MONTHLY FIXED INCOME MARKET UPDATE

VICTORY income investors
A VICTORY CAPITAL® INVESTMENT FRANCHISE

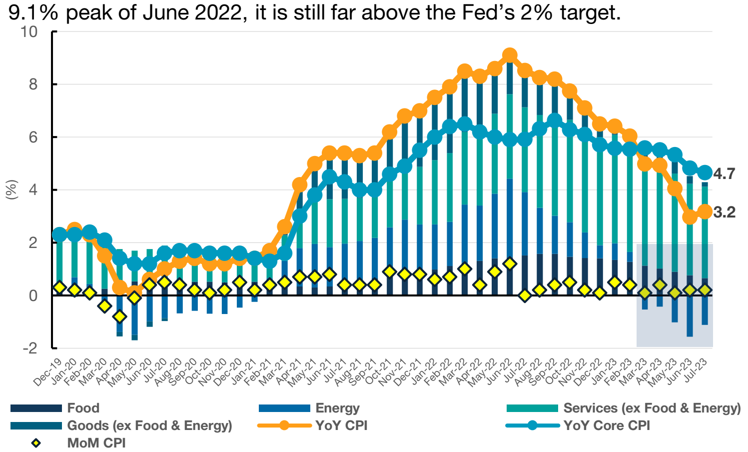
As of September 30, 2023

Key Takeaways

1. **Interest rates increased, despite the FOMC leaving rates unchanged at its September meeting.** Chairman Powell's hawkish comments at the press conference afterward indicated inflation was not yet contained, so *at least* one more hike in 2023 might be required. Further, to keep inflation under control, rates might have to stay high for a while.
2. **Fixed income markets performed poorly.** The Treasury curve shifted sharply higher and steepened in the middle and out years. Yields jumped and fixed income indices generated negative returns for the month.
3. **Higher yields, in our view, offer a compelling opportunity for fixed income investors.** The yields at which you invest in fixed income have historically been a reliable indicator of prospective annualized returns. The yields on offer are the highest we have seen in more than a decade.

The Month in Charts

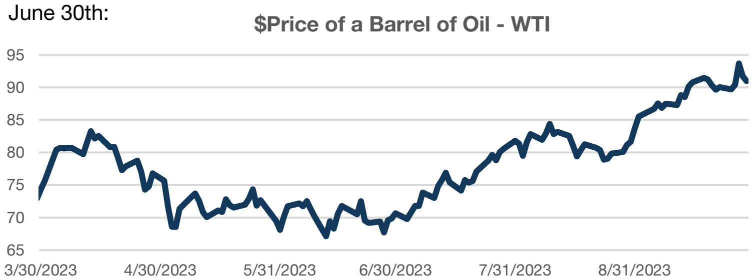
Core CPI trended lower by 30 basis points (bps) to 4.3% in August, as reported September 13th. While the index has declined markedly from its 9.1% peak of June 2022, it is still far above the Fed's 2% target.



*Basis point "bps" is 1/100th of a percentage point.

Source: Bloomberg

CPI readings need to fall further if the FOMC is to reduce rates. Rising oil prices have become an inflationary force – driving headline inflation higher. The price of energy is important not only for what it means for consumers at the gas pump but because energy is a key input in manufacturing goods, transportation, and services. Oil prices are up 30% as of September 28 from June 30th:

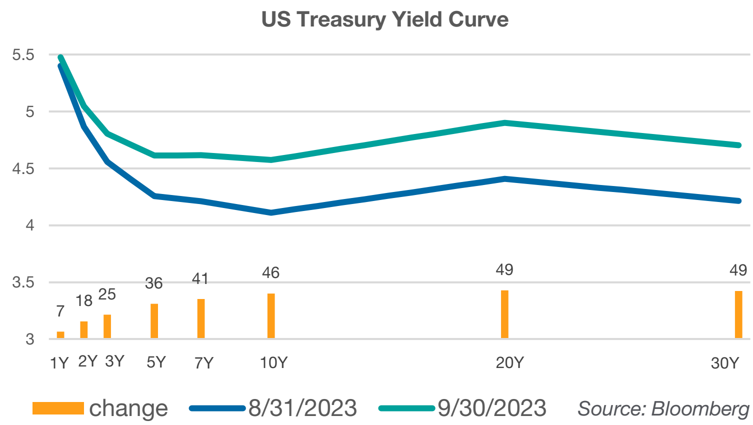


Source: Bloomberg

The path of monetary policy is uncertain. However, compared to the end of August, markets collectively anticipate rates to remain higher for longer. The first cut is further away than previously expected, based on the Federal Reserve's projections for the Fed's short term interest rate (aka the "dot plot").

Fed Funds Futures as of	Implied Policy Rate	Count of Cuts
31-Aug	4.1%	5
30-Sep	4.6%	3.5

Chairman Powell's statements that rates may have to be higher for longer shifted the entire Treasury yield curve upward. The most pronounced move was between the 5-year and 30-year tenors:



Source: Bloomberg

Credit spreads over the month were roughly unchanged. The exception was High Yield which was wider by 25 bps on investors' fears that a protracted period of higher rates would prove more difficult for weaker, non-investment grade-rated companies to weather than investment grade-rated companies.

				Quarter		Change		
Asset Class	Yield	Spread	Trend	Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	4.85							
U.S. MBS	5.57	66		48	66	13	14	-4
U.S. Corporate	6.04	120		112	126	3	-1	-38
U.S. Corporate High Yield	8.98	395		367	402	25	3	-156
CMBS	6.12	131		129	136	-1	-3	27
ABS	5.75	66		59	69	4	-2	13
A	5.90	106		97	109	4	2	-27
BBB	6.29	146		138	154	3	-4	-47
BB	7.63	265		238	269	18	14	-88

Source: Bloomberg; Asset Classes represented by: ICE BofA US Treasury & Agency Index, Bloomberg US Agg Total Return Value Unhedged USD, ICE BofA US High Yield Index, ICE BofA US Fixed Rate CMBS Index, ICE BofA US Fixed Rate Asset Backed Securities Index, Bloomberg US Agg A Total Ret Index, Bloomberg US Agg Baa Total Ret Index, Bloomberg Ba US High Yield TR Index. MoM/QoQ/YoY as of 9/30/23

Source: Bloomberg

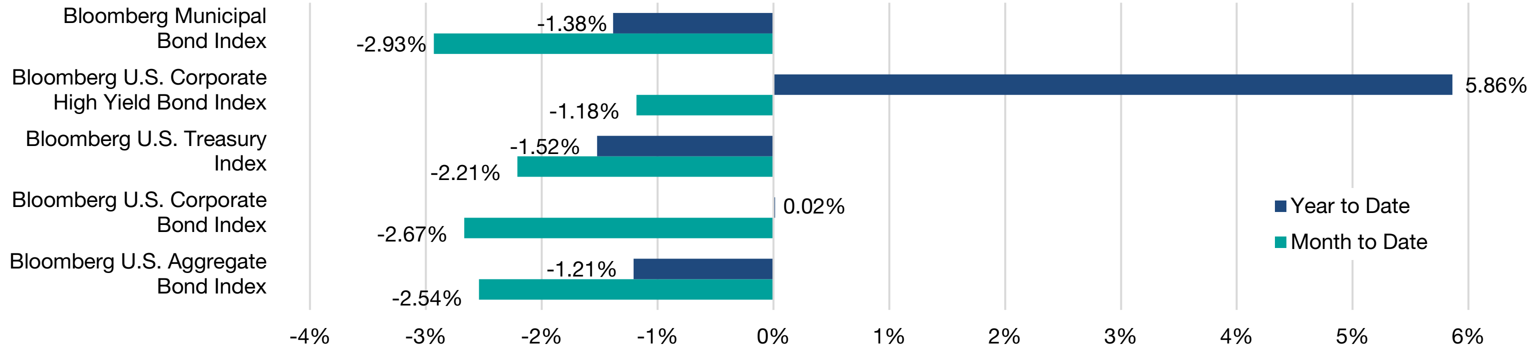
Bonding over Bonds

Our video series on the fixed income markets

In our #BondingOverBonds video series, experts discuss notable activity in the fixed income markets: Watch Now

The overall upward shift in the Treasury curve combined with largely unchanged credit spreads resulted in negative returns across all fixed income indices in September.

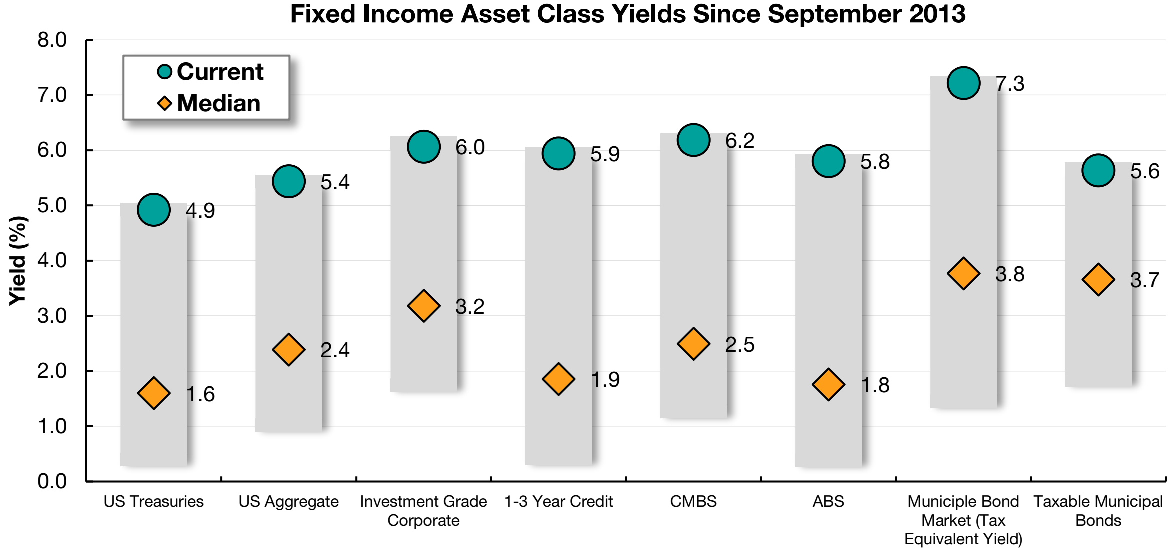
Returns (%) for Fixed Income Indices



Past performance is no guarantee of future results. Performance as of September 30, 2023 *Source: Bloomberg*

Our Current Thinking

At the September FOMC meeting, the Fed communicated that despite their decision to hold rates constant, inflation was persistently high and that policy would need to remain restrictive for some time. The market is grudgingly coming around to the realization that we will all have to get used to higher rates through 2024 and maybe into 2025. On the brighter side, bond investors will have a longer period in which to invest in higher yielding newly issued bonds. Our research tells us that absolute yields are the greatest determinant of a bond's ultimate performance. Looking back, we see that today's starting yields—if one bought a bond today—are among the highest in the past ten years in virtually every fixed income asset class:



Source: Bloomberg; Indices represented are Bloomberg US Treasury Index, Bloomberg US Aggregate Index, Bloomberg US Corporate Index, Bloomberg 1-3 yr Credit Index, Bloomberg US CMBS: Erisa Eligible Index, Bloomberg US Aggregate ABS Index, Bloomberg Municipal Bond Index, and Bloomberg Taxable Municipal Bond Index. Yield-to-worst is the lowest possible yield received on a bond, absent default. Tax Equivalent yield for Municipals assumes the highest tax bracket.

Past performance is no guarantee of future results.

This opportunity to invest with higher starting yields, we believe, provides a rare opportunity for investors to position themselves for strong performance in the years ahead.

What We'll Be Watching in the Month Ahead

Trends in the broader economy and overall financial conditions will set monetary policy. In the month to come, we will be watching:

- **October 6th:** The next Non-Farm Payrolls report, which will reveal the unemployment rate, trends in compensation, and how the supply of labor is evolving.
- **October 12th:** The next CPI release, which will indicate where we are still seeing inflation and by how much the overall rate is over the Fed's targeted 2% rate.
- The continuing industrial action surrounding the largest US automobile manufacturers, which is a headwind to economic activity.

All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class. Interested parties are strongly encouraged to seek advice regarding the best options for their particular circumstances from qualified tax and financial experts.

The opinions are as of the date noted and are subject to change at any time due to changes in market or economic conditions.

Index returns are provided to represent the investment environment during the periods shown. Index performance includes reinvestment of dividends and other income. Index returns do not include transaction costs, management fees or other costs. Non-US indices are net of withholding taxes, if any.

Credit spread is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury. **The Treasury Yield Curve** shows the relationship between the US bond yield and the time to maturity. Yield and price have an inverse relationship. As the yield curve lowers, the price of bonds increase. **Tenor:** the length of time until a debt is due. **Core CPI:** CPI excluding food and energy. **Consumer Price Index (CPI),** a popular measure of inflation and deflation calculated by the Bureau of Labor Statistics, measures the monthly change in prices paid by U.S. consumers. **Personal Consumption Expenditure Price Index** is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services and is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

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