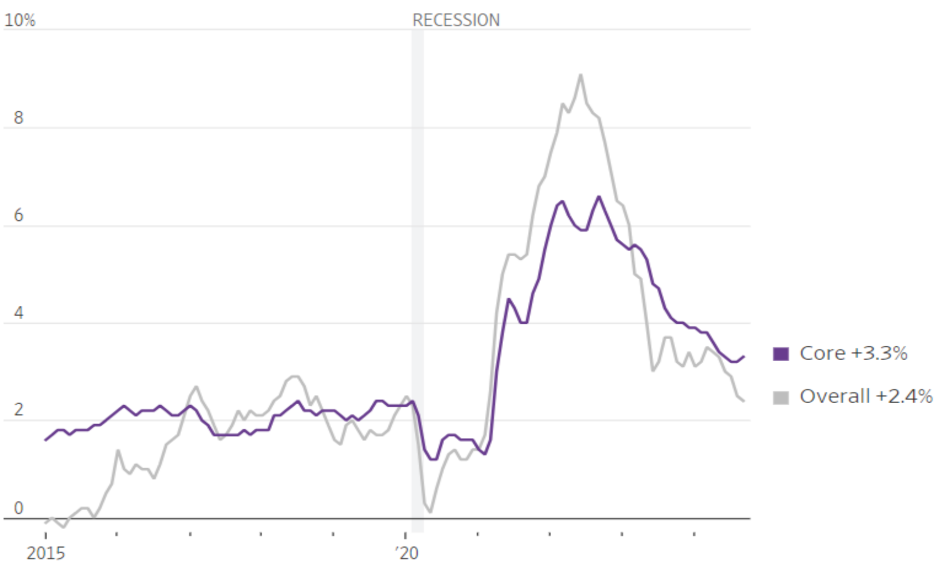
Third Quarter 2024
Bond Market Review
and Outlook

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

"Inflation has eased, and my Federal Open Market Committee colleagues and I have greater confidence that it is on a sustainable path to 2 percent." Jerome Powell, Chairman Federal Reserve 9/30/24

Consumer-price index, change from a year earlier



Note: Core excludes food and energy prices.
Source: Labor Department

The September inflation report issued by the Labor Department reports the consumer price index rising 2.4% from a year ago and the core index rising 3.3%. Both were, slightly above economists' forecasts. However inflation hit another three year low (source: *Wall Street Journal* 10/10/24). The path to lower inflation remains intact, but uneven.

As noted in previous letters many at the Federal Reserve and private sector economists believed the trend to lower inflation to the FED's 2% target would be bumpy. That has certainly been the case of late.

The consensus among economists for easing by the Federal Reserve of overnight rates is now projected at two cuts in 2024 and an additional three in 2025 (Source: *Bloomberg economic Forecasts* 7/18/24). This represents a reversal of the consensus just a month ago, when many feared elevated inflation over a much longer term.

CPI change forecasts by Bloomberg's survey of economists predicts a rate of 2.2% for 2025 and 2.3% for 2026. While the forecast survey for the Federal Reserve's preferred inflation gauge, the PCE predicts annual increases of 2.4%, 2.1% and 2.0% respectively for 2024, 2025 and 2026 (source: *Bloomberg* 10/10/24).

Given those forecasts, the Federal Reserve's overnight or Central Bank Rate is predicted to decline significantly impacting most money market funds and short Maturity Treasury Bills. The Bloomberg survey of economists forecasts a Central Bank Rate of 5.0% for 2024's third quarter declining to 4.5% in the fourth quarter of 2024. The decline continues in 2025 to 4.0% in the first quarter, 3.7% in the second quarter, 3.5% in the third quarter and 3.0% by 2026 (source: ibid).

Powell's recent comments underscore the Federal Reserve's confidence

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Yields* on 09/30/2024	Yield*
CAM Broad Market (corporate core plus) Strategy (6.1 year maturity; 4.8 duration)	**4.94%**
CAM Investment Grade (100% corporate bonds) Strategy (6.5 year maturity; 5.4 duration)	**4.49%**
CAM High-Yield Strategy (only BA & B rated purchased) (4.9 year maturity; 3.5 duration)	**5.88%**
CAM Short Duration Strategy (2.9 year maturity; 2.1 duration; 50% IG & 50% HY)	**4.84%**
CAM Short Duration Investment Grade Strategy (2.5 year maturity; 2.1 duration)	**4.28%**
U.S. Treasury** (10 year maturity)	**3.78%**
U.S. Treasury** (5 year maturity)	**3.56%**
U.S. Treasury** (2 year maturity)	**3.64%**

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

Contact us: Artie Awe, Mike Lynch, & Bill Sloneker are always available to assist.
Phone: (513) 554-8500 — Website: www.cambonds.com
Email: aawe@cambonds.com, mlynch@cambonds.com, & wsloneker@cambonds.com

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.

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 (%)				
	3Q '24	YTD	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	4.67	5.52	13.10	-0.17	1.81	2.74
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	3.67	6.30	14.44	1.19	3.29	3.03
Bloomberg US Corporate High Yield Index	5.28	8.00	15.74	3.10	4.72	5.04
CAM Investment Grade Strategy—Net 100% corporate bonds	5.14	5.13	12.45	-0.82	1.10	2.58
Bloomberg US Corporate Index	5.83	5.32	14.28	-1.18	1.16	2.93
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	3.12	5.46	9.95	1.56	2.90	2.30
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	3.11	4.62	8.07	0.50	1.51	2.03

Relative Performance Review 09/30/2024

CAM's **Investment Grade Strategy ("IG")** produced a gross total return of 5.20% in the quarter ended September 30, 2024, compared to 5.83% for the Bloomberg U.S. Corporate Index. CAM always positions a majority of the portfolio within intermediate maturities. Longer dated securities (10+ years) returned 8.20% for the period, outperforming the broader index. CAM's underweight in this duration bucket produced a -70 basis point contribution to excess return. CAM's positioning within the Banking industry was the largest positive impact to performance, with a +10 basis point contributions to excess return. Our positioning within the Electric Utility industry was the largest negative contribution of -12 basis points. The YTD return for the CAM IG strategy was 5.32%, matching the Index return of 5.32%. Approximately 4% of CAM's IG portfolio is comprised of HTM securities having a maturity of one year or less. Given the outperformance of intermediate maturities the period, the allocation effect was -22 basis points. CAM's positioning within the Airline industry was the largest positive impact to performance, with a +6 basis point contribution to excess return. Our positioning within the Technology industry was the largest negative contribution of -4 basis points.

The **High Yield Strategy ("HY")** delivered a gross total return of 3.75% in Q3 while the Bloomberg US Corporate High Yield Index returned 5.28%. CAM's zero-weight on the P&C insurance industry had the largest positive impact on performance relative to the index with a +13 basis point contribution to excess return during the quarter. As far as negative impact relative to the index was concerned, CAM's zero-weight on the Wirelines industry group was the biggest detriment to relative performance with a -37 basis point contribution to excess return during the quarter. CAM's underweight on the Cable & Satellite industry was next at a -31 basis point contribution. These two aforementioned industries in particular are home to several companies in distress with large capital structures all of which rallied off the lows significantly during the quarter. The HY YTD return was 6.53% while the Index returned 8.00%. CAM's overweight and security selection in the Banking industry had the biggest positive impact on performance relative to the index with a +30 basis point contribution to excess return. As far as negative impact relative to the index was concerned, CAM's overweight and security selection within the Midstream industry had a -26 basis point impact.

Our **Broad Market Strategy ("BM")** – a 67%/33% blend of the IG and HY strategies above – produced a gross total return of 4.74% for the quarter compared to 5.64% for the Index, a similar blend of Bloomberg IG and HY corporates. At 09/30/2024 the modified duration of CAM's broad market portfolio was 4.82 while the modified duration of the Blended Benchmark was 6.02. Interest rates moved meaningfully lower during the quarter which had a negative impact on CAM's performance relative to the index as the benchmark benefited from its higher duration. The allocation effect of CAM's maturity profile served as a -64 basis point negative impact relative to the index during the quarter. The YTD return for the CAM Broad Market strategy was 5.73% compared to a blended Index return of 6.21%. CAM's security selection in the Media & Entertainment industry had the biggest positive impact on performance relative to the index with a +7 basis point contribution to excess return. As far as negative impact relative to the index was concerned, CAM's security selection within the Pharmaceuticals and Technology industry groups yielded -17 and -7 basis point contributions to excess return, respectively.

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

Periods ended 09/30/2024	10-yrs	20-yrs
U.S. Aggregate	1.84	3.22
U.S. Corporate	2.93	4.20
CAM Investment Grade Strategy (gross)	2.83	4.24
CAM Investment Grade Strategy (net)	2.58	4.00

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 the lower tier, CAA-rated cohort underperformed BA-rated bonds for the 10-year and 20-year periods. CAA-rated bonds modestly outperformed B-rated bonds over all periods. Not shown in the table is the pronounced volatility that has characterized the CAA-rated and lower subsectors. For example, the CAA credit tier returned -20.55% in Q1-2020 (i.e. start of the COVID pandemic) versus -12.69% for the HY Index as a whole. Over the 10-year period, the standard deviation of the CAA credit tier has been approximately 47% greater than the broader Bloomberg US Corporate HY Index (12.52% versus 8.51%). This shows investors may not be rewarded for the additional volatility and 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.

The above 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 09/30/2024) Source: Bloomberg US Corporate Indices **(annualized %)**

High-Yield Bond Sectors	5-years	10-years	20-years
BA-rated bonds	4.65	5.26	6.71
B-rated bonds	4.22	4.62	5.91
CAA-rated bonds	5.39	4.93	6.57
CA & D-rated bonds	10.10	1.84	4.45

Performance of Other Asset Classes

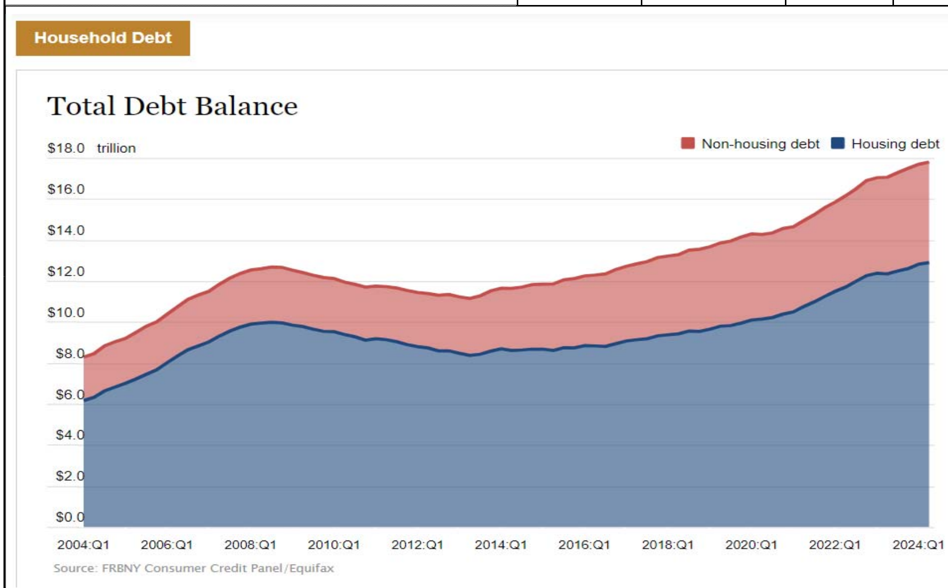
(periods ended 09/30/2024) Source: Bloomberg & Lipper

S & P 500 Stocks	15.98	13.38	10.70
Bloomberg U.S. Aggregate	0.33	1.84	3.22

The September 30 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 9/30/2024 all spread cohorts have tightened modestly on a YTD basis while Treasury yields moved meaningfully lower. The 10-year U.S. Treasury started Q3-2024 at 4.40%, and closed at 3.78%, 62 basis points lower.

Although credit spreads remained in a tight range during the third quarter the movement in Treasury yields created a tailwind for total returns. We continue to believe that the current environment is opportunistic for bond investors but it may require patience.

Credit Rating	20-Year Average Spread (as of 12/31/23)	09/30/24	12/31/23	12/31/22	12/31/21	12/31/20	Tightest This Decade (as of 12/31/23)
A	1.26%	0.73%	0.85%	1.09%	0.74%	0.73%	0.63%
BAA	1.87%	1.11%	1.21%	1.59%	1.13%	1.21%	1.00%
BA	3.51%	1.80%	2.01%	2.95%	1.94%	2.64%	1.82%
B	4.88%	2.85%	3.10%	4.89%	3.13%	3.79%	2.94%
CAA	8.84%	7.65%	8.09%	11.54%	5.96%	7.15%	4.91%



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that inflation is continuing to decline and labor markets have cooled. Absent a change in trend, these conditions will compel them to lower interest rates.

Recent employment data is of little concern, even though it was elevated from previous monthly reports. In September employment increased by 254,000 higher than the twelve month average of 203,000.

However, when examined by sector, the increases were largely concentrated in those with lower wages and effected by government largess. The sectors with the largest increases were food services and drinking establishments, healthcare, government, social services and construction. Of concern is the very low or no growth in the other sectors, which include energy, manufacturing, technology and retail (source: Bureau of Labor Statistics 10/4/24).

Another sign of employment softness was the average workweek, which eased by 0.1 hours to 34.2 hours (source: ibid).

Further indication of a softer economy is the fall in the University of Michigan's consumer sentiment pool, which fell to 68.9 (see graph on page 4 from the University of Michigan 10/11/24). The fall in sentiment is due to consumers feeling that their incomes will not keep up with prices over the next year (source: *Wall Street Journal* 10/11/24). Since inflation accelerated in 2021, consumer sentiment has been lower.

Consumers have been taking on more and more debt to finance their earnings-spending shortfall. The graph to the left shows the increasing rate of borrowing.

While mortgage refinancings remained flat, increasing home equity loans (HELOCs) are now up about 20% from the low reached in the third quarter of 2021 (source: Federal Reserve Bank of New York 8/6/24). This was when inflation started to begin a sustained increase. Borrowing home equity to finance day to day necessities is neither a favorable nor comfortable position for the consumer.

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Footnotes and Disclosure

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Further evidence of a strained consumer can be seen in the chart detailing "transition into delinquency" on this page. Credit card and auto loans lead the developing trend. Mortgages are starting a disturbing path of increasing delinquency.

All of these data points are indicative of a slowing economy. Hence, the Federal Reserve will probably continue cuts to the Central Bank Rate (overnight rate) for the remainder of the year and throughout 2025.

The markets have responded over the course of the year. The High Yield Bond ETF is up over 7% and the Investment Grade U.S. Aggregate Bond ETF is up 3% (source: *Barron's* 10/10/24).

Indicative of investors' increasing preference to lock in yield rather than rolling over short maturity debt are the recent flows into various fixed income funds. High Yield funds have reported inflows for the past seven weeks through October 2 (source: ibid). Morningstar reports positive fund flows into long government bond funds, while bank loan funds (short term in nature and regularly used as inflation hedges) reported outflows (source: Morningstar 9/18/24).

There are a number of factors that influence slower growth. The war in Ukraine and the Middle East is a primary concern. Another is the prospect of the spread of warfare across the region and Iranian oil export disruption. Another concern is China's chronically moribund economy burdened by massive overbuilding and debt. There are others as well, but too numerous to detail.

Sharpe Ratios (risk & reward relative value) Inception-Q3 2024

CAM Investment Grade Strategy 0.34
Bloomberg U.S. Corp Bonds 0.31

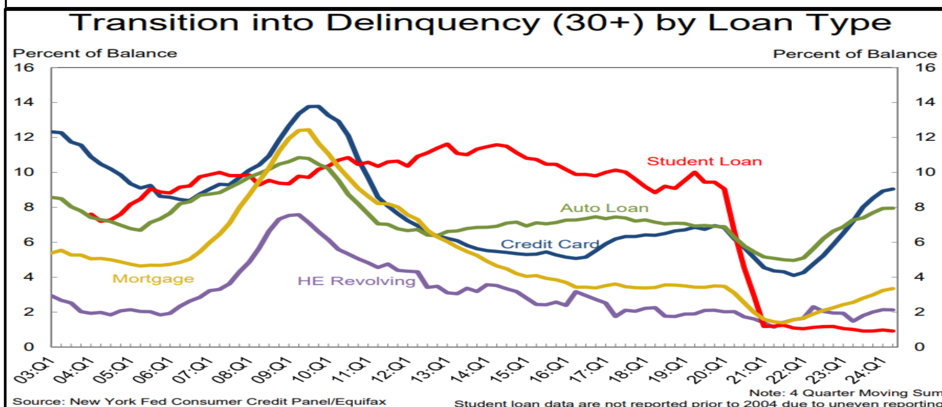
CAM High Yield Strategy 0.48
Bloomberg High Yield Corp Bonds 0.47

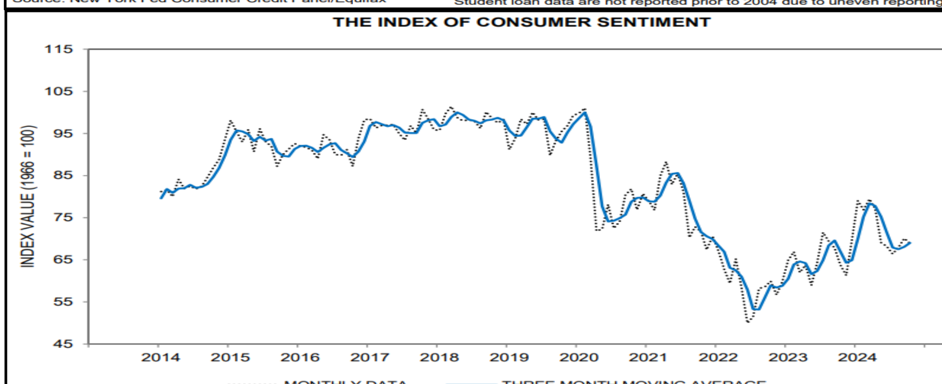
CAM Short Duration 0.43
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.53

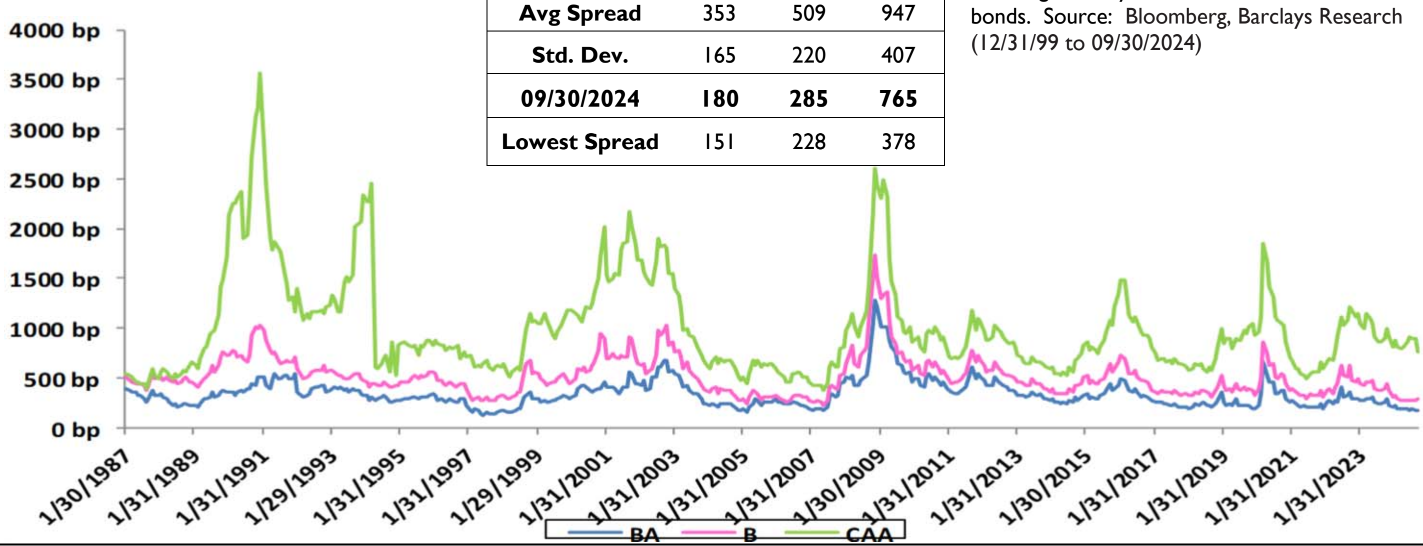
CAM Short Duration IG Strategy 0.77
Bloomberg U.S. Corporate 1-5 Yr 0.80

CAM Broad Market Strategy 0.55
Bloomberg Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.57

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 Sharpe Ratio exceeded its benchmark by approximately 2%. The Short Duration Investment Grade and Broad Market strategies modestly fell short of their respective benchmarks (<4%).







Rating	BA	B	CAA
Avg Spread	353	509	947
Std. Dev.	165	220	407
09/30/2024	**180**	**285**	**765**
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 09/30/2024)