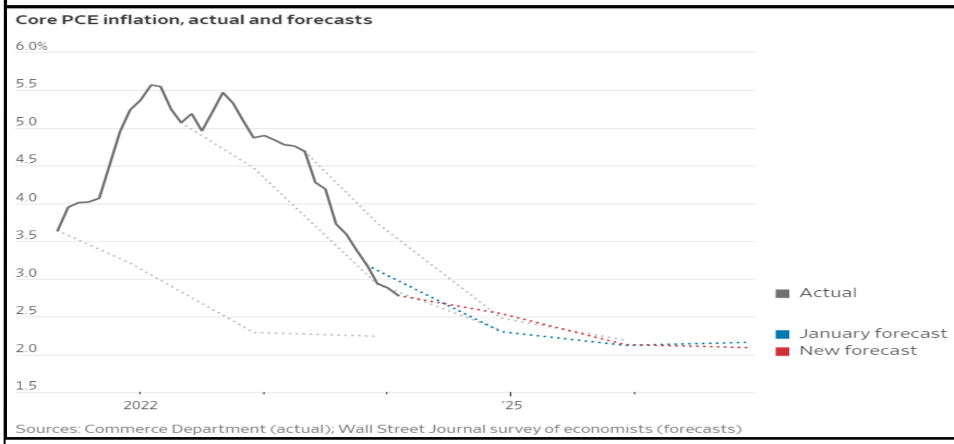
First Quarter 2024 Bond Market Review and Outlook

CAM
Cincinnati Asset Management, Inc.
Investment Grade & High Yield Bond Specialists

“Monetary policy operates with long and variable lags.” (Milton Freidman as quoted in *Bloomberg* 10/16/23)



In our previous letter in January we noted that the trend to lower inflation and interest rates will be bumpy as it usually is. The consensus then pointed toward lower yields ahead driven by perceptions of a slowing economy both here in the U.S. and abroad.

The graph above shows actual and forecasted inflation by the Federal Reserve’s preferred measure (the PCE, personal consumption expenditures index). The survey of forecasts was conducted 4/9/24. By mid-2025 the forecast shows inflation nearing the Federal Reserve’s target of 2%.

Since the bond market low in mid-October 2023, a strong rally ensued. The 10-year Treasury yield fell from 4.99% on October 19, 2023 to 3.79% on December 27, 2023 (source: *Bloomberg* 1/17/24). Following stronger than anticipated GDP growth and CPI inflation data, the 10-year Treasury yield rose to 4.20% at the end of the first quarter, March 28th (source: *Bloomberg 4/16/24)*. Successive stronger than anticipated economic data in April has push the yield up to 4.66% on 4/16/24 (source: *Bloomberg* 4/16/24).

A strong and quick reversal of widespread expectations in December of up to six rate cuts by the Federal Reserve in 2024, starting in March has shaken the market. Now many anticipate three to four cuts with the Central Bank rate ending 2024 at 4.65% and the 10-year yield falling to 3.89%, near it’s 2023 year-end yield (source: *Bloomberg Economic Forecasts Survey* 4/16/24).

In December the Federal Reserve projected GDP growth of just 1.4% in 2024, 1.8% in 2025 and 1.9% in 2026 (source: *Bloomberg* 4/16/24). However latest reading from the Atlanta Federal Reserve’s GDPNow projection of first quarter GDP is 2.9%. This would be quite a rise from even the most recent March Federal Reserve annual GDP projections of 2.1%, 2.0% and 2.0% (source: *Bloomberg* 4/16/24). It would possibly set the stage for fewer or even no rate cuts by the Federal Reserve in 2024.

A GDP print of 2.9% would be the seventh consecutive quarter of growth above the long-term trend (source: *Bloomberg* 4/16/24), accompanied by higher oil prices and higher inflation readings.

On page three is the graph of actual and forecasted Federal Funds rates form the survey of economists on April 9, 2024. About 35% of respondents feel there will be just 2 rate cuts in 2024 and end the year at 4.75% (source: *Wall Street Journal* 4/17/24). Recent comments by Chairman Powell imply that

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Yields* on 03/31/2024	**Yield***
CAM Broad Market (corporate core plus) Strategy (6.0 year maturity; 4.9 duration)	**5.35%**
CAM Investment Grade (100% corporate bonds) Strategy (6.4 year maturity; 5.4 duration)	**5.07%**
CAM High-Yield Strategy (only BA & B rated purchased) (5.2 year maturity; 4.0 duration)	**5.92%**
CAM Short Duration Strategy (2.8 year maturity; 2.3 duration; 50% IG & 50% HY)	**5.45%**
CAM Short Duration Investment Grade Strategy (2.2 year maturity; 1.9 duration)	**5.14%**
U.S. Treasury** (10 year maturity)	**4.20%**
U.S. Treasury** (5 year maturity)	**4.21%**
U.S. Treasury** (2 year maturity)	**4.62%**

* The lower of yield to maturity or yield to worst call date ** Source: Bloomberg

CAM’s Key Strategic Elements

- Bottom-up credit analysis determines value and risk.
- Primary objective is preservation of capital.
- Larger, more liquid issues preferred.
- Target is always intermediate maturity.
- No interest rate forecasting.
- All clients benefit from institutional trading platform and multi-firm competitive bids and offers.

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CAM returns are after CAM's average management fee & all transaction costs but before any broker, custody or consulting fees. **The indices are unmanaged and do not take into account fees, expenses, and transaction costs.**	Total Return (%)	Annualized Returns (%)				
	1Q '24	YTD	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	0.24	0.24	5.29	-0.94	1.98	2.40
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	1.47	1.47	9.04	0.80	3.49	2.60
Bloomberg US Corporate High Yield Index	1.47	1.47	11.15	2.19	4.20	4.44
CAM Investment Grade Strategy—Net 100% corporate bonds	-0.36	-0.36	3.70	-1.75	1.26	2.30
Bloomberg US Corporate Index	-0.40	-0.40	4.44	-1.87	1.53	2.61
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	1.28	1.28	6.43	0.79	2.74	1.92
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	0.55	0.55	3.79	-0.55	1.33	1.74

Relative Performance Review 03/31/2024

CAM's **Investment Grade Strategy** ("IG") produced a gross total return of -0.30% in the quarter ended March 31, 2024, compared to -0.40% for the Bloomberg U.S. Corporate Index. Notably, CAM always positions a majority of the portfolio within intermediate maturities. Longer dated securities (10+ years) returned -1.89% for the period, underperforming the broader index. CAM's zero weighting in this duration bucket produced a +41 basis point contribution to excess return. The LTM return for the CAM IG strategy was 3.95% compared to the Index return of 4.44%. CAM's positioning within the Retailers and Airline industries were the largest positive impact to performance, with +43 and +5 basis point contributions to excess return, respectfully. Our positioning within the Banking industry was the largest negative contribution of -28 basis points.

The **High Yield Strategy ("HY")** delivered a gross total return of 1.55% in Q1 while the Bloomberg US Corporate High Yield Index returned 1.47%. CAM's overweight and security selection within the Banking industry group had the biggest positive impact on performance relative to the index with a 35 basis point contribution to excess return during the quarter. The HY LTM return was 9.36% while the Index returned 11.15%. CAM does not purchase securities rated CAA and lower. The impact of CAM's underweight in lower quality credit was a -65 basis point contribution to excess return during the period.

Our **Broad Market Strategy ("BM")** – a 67%/33% blend of the IG and HY strategies above – produced a gross total return of 0.30% for the quarter compared to 0.22% for the Index, a similar blend of Bloomberg IG and HY corporates. Our BM strategy is structurally underweight the 10+ year maturity bucket relative to the Index, which underperformed the Index as a whole. The result of our underweight was a 38 basis point contribution to excess return. The LTM return for the CAM Broad Market strategy was 5.57% compared to a blended Index return of 6.64%. CAM does not purchase CAA and lower-rated securities, and these cohorts dramatically outperformed the index as a whole. The result was a -32 basis point contribution to excess return.

The CAM **Short Duration Strategy ("SD")** blends equal weights of IG and HY bonds with a target duration of 3 years. The strategy's gross total return for the quarter was 1.34% while the Index, a similar blend of intermediate IG and HY corporates, returned 1.03%. CAM's positioning within the Wirelines industry posted the single largest positive impact to performance, generating a +23 basis point contribution to excess return. CAM's exposures to the Retail industry was the largest negative contributor, generating a -7 basis point contribution to excess return. The strategy's LTM gross total return was 6.70% compared to the blended Index return of 8.06%. For this period, CAM's positioning within the Wirelines and Leisure industries generated the largest positive impacts to performance of +25 and +22 basis points, respectively.

The **Short Duration Investment Grade Strategy ("SD-IG")** delivered a gross total return of 0.61% for Q1 while the Bloomberg U.S. Corporate 1-5 Index returned 0.60%. CAM's duration profile differs from that of the index, with an overweight in the front end of the curve (0-1yrs) and an underweight of the 3-to-5 year bucket. Overall, the duration allocation effect was +18 basis points given the outperformance of the 0-to-1yr portion of the curve. Over the LTM period, SD-IG underperformed the Index, by delivering 4.04% gross total return versus an Index return of 5.08%. Exposure to the Chemicals and Food & Beverage industries generated the largest positive contributions to return of +4 and +3 basis points, respectively. Exposure to the Banking industry generated the largest negative contribution of -27 basis points.

Bloomberg Bond Indices Returns vs. CAM Gross (annualized %)

Periods ended 03/31/2024	10-yrs	20-yrs
U.S. Aggregate	**1.54**	**2.99**
U.S. Corporate	**2.61**	**3.95**
CAM Investment Grade Strategy (gross)	**2.54**	**3.98**
CAM Investment Grade Strategy (net)	**2.30**	**3.74**

Better Asset Allocation Might Result from More Exacting Analysis

CAM looks to minimize the overall volatility of our High Yield strategy by focusing on the upper tier of High Yield credit (BA-B), as well as the conservative portion of a firm's capital structure. The chart to the right indicates that lower tier securities (CAA-rated cohorts and below) underperformed BA-rated bonds for all periods shown. B-rated bonds also performed favorably relative to the lower tiers. Not shown in the table is the pronounced volatility that has characterized the CAA-rated and lower subsectors. For example, the standard deviation of the CAA credit tier has been approximately 45% greater than the broader Bloomberg US Corporate HY Index over the 10-year period (12.26% versus 8.48%). This shows investors may not be rewarded for the additional risk of the CAA-rated and lower subsectors.

Upper tier High Yield credit (BA-B) has also outperformed the Bloomberg US Aggregate Index (the "Agg") for all periods shown. This connotes BA and B rated credit quality stripes have also kept better pace with inflation than the Agg.

These points suggest that upper tier High Yield bonds deserve consideration as a core holding over a complete market cycle.

Total Return of High-Yield Bonds by Credit Quality
(periods ended 03/31/2024) Source: Bloomberg US Corporate Indices
(annualized %)

High-Yield Bond Sectors	5-years	10-years	20-years
BA-rated bonds	**4.56**	**4.82**	**6.57**
B-rated bonds	**3.97**	**4.08**	**5.83**
CAA-rated bonds	**3.06**	**3.87**	**6.33**
CA & D-rated bonds	**2.96**	**-2.67**	**3.29**

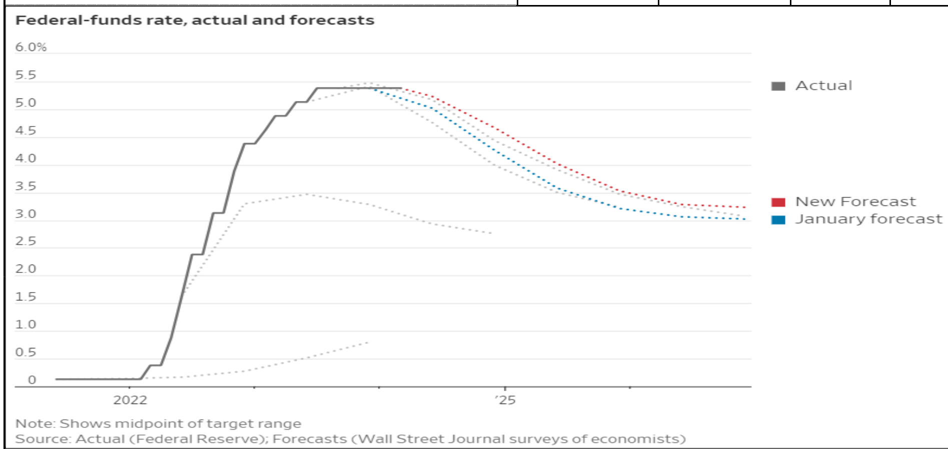
Performance of Other Asset Classes
(periods ended 03/31/2024) Source: Bloomberg & Lipper

S & P 500 Stocks	**15.05**	**12.96**	**10.12**
Bloomberg U.S. Aggregate	**0.36**	**1.54**	**2.99**

The March 31 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 3/31/2024 spreads have tightened on a YTD basis, while the 10-year U.S. Treasury ended Q1 2024 at 4.20%, 32 basis points higher than 12/31/2023 (3.88%).

We are realistic about the upside potential in credit spreads. The good news is that when you are starting with a >5% yield, there is a comfortable margin of safety available for spread widening while still generating positive total returns.

Credit Rating	20-Year Average Spread	03/31/24	12/31/23	12/31/22	12/31/21	12/31/20	Tightest This Decade
A	1.26%	0.77%	0.85%	1.09%	0.74%	0.73%	0.63%
BAA	1.87%	1.10%	1.21%	1.59%	1.13%	1.21%	1.00%
BA	3.51%	1.84%	2.01%	2.95%	1.94%	2.64%	1.82%
B	4.88%	2.66%	3.10%	4.89%	3.13%	3.79%	2.94%
CAA	8.84%	7.93%	8.09%	11.54%	5.96%	7.15%	4.91%



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while rates won't rise from here, the path to lower rates will take longer, unless inflation declines more quickly and GDP slows.

The U.S. economy stands in sharp contrast to that of the rest of the world. Growth in the 20 nation euro zone has stagnated for more than a year. This has resulted in more confidence that the euro zone will soon hit its 2% inflation target. The European Central Bank has heightened expectations of a series of interest rate cuts commencing in June. Economists surveyed by Bloomberg anticipate three 1/4 point rate cuts in 2024.

Similarly, China, the world's second largest economy shows many signs of weakness. The enduring real estate crisis is crippling many citizens, investors and banks that lent to now bankrupt developers. Many metrics tracking the industry continued to worsen in March (source: *Bloomberg* 4/14/24). Factory prices have been declining for more than a year and China's GDP deflator index shows the economy moving further into deflation (source: *Bloomberg* 4/16/24) .

The deflation results from lower domestic demand for goods and services and excess capacity in a number of industries. Capacity utilization declined to 73.6% for the first quarter, down from 75.9% in 2023's fourth quarter and the lowest since the pandemic impacted first quarter of 2020 (source: *Bloomberg* 4/15/24). The U.S. is considering increasing steel and aluminum tariffs in response to China dumping on the global market.

How long the can U.S. GDP significantly outpace the rest of the world and especially China and Europe? A major factor is government spending. The chart on page four shows that government was one of the largest sources of job growth over the past 12 months. The largest was education and healthcare, significantly funded by government. Given the current federal budget deficit and projections, these major job growth sources will probably moderate.

Another concern is consumer spending, which accounts for roughly two-thirds of GDP. Consumer spending in March rose by the most in a little over a year at 0.8% (source: Department of Commerce 3/29/24). Funding a good portion of this spending is consumer debt (credit cards, mortgages and home equity loans), which has hit new highs. Household debt hit a new high in the latest quarterly report (New York Federal Reserve 4th qtr 2023) reaching $17.5 trillion, a 24% increase since the end of 2019 before the pandemic recession. Credit card

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Footnotes and Disclosure

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debt, which stood at $770 billion at the end of 2020 has risen to $1.13 trillion, up about 46%. It rose 14.1% for the 12-months ending 12/21/2023 (source: U.S. Bank 3/26/24). Home equity line limits have increased consumer debt capacity, rising over 10% over the past two years after ten years of decreases.

Debt and spending may moderate, with savings mostly depleted (source: US Bank 3/26/24). The key is the strong labor market with low unemployment and good wage growth.

Adding more confusion to the outlook, The Conference Board's Leading Economic Index inched up in February for the first time in two years. The sustained period of 23 negative months portends headwinds to economic growth (source: The Conference Board 3/21/24).

Another important data point is the National Federation of Independent Businesses, representing smaller employers, reported Small Business optimism fell to 88.5, its lowest level in March of 2024 since 2012. This is the 27th consecutive month below the 50-year average of 98. Inflation and a lack of qualified job applicants are two major problems. Only 4% reported that they felt it was a good time to expand and net sales expectations fell (source: NFIB March report).

So there are a number signs that GDP growth and employment may moderate from current levels.

We appreciate your confidence in CAM and enjoy your inquiries.

Sharpe Ratios (risk & reward relative value) Inception-Q1 2024

CAM Investment Grade Strategy 0.33
Bloomberg U.S. Corp Bonds 0.30

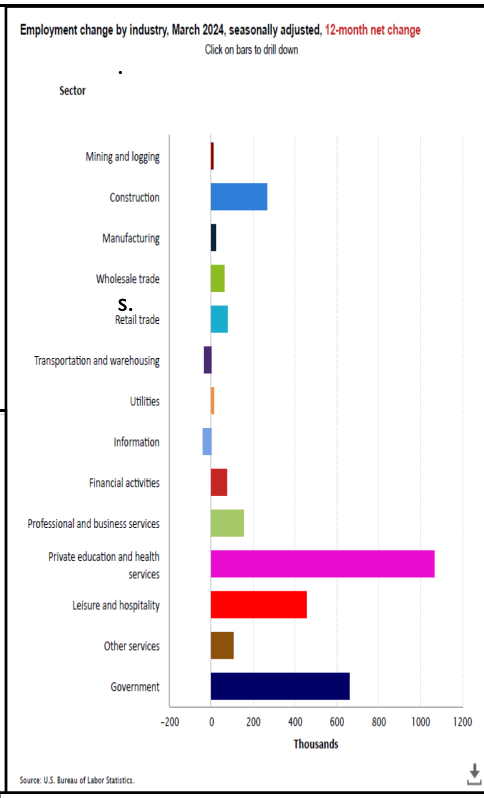
CAM High Yield Strategy 0.47
Bloomberg High Yield Corp Bonds 0.46

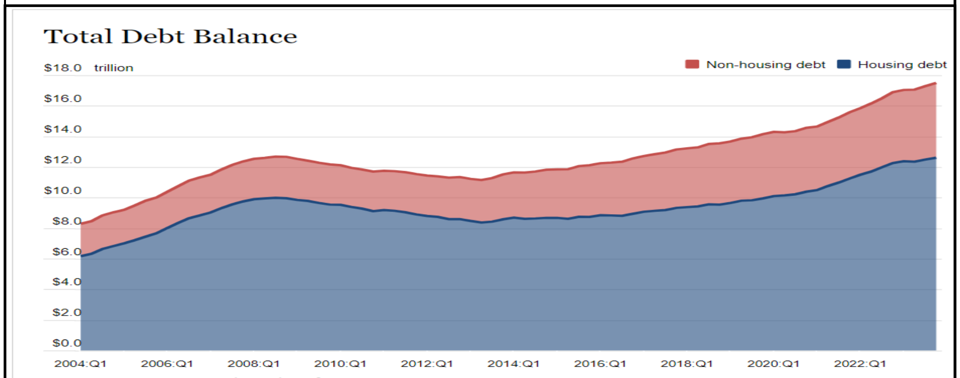
CAM Short Duration 0.43
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.51

CAM Short Duration IG Strategy 0.75
Bloomberg U.S. Corporate 1-5 Yr 0.76

CAM Broad Market Strategy 0.54
Bloomberg Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.56

An important objective for all Cincinnati Asset Management investment strategies is to deliver superior risk-weighted returns. A quantitative indication of our success is the Sharpe Ratio that calculates total return per unit of risk. The data on the left indicates we have largely been successful. The Sharpe Ratio of the Investment Grade Strategy exceeded its respective benchmark by approximately 10%. The High Yield, Short Duration Investment Grade, and Broad Market strategies approximated their benchmarks. The Short Duration Strategy's Sharpe Ratio trailed the benchmark primarily due to total return underperformance in the 5-year and older periods.





Rating	BA	B	CAA
Avg Spread	356	513	949
Std. Dev.	164	220	411
03/31/2024	**184**	**266**	**793**
Lowest Spread	151	228	378

Spreads to Treasuries by Credit Rating show significantly lower risk of BA and B rated bonds. Source: Bloomberg, Barclays Research (12/31/99 to 03/31/2024)