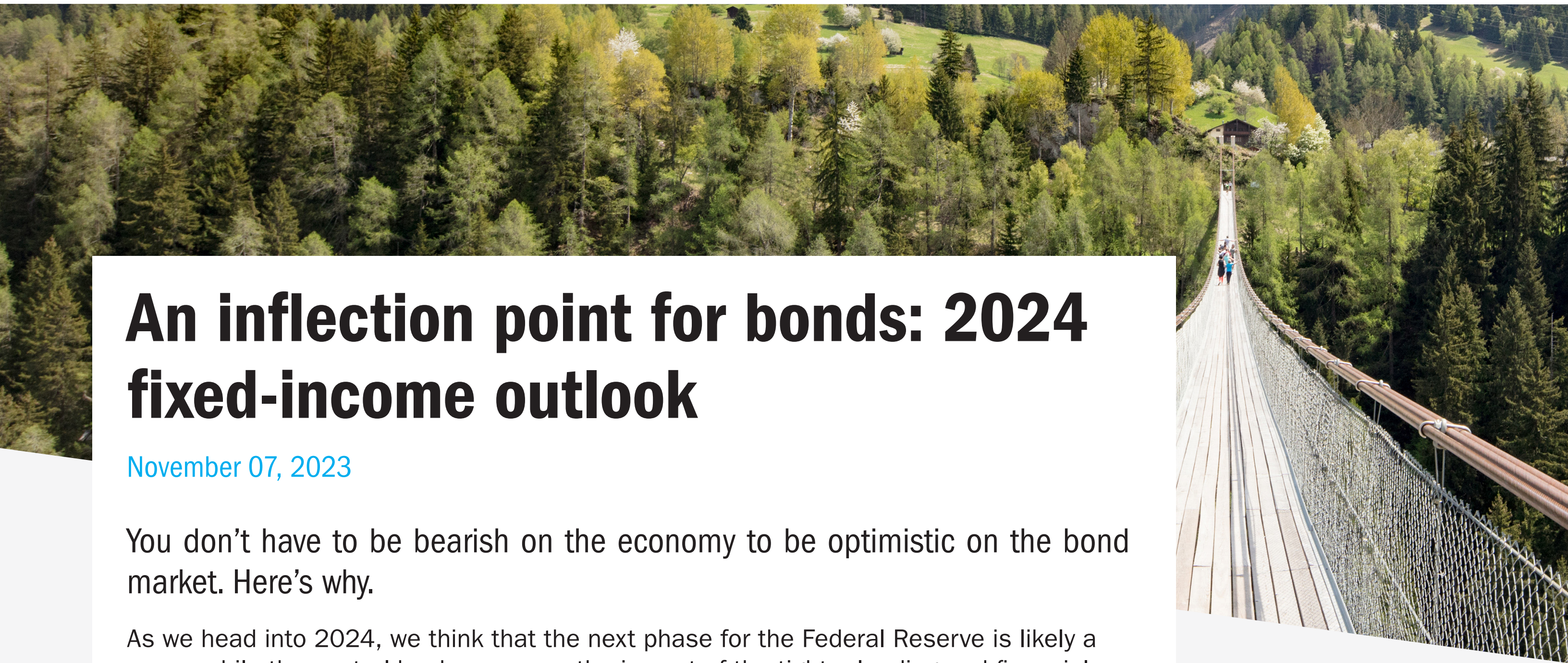


An inflection point for bonds: 2024 fixed-income outlook

November 07, 2023

You don't have to be bearish on the economy to be optimistic on the bond market. Here's why.

As we head into 2024, we think that the next phase for the Federal Reserve is likely a pause while the central bank assesses the impact of the tighter lending and financial conditions it's established. Investors should expect a lot of talk about whether the Fed will achieve a soft landing, but bond investors have the potential to generate attractive returns either way. Here's our rationale:

Bonds have performed well around Fed pauses
Typically, Fed pauses like this last less than a year, and it doesn't take a cut in rates for bonds to rally. History suggests that when the Fed reaches the peak of its rate hike cycle, overall bond performance in the period afterward is exceptional.

Bond returns after Fed rate hike peaks
(Average forward return after a pause, %)

	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
Munis	3.8	6.0	10.4

Source: Columbia Threadneedle Investments. See notes for indices used.

We're not in the hard landing camp, but given the unknown magnitude of an economic slowdown and the level of inflation, we think where investors are on the quality spectrum will make a difference. While lower rated bonds have been strong performers in 2023, we think the market is going to be more discerning as we head into 2024. We expect higher quality bonds will be the best bond performers over the next year.

Gene Tannuzzo, CFA
Global Head of Fixed Income

We also think performance will be more dispersed than it has been. As we enter a higher-for-longer rate environment, we should see more separation between the winners and the losers — especially in lower quality segments of the market. This will make credit selection more important, which is one of our core strengths.

Investors can lock in higher rates for the long term
Bond yields have risen to levels we haven't seen in decades. We think investors shouldn't miss the opportunity to lock in higher yields for the long term (not to mention the total return potential as prices on those bonds rise). It's also a great incentive to move out of cash. There's been a money market renaissance as investors realized they can own cash and get a competitive yield. The attractiveness of cash will start to fade when short-term interest rates move lower and the diversification benefits of owning high-quality, long-term bonds at higher yields start to make more sense.

Opportunities in municipal bonds are even more attractive when you consider the effect of taxes, especially in high tax states, where tax equivalent yields on high-quality munis create a further incentive. Underlying municipality fundamentals are generally healthy, but we're cautious on high-yield munis, which are not offering yields that much higher than better quality bonds for the added risk.

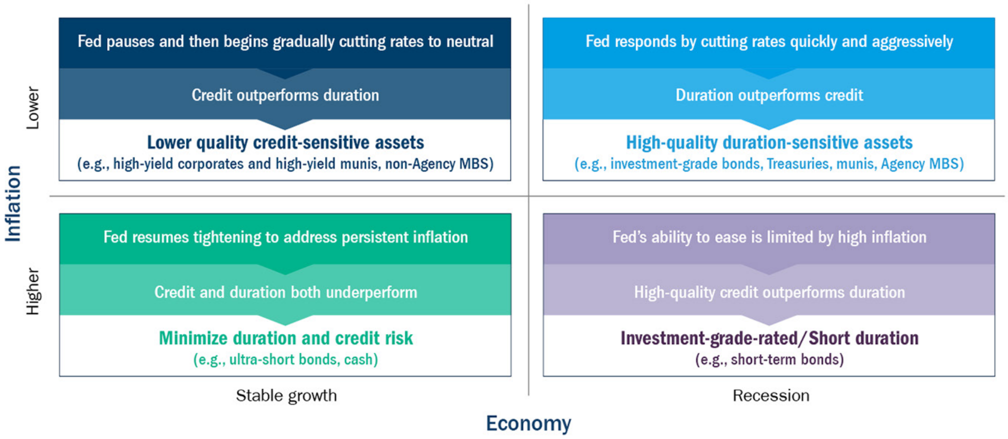
Looking outside U.S. markets, opportunities may be even more striking in Europe, despite lower absolute yields. Unlike the U.S., they're coming off not just near-zero interest rates, but negative rates. Now, we're not only seeing positive real interest rates, but also wider credit spreads. That means you're going to get more risk premium for a similarly rated bond in Europe than you would in the U.S.

There's more than one way to take advantage
There are several paths to invest in the bond market in 2024, depending on how you feel about the economy:

1. **Get paid with higher yielding credit.** If you feel growth will remain resilient, you could benefit from the income of high yield (if you are comfortable with the risk) and ultra-short bonds.

Looking for direction in fixed income?

We believe there are several paths to invest in 2024, depending on how you feel about the economy



Source: Columbia Threadneedle Investments

2. **Seek income and mitigate risk with high-quality bonds.** If you're not confident about the economy, high-quality assets like municipals and short-term bonds could help mitigate risk in case of a harder landing.

The bottom line

Our optimism for bonds is balanced by a realistic view of a still uncertain economy, and the understanding that geopolitical risk has the potential to introduce volatility. Having said that, we still think a hard landing is unlikely. More importantly, we believe the peak in rates is near and a Fed pause will be a significant market event. It's an inflection point that has historically delivered outsized returns for bondholders. Combined with the opportunity to lock in attractive yields, we think now is an opportune time for investors to participate in the bond market.

To find out more, call 800.426.3750
or visit columbiathreadneedle.com

Notes: 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. Municipals are represented by the Bloomberg Municipal Bond Index, which represents the broad municipal market. Past performance is not a guarantee of future results. It is not possible to invest directly in an index.

There are risks associated with fixed-income investments, including credit risk, interest rate risk and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer term securities.

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