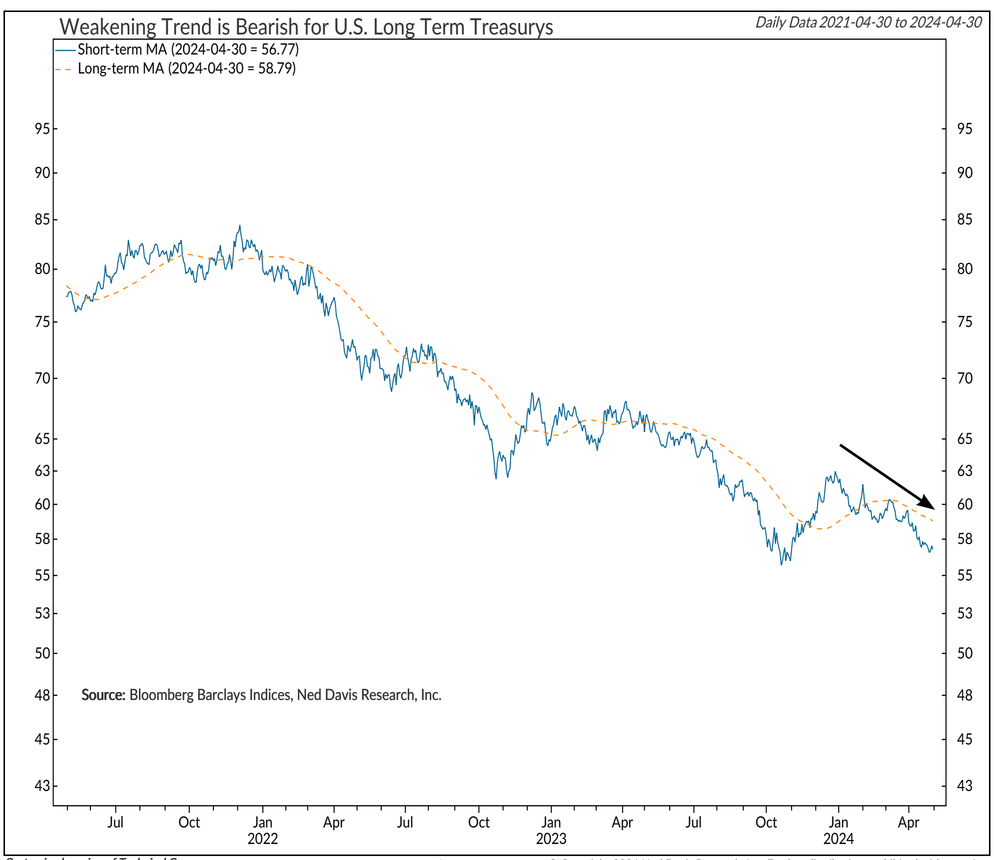


International Investment Grade bonds' allocation improved sharply and was upgraded to overweight. Externals improved. Stock market volatility (as measured by the VIX) flashed bullish for the sector, while widening spreads moved to neutral. Price-based measures are bullish—short-term trend (chart left) improved to bullish during the month and joined a relative strength slope indicator.

U.S. Mortgage-Backed Securities' allocation dropped sharply to underweight. On a fundamental basis, a bullish 10-year yield indicator was more than offset by bearish option-adjusted spreads and inflation expectations extreme spreads (chart right) which moved negative for the sector during the month. Technicals are confirming, as trend and relative strength measures remained bearish.



Customized version of MBS RS vs. Infl. Expectations Extremes



Customized version of Technical Cross

U.S. Treasurys' allocation dropped to underweight. On a fundamental basis, a weakening equity trend moved neutral for bonds, but was more than offset by bearish inflation expectations and swaps which moved negative for the sector during the month. Technicals are weak—short-term trend (chart left) joined momentum with a bearish signal during the month.

Summary

Entering May, the fixed income allocation strategy's sector positioning favors an inflationary environment. The model is overweight U.S. Floating Rate Notes, U.S. High Yield, and International Investment Grade. The model is underweight U.S. Mortgage-Backed Securities, U.S. Long-Term Treasurys, U.S. Investment Grade Corporate, and Emerging Market bonds.

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