ALLIANCEBERNSTEIN

November 26, 2024

A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

Finding Clarity in the Noise

"If you don't have clarity of ideas, you're just communicating sheer sound."—Yo-Yo Ma

Financial markets have recently faced a barrage of noise, even as the calendar turns to the traditionally "quiet" time of the year. There is still uncertainty around US fiscal and trade policy changes, central bank easing around the globe and the escalation of ongoing geopolitical conflicts. Valuations have shifted dramatically in recent weeks, and volatility is likely to persist as markets gain greater clarity on these variables. Despite all the noise, we see opportunity ahead for investors in the fixed-income markets, including those who may have had hopes of a quiet end to a volatile year. It seems the markets are playing an uncertain tune, but savvy investors can still find harmony amid the cacophony.

What Has Happened

The dust has somewhat settled following the US election results. While equity markets have been broadly unchanged since the initial post-election jump, the same has not been true for fixed-income markets. US Treasury yields have continued to rise in recent weeks, to the highest levels for both two-year and 10-year Treasury yields since early July (*Display 1*). So, what has caused this shift in sentiment for US rates?

First, greater clarity on Republican control in Washington DC has been interpreted by markets as signifying an increased possibility of continued rising deficits and inflationary pressures from tariffs and immigration policy changes. We anticipated that if either party swept to victory, the result would be increased economic growth and larger deficits. This has weighed on long-dated Treasuries, pushing yields higher further out the curve.

Second, incoming economic data and Fed speak have reduced the expectation of rate cuts in the coming month. The CPI for October in the US was in line with forecasts, but it highlights that progress toward reaching the Fed's target inflation rate has slowed (*Display 2*). Chair Powell noted that "the economy is not sending any signals" that the Fed should hurry to lower rates.[1] The market is now pricing in a roughly 50/50 chance that the Fed cuts at its December meeting, compared to near certainty that it would do so just a few weeks ago. The number of cuts that had been expected by the end of 2025 has also declined since the end of October (*Display 3*). As a result, front-end Treasury yields have also moved higher.

The mosaic of recent data points is crystalizing around a US economy that remains strong, exceeding expectations from just a few months ago. Corporate earnings announcements have been positive, with Walmart providing notably positive views on the health of the US consumer. The Fed's Senior Loan Officer Opinion Survey, a gauge of credit availability, was generally unchanged in the most recent release. By this measure, US financial markets are loosening alongside monetary policy.

While the US economic engine has shown resilience, the global economy is facing meaningful risks. Growth should be weaker in Europe than in the US next year. While the market is pricing in fewer rate cuts in the US today than it was a few months ago, the opposite is true regarding expectations for the ECB in 2025. Elsewhere, the Chinese government released the details of their stimulus plan, which fell short of market expectations. This could weigh on an economy that is already dealing with growth challenges, which may soon be exacerbated by potential US tariffs. The war in Ukraine has also escalated recently, and the Middle East conflicts continue.

Our View

All these different pockets of uncertainty are likely to create a lot of noise for investors to sort through. Although the last few weeks of the year are often labeled as the quiet period of the year, there are many potential catalysts that could inject volatility into the markets. In the coming weeks, political appointments as well as policy changes in the US should become clearer and potentially move asset prices. Therefore, we believe that investors should be prepared for a slightly more volatile than usual holiday season.

[1] November 14, 2024

On the margin, rates are likely to remain higher than they were just a few months ago. This is especially true of long-term rates. Risk and uncertainty associated with the new US leadership are likely to be concentrated further out the curve as changes in policies and the impact of continued budget deficits take time to materialize. While we understand long-term concerns about the sustainability of increased deficits, we don't see it as a near-term worry.

Rate markets historically show very little, if any, correlation with debt levels or deficits. The reserve currency status of the US dollar also makes the analysis more complex, a fact we don't expect to change anytime soon. Additional easing of monetary policy will also lead to lower financing costs from rolling short-term issuance. If US rates continue to increase, we would recommend opportunistically adding duration.

In the meantime, we find better opportunity in shorter-dated bonds. Our expectation is for the yield curve to continue to normalize in the coming months. The Fed has begun easing rates and will continue to do so unless there is a dramatic shift in inflation data. Markets also have another CPI release and a payrolls number to digest before the Fed's next meeting in December. These releases should help codify the market's expectation on if the Fed will ease by another 25 basis points (bps). Our expectation is that the Fed will reduce its policy rate by 25 bps at its December meeting. It is also worth noting that the pace of cuts could accelerate if there is continued softening in labor markets, a scenario which markets are discounting.

Credit spreads are tight, but we don't see any near-term catalysts that could cause a major dislocation, agnostic of any exogenous shocks. Corporate fundamentals are healthy, and the macro backdrop is supportive. Yields, which are a better proxy for investor returns than spreads, are still attractive, and the technical backdrop for credit remains strong. We prefer credit, but with a skew toward higher quality, as we don't see adequate compensation in the lowest-rated portions of the credit landscape (*Display 4*). If the pendulum of growth were to swing, these lower-rated credits would see the biggest challenges.

The markets have clearly displayed that inflationary risks are greater today than they were a few months ago. Although we do not foresee inflation getting anywhere close to its 2022 levels, we do see the potential for the episodic repricing of inflation expectations. As a result, we like adding Treasury Inflation-Protected Securities (TIPS) exposure as protection to this risk.

Investment Implications

A clarity of ideas can help cut through the deluge of noise. As bouts of volatility occur, valuations will continue to shift—presenting opportunity for nimble managers who take an active approach to evaluating risk. In our view, there are three key avenues for investors seeking to take advantage of current opportunities in fixed income:

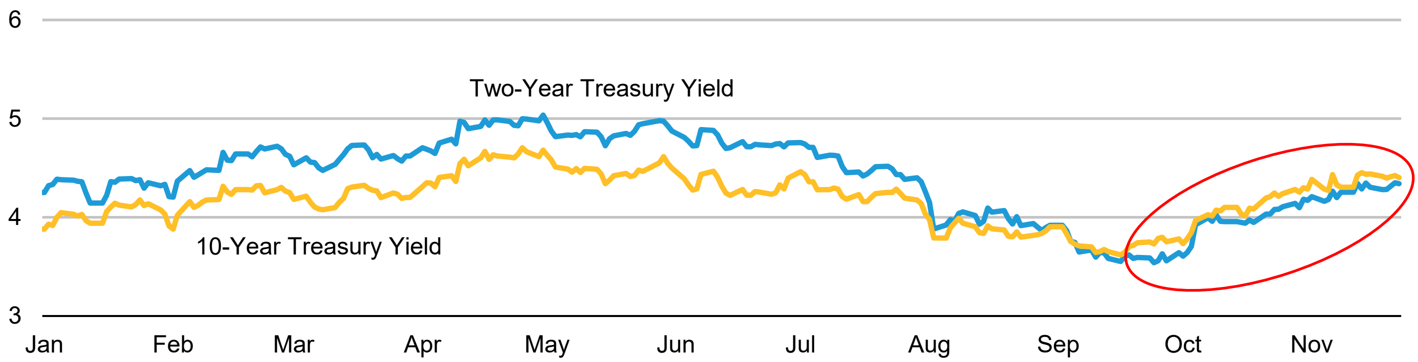
- **Crawl** out of cash positions and into short-term bonds. Cash returns may seem attractive but will continue to decline as the Fed cuts rates in the months ahead. Short-term bonds provide greater yields than cash, with relatively low volatility, and the ability to lock-in higher levels of income for longer periods of time.
- **Walk** into duration and quality credit through core-plus bond exposure. In a "higher-for-longer" environment, higher Treasury yields equate to greater returns for bonds over the long term. On the other hand, if the Fed continues to ease and the economy stays resilient, duration and credit should both perform well. If the economy slows more than expected, duration should perform well, as the Fed will need to ease rates at a faster-than-expected pace.
- **Run** into credit as an alternative to stocks. For investors who believe this year's economic momentum will continue, high yield should continue to perform well and provide bondholders with high-single-digit yields. In periods in which the Fed is easing rates, high yield has generated similar returns to equities with much less volatility (*Display 5*). In contrast, if the economy weakens, high yield has historically had significantly lower drawdowns than stocks, with faster recoveries. While our equity team sees opportunities in select names, it is worth noting that equity multiples are at extremely high levels.

Wishing you continued success in your investment journey,

Scott DiMaggio, Gershon Distenfeld, Matt Sheridan, Fahd Malik, Will Smith, John Taylor, Mike Rosborough, Serena Zhou, Tim Kurpis and AJ Rivers

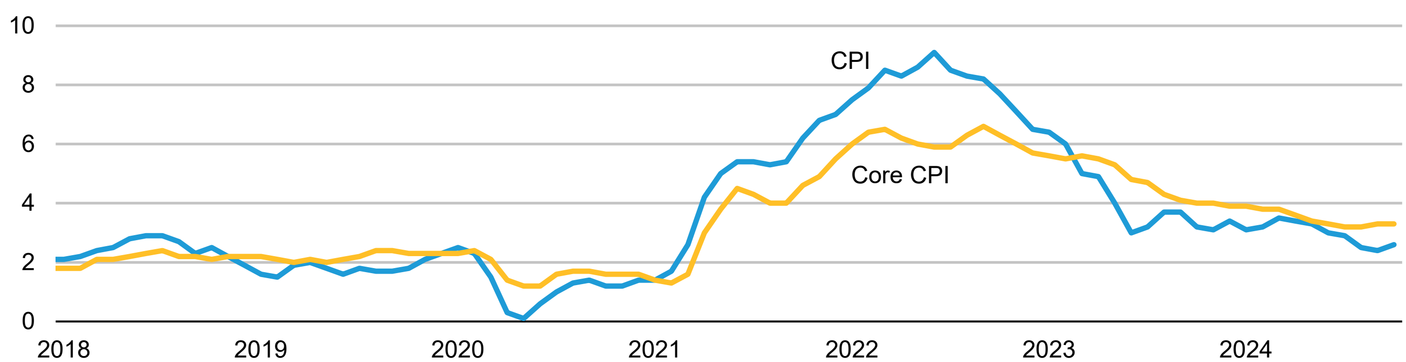
Area	Where We See Opportunity	Where We Are Cautious
Duration	**Short-Dated Part of Curve:** Yields are similar for short-term and long-term Treasuries, but greater uncertainty means more risk in the long end. **Steepeners:** Yield curves are inverted, allowing an attractive entry point for steepener positioning.	**Belly of the Curve:** Compensation is not as attractive as short-dated and long-term segments given a lack of clarity on US fiscal and economic trajectories.
Global Bonds	**UK:** We prefer the long-end part of the curve, as the UK market is pricing in a less-aggressive removal of restrictive monetary policy than are other markets. **Japan:** The long end of the curve is attractive for both local and foreign investors on a hedged basis. We expect the curve to flatten.	**China:** Uncertainty around growth and spending may be a drag on the longer parts of the yield curve.
Investment-Grade (IG) Corporates	**Broadly:** IG credit offers attractive yields despite relatively low spread levels. We prefer BBB credits. **Banks:** Senior bank debt trades at attractive levels relative to other industries. **Media:** Company fundamentals remain strong, and the industry offers attractive valuations.	**Long-End IG Corporates:** Curves are flat, and the long end is usually more volatile. We see limited upside in the long end of the IG space.
High-Yield Corporates	**High-Quality Credit:** Better insulated from economic uncertainty and default risk **Non-Cyclicals:** Less sensitive to slowing economic growth	**CCC-Rated Credits:** Defaults have increased, and valuations are likely to come under pressure. **Oil/Energy and Commodity Chemicals:** Valuations look full, and the risk/reward profile is not compelling. **Real Estate Investment Trusts (REITs):** Valuations are not attractive, and the growing illiquidity in the space creates headwinds for the sector.
Emerging-Market Debt	**USD-Denominated Corporates:** Attractive risk-adjusted returns, driven by lower volatility, alongside strong fundamentals and supportive technicals **USD-Denominated Sovereign Debt:** Slightly positive outlook as developed-market easing increases the yield differential offered by emerging-market debt	**Local-Currency Debt:** FX volatility and the strength of the dollar can be a drag on local-currency borrowings.
Securitized	**AAA Collateralized Loan Obligations:** Strong risk/reward profiles and relative value to corporates **Agency Residential Mortgage-Backed Securities (MBS):** Provide a compelling relative value to corporates and an offset to credit exposure in a risk-off environment **Credit Risk–Transfer Securities (CRTs):** Borrowers are of strong quality, and underwriting standards are tighter than they were a few years ago. Housing market technicals are supportive.	**Riskier Securitized Credit:** Lower-quality segments are more exposed to idiosyncratic risk or secular deterioration. **Less-Liquid Segments:** Liquidity will be at a greater premium the longer that rates are at restrictive levels.

Display 1: Treasury Yields Have Continued to Rise in Recent Weeks
Yield (Percent)



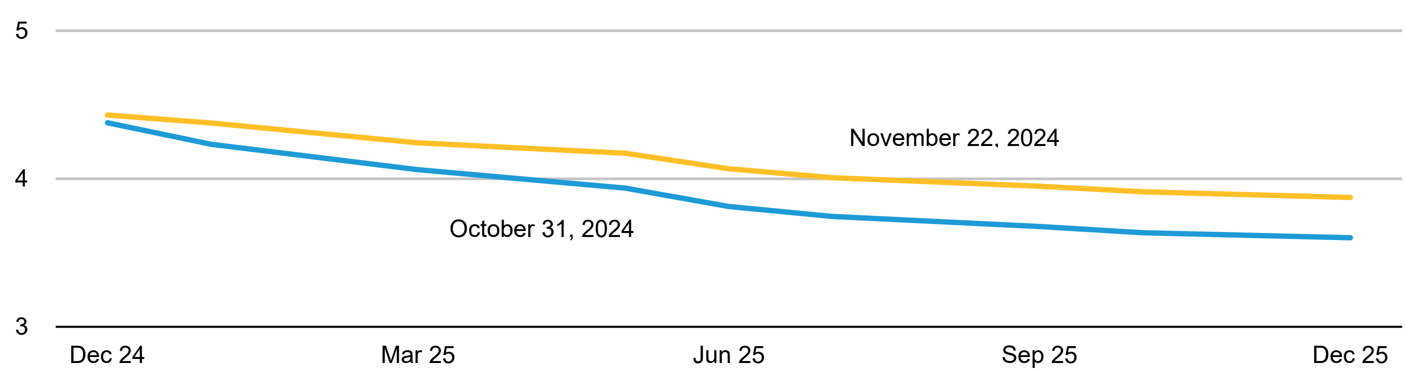
As of November 22, 2024
Source: Bloomberg

Display 2: The Decline in Inflation Has Slowed
Inflation Rate (Percent)



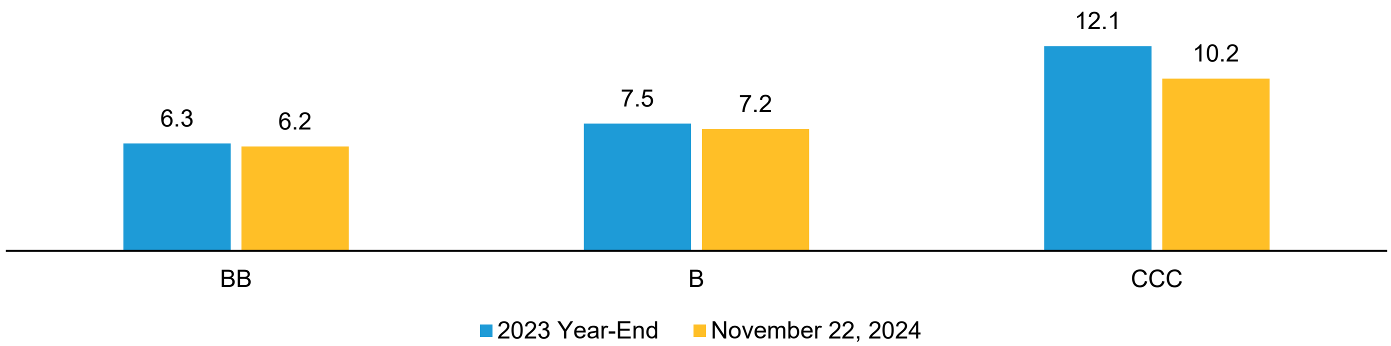
As of November 22, 2024
Source: Bloomberg

Display 3: The Fed Is Now Expected to Cut Rates at a Slower Pace Through the End of 2025
Market-Implied Fed Funds Rate (Percent)



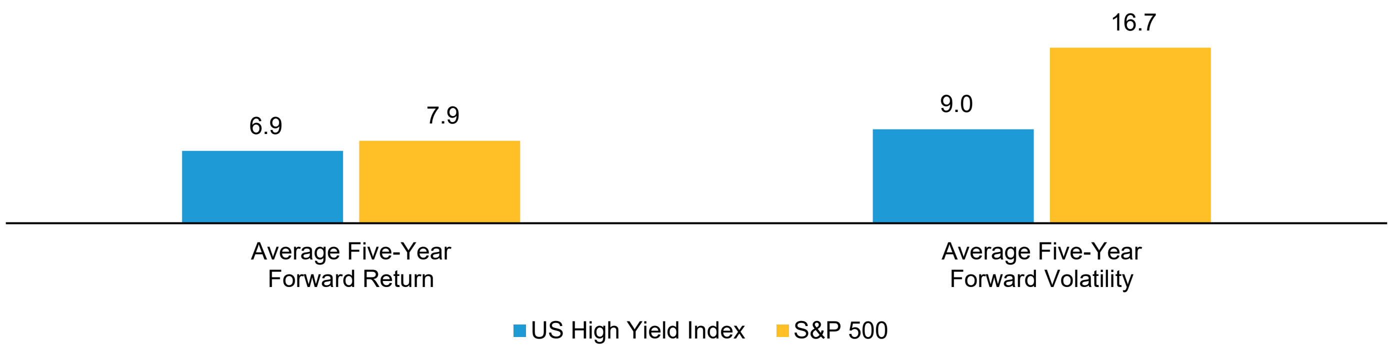
As of November 22, 2024
Source: Bloomberg

Display 4: The Compensation for Buying CCC-Rated Bonds Has Compressed
Yield (Percent)



As of November 22, 2024
Source: Bloomberg

Display 5: High Yield Provided Equity-Like Returns After Fed Hiking Cycles with Much Less Volatility



Hiking cycle measured by the Federal Reserve upper-bound rate policy. End of the hiking cycle is measured by the last increase before a period of no hikes that is followed a rate cut.
As of November 22, 2024
Sources: Bloomberg and Morningstar

Investment Risks to Consider

The value of an investment can go down as well as up and investors may not get back the full amount they invested. Capital is at risk. Past performance does not guarantee future results. Important Information: The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor’s personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material, or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates. References to specific securities are presented to illustrate the application of our investment philosophy only and are not to be considered recommendations by AB. The specific securities identified and described herein do not represent all the securities purchased, sold or recommended for the Portfolio, and it should not be assumed that investments in the securities identified were or will be profitable. AllianceBernstein and its affiliates may have positions in, and may effect transactions in, the markets, industry sectors and companies described herein. **Note to All Readers:** The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. **Note to Readers in Canada:** AllianceBernstein provides its investment-management services in Canada through its affiliates Sanford C. Bernstein & Co., LLC and AllianceBernstein Canada, Inc. It should not be construed as advice as to the investing in or the buying or selling of securities, or as an activity in furtherance of a trade in securities. **Note to Readers in the United Kingdom and Europe: For Investment Professional use only. Not for inspection by, distribution or quotation to, the general public.** This document has been approved by AllianceBernstein Limited, an affiliate of AllianceBernstein L.P. **Note to Readers in the United Kingdom:** Issued by AllianceBernstein Limited, 60 London Wall, London EC2M 5SJ, registered in England, No. 2551144. AllianceBernstein Limited is authorised and regulated in the UK by the Financial Conduct Authority (FCA). **Note to Readers in Europe:** This information is issued by AllianceBernstein (Luxembourg) S.à r.l. Société à responsabilité limitée, R.C.S. Luxembourg B 34 305, 2-4, rue Eugène Ruppert, L-2453 Luxembourg. Authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier (CSSF). **Note to Readers in Switzerland:** This information is directed at Qualified Investors only. Issued by AllianceBernstein Schweiz AG, Zürich, a company registered in Switzerland under company number CHE-306.220.501. AllianceBernstein Schweiz AG is a financial service provider within the meaning of the Financial Services Act (FinSA) and is not subject to any prudential supervision in Switzerland. Further information on the company, its services and products, in accordance with Art. 8 FinSA can be found on the Important Disclosures page at www.alliancebernstein.com. **Note to Readers in Japan: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been provided by AllianceBernstein Japan Ltd. AllianceBernstein Japan Ltd. is a registered investment-management company (registration number: Kanto Local Financial Bureau no. 303). It is also a member of the Japan Investment Advisers Association; the Investment Trusts Association, Japan; the Japan Securities Dealers Association; and the Type II Financial Instruments Firms Association. The product/service may not be offered or sold in Japan; this document is not made to solicit investment. **Note to Readers in Australia and New Zealand: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended only for persons who qualify as “wholesale clients,” as defined in the Corporations Act 2001 (Cth of Australia) or the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice. **Note to Readers in Hong Kong: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** The issuer of this document is AllianceBernstein Hong Kong Limited 聯博香港有限公司<OK if pictogram is not included>. This document has not been reviewed by the Securities and Futures Commission. **Note to Readers in China:** This information contained here reflects AllianceBernstein Hong Kong Limited (“AB”) or its affiliates and sources it believes are reliable as of the date of this publication. This presentation has been provided to you for the sole use in a private and confidential meeting. AB makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This presentation is for informational purposes only and does not constitute investment advice. AB does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions. This presentation or any information contained or incorporated by reference herein does not constitute an offer to sell or the solicitation of an offer to purchase any financial instrument, product or service sponsored by AB or its affiliates within the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macao and Taiwan). **Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia and India:** This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries. **Note to Readers in Malaysia: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AB is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AB does not hold a capital-markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial-planning services in Malaysia. **Note to Readers in Singapore: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been issued by AllianceBernstein (Singapore) Ltd. (“ABSL”, Company Registration No. 199703364C). AllianceBernstein (Luxembourg) S.à r.l. is the management company of the Portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative. AllianceBernstein (Singapore) Ltd. is regulated by the Monetary Authority of Singapore. This advertisement has not been reviewed by the Monetary Authority of Singapore.

IMA-647536-2024-11-25