Fixed Income Allocation Strategy

APRIL 2023

Fixed Income Market Update

After about a 2.5% drop in February, the Bloomberg Barclays U.S. Aggregate Bond Total Return Index gained over 2.5% in March. The index has been positive for six of the past 12 months. Of the nine fixed income sectors we track, all of them except Floating Rate Notes had positive returns in March.

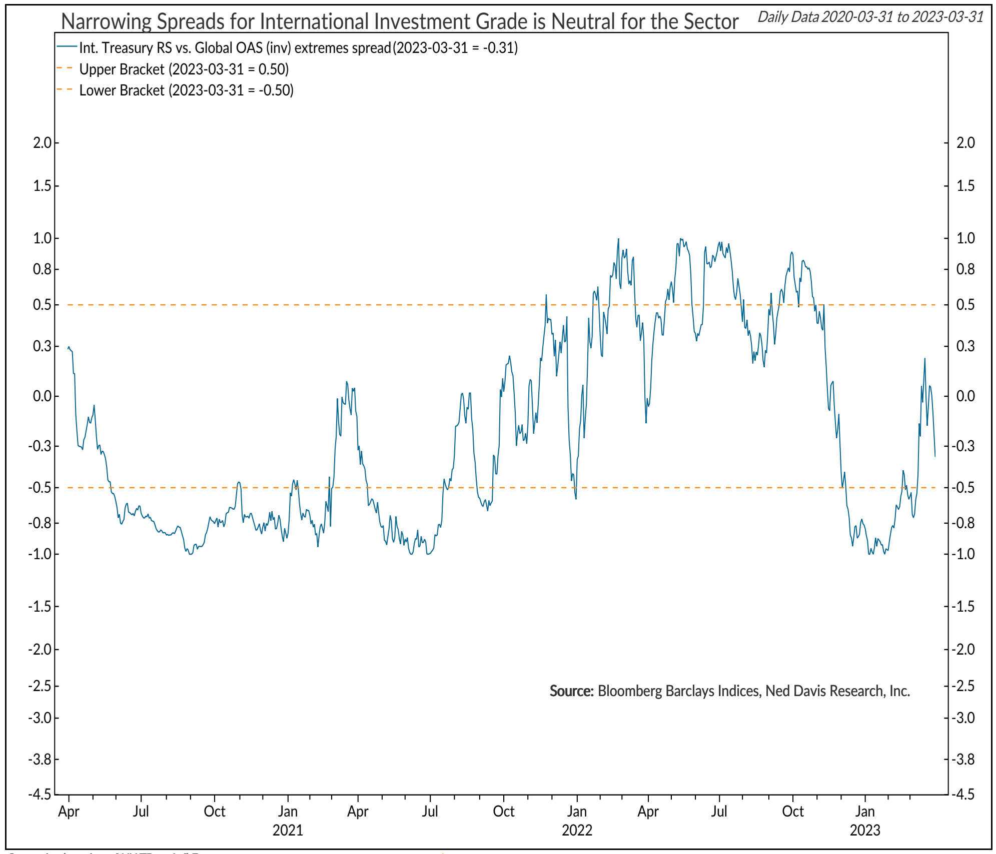
After last month's liquidity backstop by the Swiss National Bank for Credit Suisse and the $30 billion capital injection into First Republic by a consortium of U.S. banks, it looks like authorities have successfully ringfenced the banking problems.

Following the anticipated 25 basis point rate hike in March, the Fed provided an update to their economic outlook. The Fed is effectively forecasting a recession this year. We can't have 3.2% GDP growth in Q1 and end up at 0.4% for the year without having negative quarters. Unemployment is projected to rise to 4.5% from 3.6%. As a result, market participants are starting to price in a reversal of the tightening cycle. The decline in rates across the curve impacted fixed income sector leadership, as well as the trend in the U.S. Dollar (chart below).

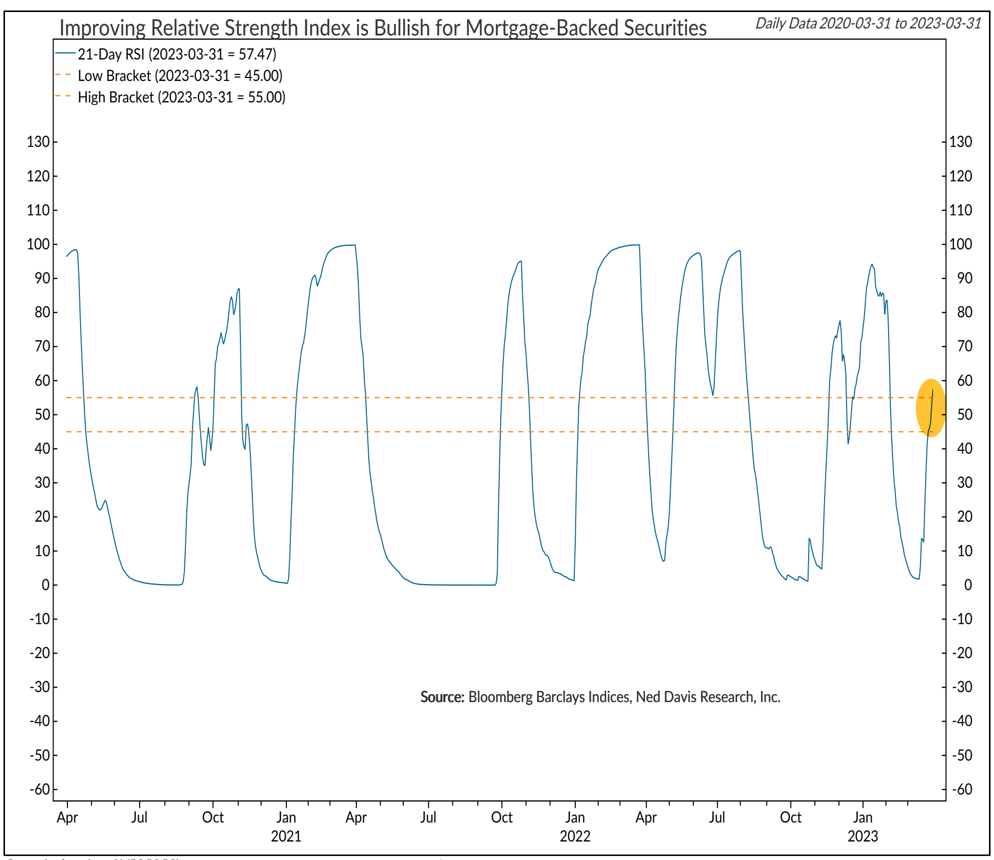
Entering April, the fixed income allocation strategy is overweight International Investment Grade, Emerging Market Bonds, Treasury Inflation-Protected Securities, and Mortgage-Backed Securities, while Floating Rate Notes, U.S. Long-Term Treasurys, and U.S. High-Yield Bonds are underweight.

Customized version of I200

International Investment Grade bond's allocation rose sharply to the largest overweight position. Equity volatility and international investment grade bond price trends are bullish for the sector. Narrowing global option-adjusted spreads improved to neutral this past month (chart right).



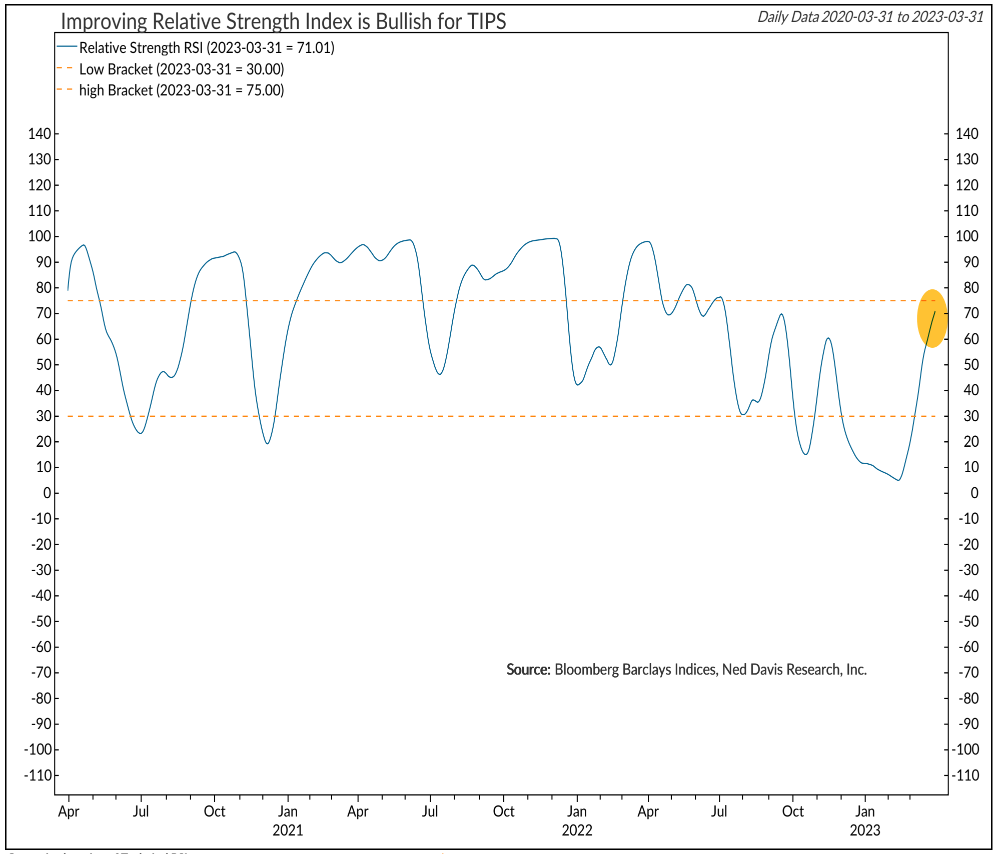
Customized version of HY TR vs. Infl Extremes



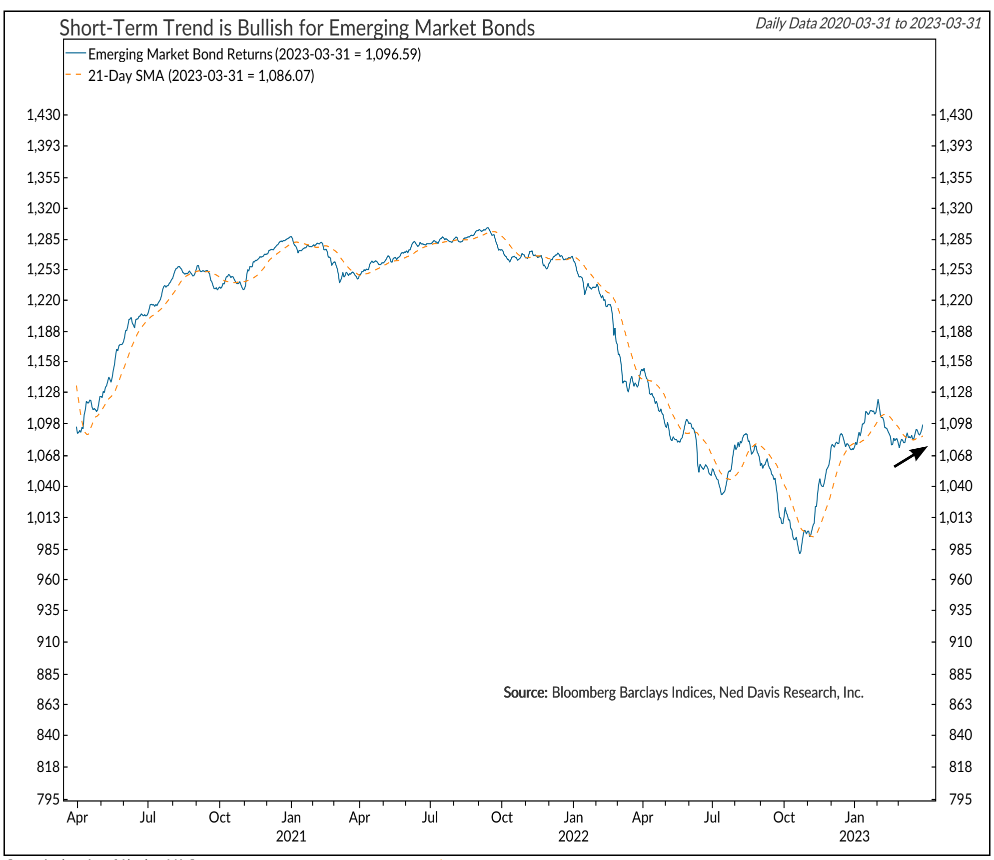
Customized version of MBS RS RSI

Mortgage-Backed Securities' (MBS) allocation increased sharply, moving it from an underweight to overweight position in April. With mortgage rates falling during March, two of the six indicators flipped bullish for MBS—the sector's relative strength index (chart left) and narrowing high-yield option-adjusted spreads.

Treasury Inflation-Protected Securities' (TIPS) allocation increased sharply, moving it from an underweight to overweight position in April. On a fundamental basis, narrowing high-yield option-adjusted spreads is bullish for the sector. Technicals also improved—the relative strength index (chart right) moved bullish during the month.



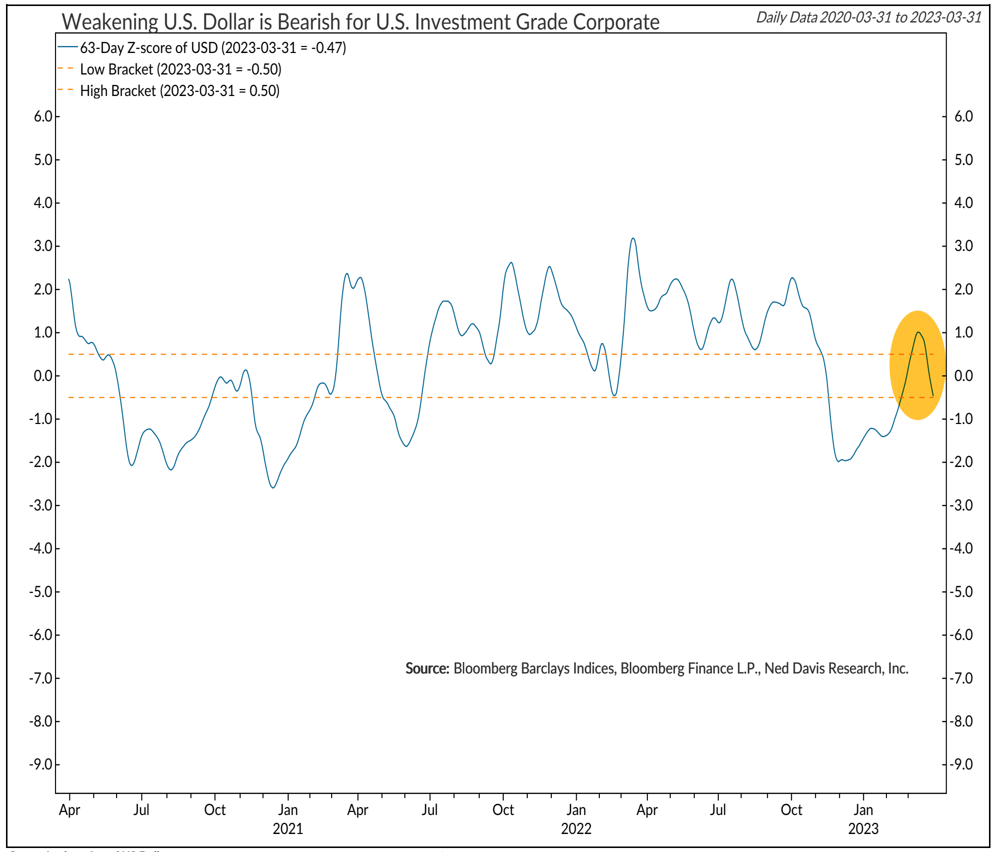
Customized version of Technical RSI



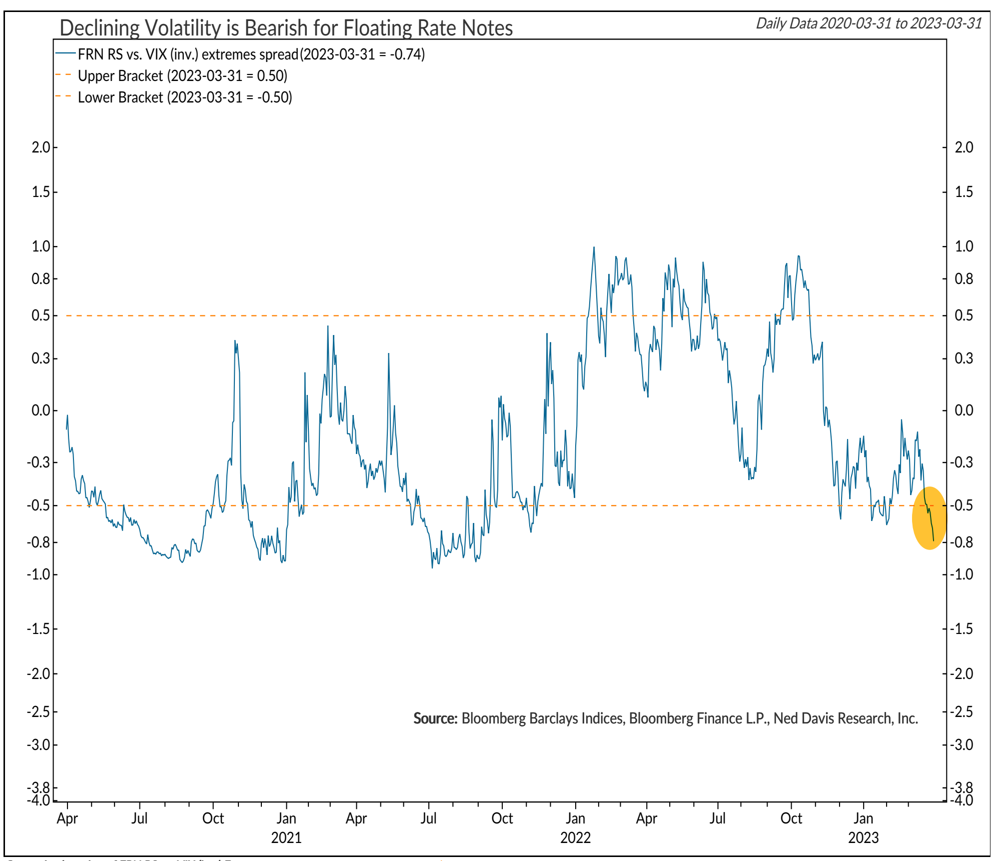
Customized version of Absolute MA Cross

Emerging Market (EM) bonds' allocation rose sharply in April, moving the sector from an underweight to an overweight. Due to the inverse relationship with Emerging Markets, the weakening of the U.S. Dollar relative to EM currencies became a bullish condition for both emerging market equities and bonds. As a result, short-term trend turned bullish for the sector (chart left).

The allocation to U.S. Investment Grade Corporate bonds rose in April, driving the sector from underweight to neutral. Most of the fundamental and technical indicators are bearish for the sector. Over the last month, the reversal in the U.S. Dollar Index was bearish for the sector (chart right).



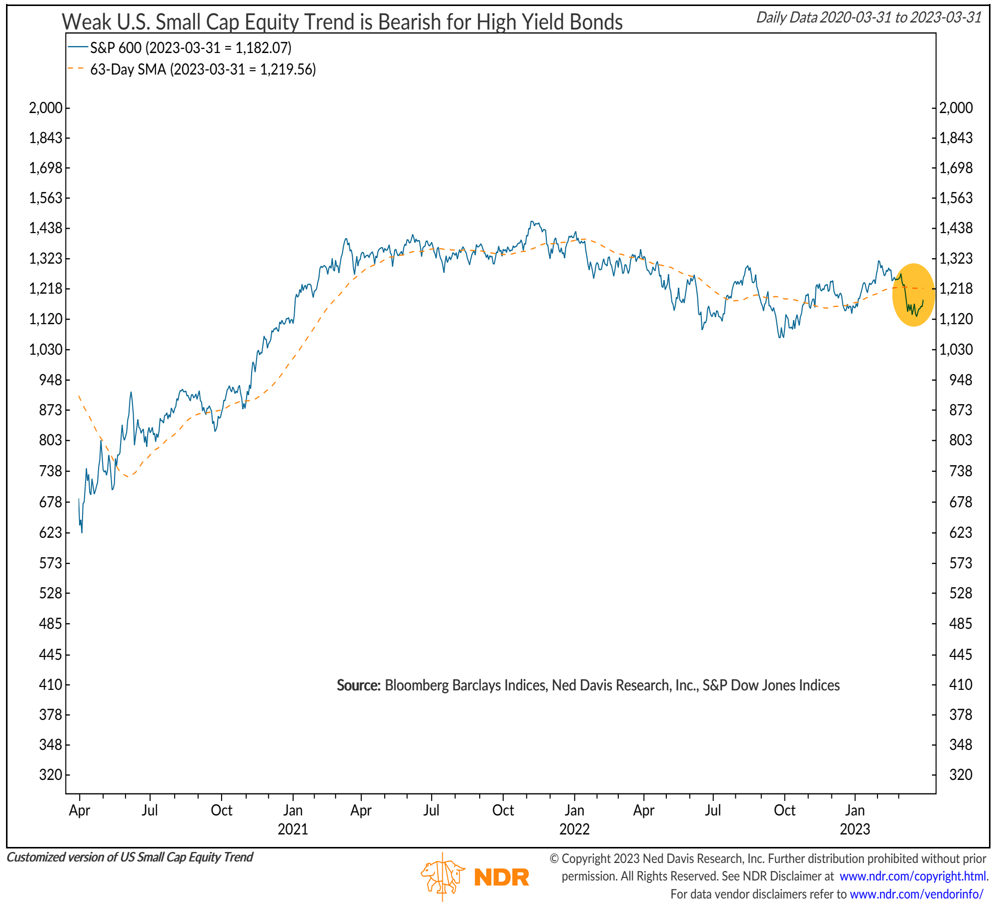
Customized version of US Dollar

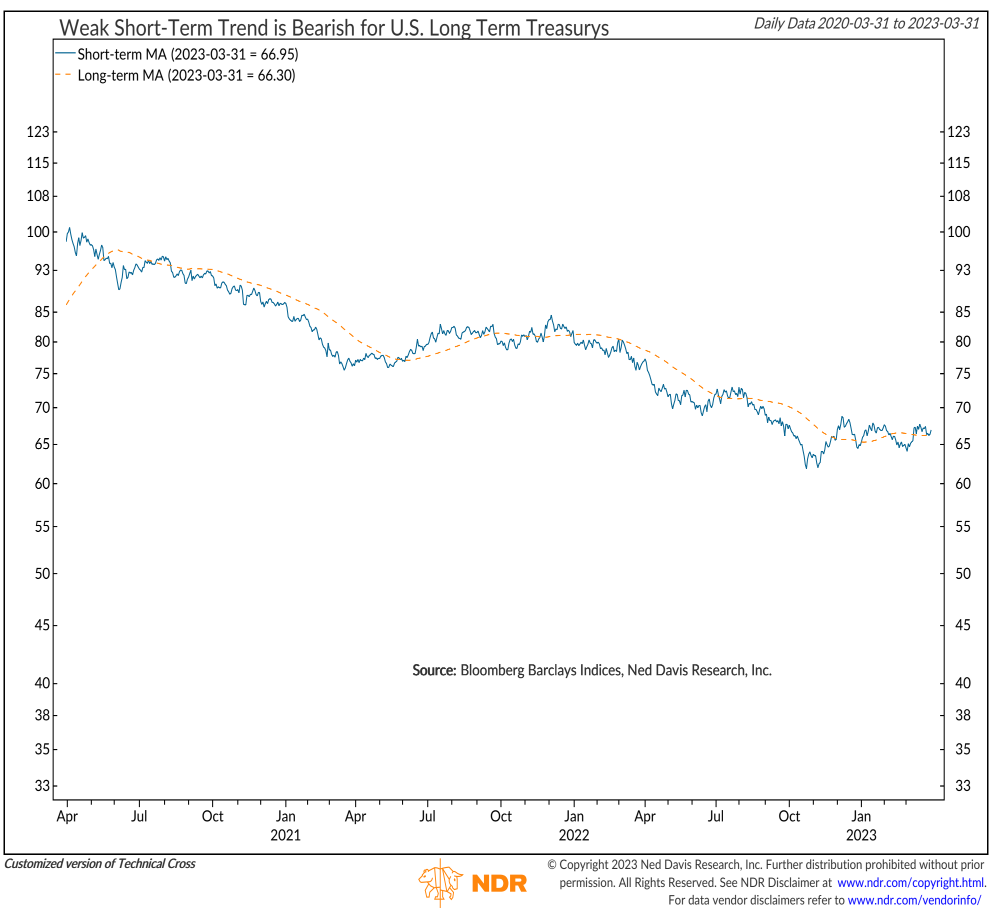


Customized version of FRN RS vs. VIX (inv.) Extremes

Floating Rate Notes' allocation fell sharply in April, moving it from the highest overweight to the largest underweight position. Floating rate notes typically outperform during a rising rate environment—yields across the board fell in March. All fundamental and technical indicators are now bearish. A decline in volatility, as measured by the VIX (chart left), turned bearish for the sector in March.

U.S. High Yield bonds' allocation declined sharply in April, moving it from overweight to underweight. Indicators are mixed. Improving breadth was offset by a weaker small-cap equity trend (chart right) and lower volatility.





Allocation to U.S. Long-Term Treasurys declined, moving the sector from neutral to underweight. Most indicators are neutral or bearish. Improving price momentum, now bullish, was offset by deteriorating short-term trend (chart left).

Summary

With yields across the board declining in March, fixed income sectors rallied. A weaker U.S. Dollar led to Emerging Market and International Investment Grade bonds improving to overweight. U.S. Investment Grade bonds improved to neutral. Lower rates helped push TIPS and MBS to overweight and Floating Rate Notes to underweight. U.S. Long-Term Treasurys and U.S. High Yield bonds also dropped to underweight.

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