BONDS ARE BACK?!

Many believe "bonds are back"! When bonds were clobbered in 2022 by the steep increase in interest rates, in fact, according to Schwab Center for Financial Research, the steepest we've ever seen in our history, all bonds performed poorly, even the less volatile and the shortest term. If indeed the Federal Reserve is close to the end of their Fed hiking cycle, we believe we should expect bond prices to return to their levels prior to the down year in 2022. Many who advise us say they haven't seen this kind of potential opportunity in bonds for a very very long time since yields have been in the 0-2% range. Now that money market funds are paying over 5% and almost all bonds are paying greater than 5%, if the Fed stops raising interest rates, and the economy slows, we would expect to see interest rates go down and bond prices go up substantially.

Better Bond Days are Ahead

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Historically, a pause in a rate hiking cycle has meant positive performance across fixed income

(forward returns, %)

	3 months	6 months	12 months
3-month T-bills	1.5	3.1	5.6
10-year Treasuries	5.9	8.9	11.6
Investment grade	5.1	9.4	14.3
High yield	5.3	8.7	12.9
MBS	4.7	7.4	12.4

We looked at the performance of fixed income during periods when the Fed stopped or paused a rate hiking cycle.

Historically, fixed income posts positive returns around the end of a rate hiking cycle, benefiting from higher starting yields and lower interest-rate volatility as uncertainty decreases.

Although we don't know when the current rate hiking cycle will end or pause, we do know that we're getting closer. And with the potential for compelling returns, investors may want to consider stepping off the sidelines — sooner rather than later — to take advantage of this opportunity.

Past performance is not a guarantee of future results. Source: Columbia Threadneedle Investments, Bloomberg. Represents data from 1984 to 2023. Three-month bills are represented by the Bloomberg U.S. Treasury Bellwethers 3 Month Index, which is an unmanaged index representing the on-the-run (most recently auctioned) U.S. Treasury bill with 3 months' maturity; 10-Year Treasuries bonds are represented by The Bloomberg U.S. Treasury Bellwethers 10 Yr. Index, an unmanaged index representing the on-the-run (most recently auctioned) U.S. Treasury bond with 10 years' maturity; Investment Grade is represented by the Bloomberg U.S. Corporate Investment Grade Index, which measures the investment-grade, taxable corporate bond market; High Yield is represented by the Bloomberg U.S. High Yield Corporate Bond Index, which represents the universe of fixed-rate, non-investment grade debt; Mortgage-backed securities are represented by the Bloomberg U.S. Mortgage-Backed Securities Index, which tracks agency mortgage-backed pass-through securities. An investment cannot be made in an Index.

COLUMBIA THREADNEEDLE INVESTMENTS

The Markets - still controlled by the Fed

The US Federal Reserve left interest rates unchanged at 5.25 to 5.5, a 22-year high. The policy statement contained minimal changes to key wording and Chair, Jerome Powell, continued to signal reasonably high odds of another rate hike later this year.

The Commerce Department reported the Fed's favorite inflation indicator, the Personal Consumption Expenditure "PCE index", rose only 0.1 % in August and 3.5% in the past 12 months. The core PCE, which excludes food and energy, also rose 0.1% in August and 3.9% in the past year. That is good news for future Fed policy decisions. If the PCE continues to cool off, the Fed will likely not need or want to raise key interest rates further. The Commerce Department also reported that consumer spending rose just 0.4 % in August down from 0.9% in July, so consumers are also becoming more cautious. According to Goldman Sachs, the risk of recession over the next year is just 15%, far below the 55% Bloomberg Consensus. They maintained that Q4 drag looks temporary and the long-term growth fundamentals remain favorable. Real disposable personal income is rising at a solid pace because of ongoing growth of employment, real wages, and interest income. The Manufacturing sector, in their opinion, seems to have bottomed.

The fourth quarter of a calendar year is very similar to the fourth quarter of a football game. Much of the time the most significant action often happens in that fourth quarter. That doesn't mean you can ignore the first three quarters, and in this year the first nine months have not given us much reason for optimism. According to Navellier Investment Counsel, in the past 25 years, the fourth quarter has delivered more than twice the returns of the first three quarters; plus 4.67% versus just 1.91%. They maintain the reasons for these 4th quarter surges are things like pension plan funding, tax loss buying or selling, and year end fund window dressing. Further engines driving that fourth quarter performance though are the holiday season, sports, family get togethers, and looking forward to the new year, especially if we get some political relief.

Since 1950, pre election years have averaged 16.6% according to Navellier Investment Counsel. You've seen performance in presidential election years in our Newsletters before. Since 1951, the 18 presidential cycles have averaged 16.6% in the S&P 500 with only 1 slight down year in 2015.

Harvesting tax losses and offsetting capital gains is a year end exercise that we feel should be considered when appropriate. We don't want to disrupt our long-term investment strategy when harvesting losses, but we also don't want to pay taxes on any money that can be offset by a loss in real estate, stocks, or mutual funds. Let us know if we can help you in this regard.

Barnes Pettey in the Community

Dudley, Andrew and Daniel joined the Clarksdale Rotary Club in a "Let's Clean up Clarksdale". They spent the better part of a day cleaning up 12 blocks of West Second Street, getting trash out of gutters and cleaning the overgrown grass on the curbside. We regret that our street sweeper is broken, but we in the Rotary Club took it into our own hands and did something about it! Greg Hoskins is pictured with the BP team.

Don't Let Year End Planning Slip Up on You!

Those of us that are over 73 must take our Required Minimum Distributions from our IRAs before December 31. If you have not already done that, make sure and contact us to get yours paid and to consider using some of your distribution for a qualified charitable distribution. Previous newsletters have pointed out that up to $100,000 can be given from your IRA to a qualified charity on a nontaxable basis. This is a win for you and a win for your favorite charities.

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