NDR
NED DAVIS RESEARCH

Fixed Income Allocation Strategy

JANUARY 2025

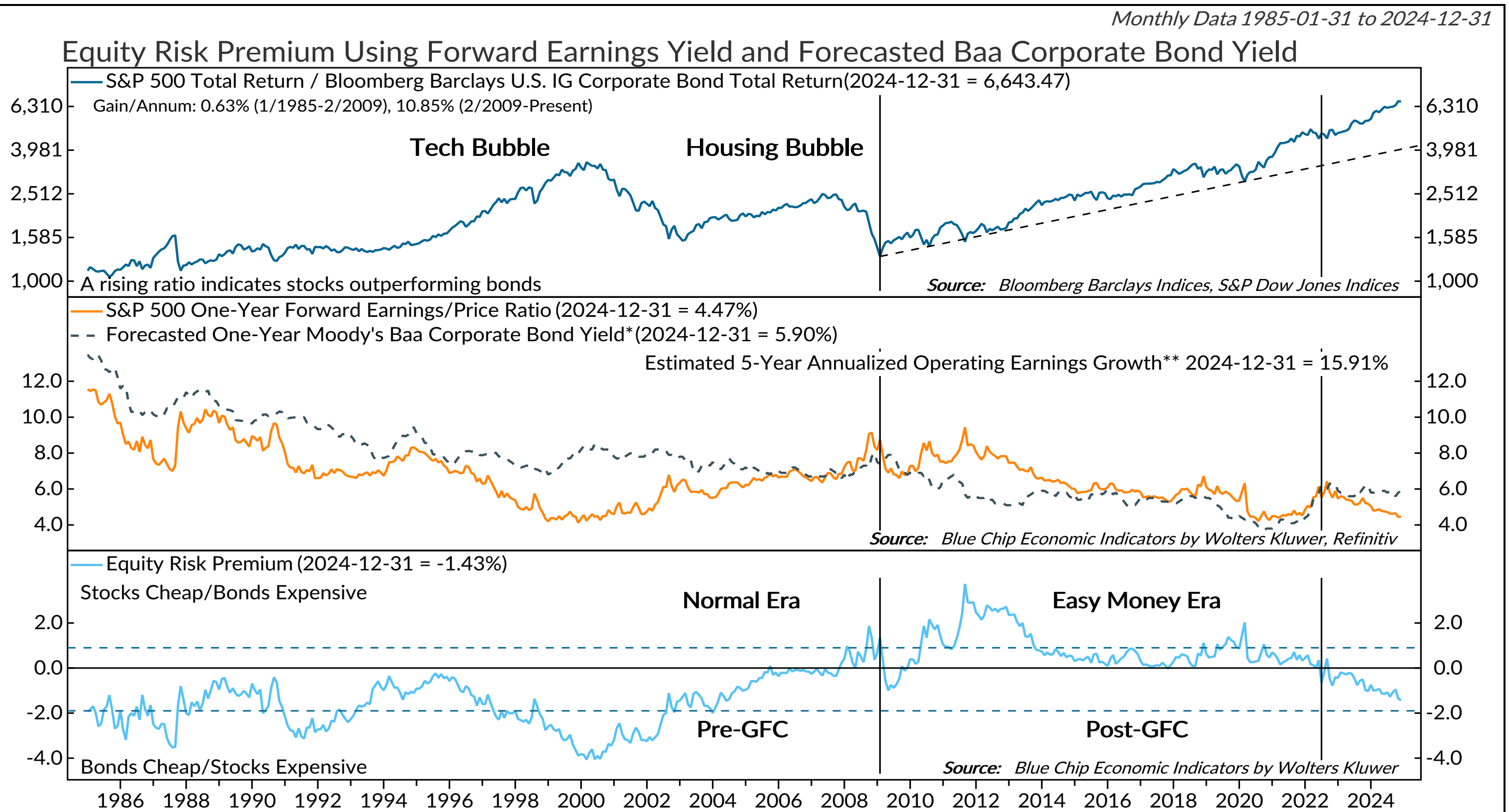
Fixed Income Market Update

The Bloomberg Barclays U.S. Aggregate Bond Total Return Index was down -1.6% in December. With Trump's policies potentially reigniting inflation, breadth deteriorated—seven of the nine fixed income sectors we track had negative returns for the month. Besides cash, U.S. Floating Rate Notes was the only other sector to post a modest gain in December.

It wasn't a December to remember unless you were bearish, with Treasury bond futures tumbling 4.7% last month. That was the worst performance since 2009 and the third worst since 1979.

The 10-year Treasury yield closed the year at 4.58%. Our forward-looking equity risk premium is one basis point away from favoring 10-year Treasurys. But our preferred equity-risk premium measure using Baa corporate yields still has a 50 basis point cushion before credit is favored (chart below). Allocators should continue to favor equities over bonds.

The fixed income allocation strategy didn't rebalance this past month. Entering January, Emerging Market bonds, U.S. Floating Rate Notes, U.S. High Yield, and International Investment Grade are above benchmark weight. U.S. Investment Grade Corporate, U.S. Long-Term Treasurys, U.S. Mortgage-Backed Securities, and U.S. Treasury Inflation-Protected Securities are below benchmark weight.



* Estimated based on Aaa Forecast Yield Prior to 1999
** Based on operating earnings before depreciation and amortization. Assumes earnings will grow over the next twelve months at the rate implied by forward earnings vs. trailing earnings.

Stock/Bond Ratio Performance
Full History: 1985-01-31 to 2024-12-31

Equity Risk Premium	% Gain/ Annum	% of Time
Above 0.9	12.10	11.71
-1.9 to 0.9 From Above	5.13	30.48
-1.9 to 0.9 From Below	10.07	34.46
Below -1.9	-7.04	23.36

Buy/Hold = 4.57% Gain/Annum

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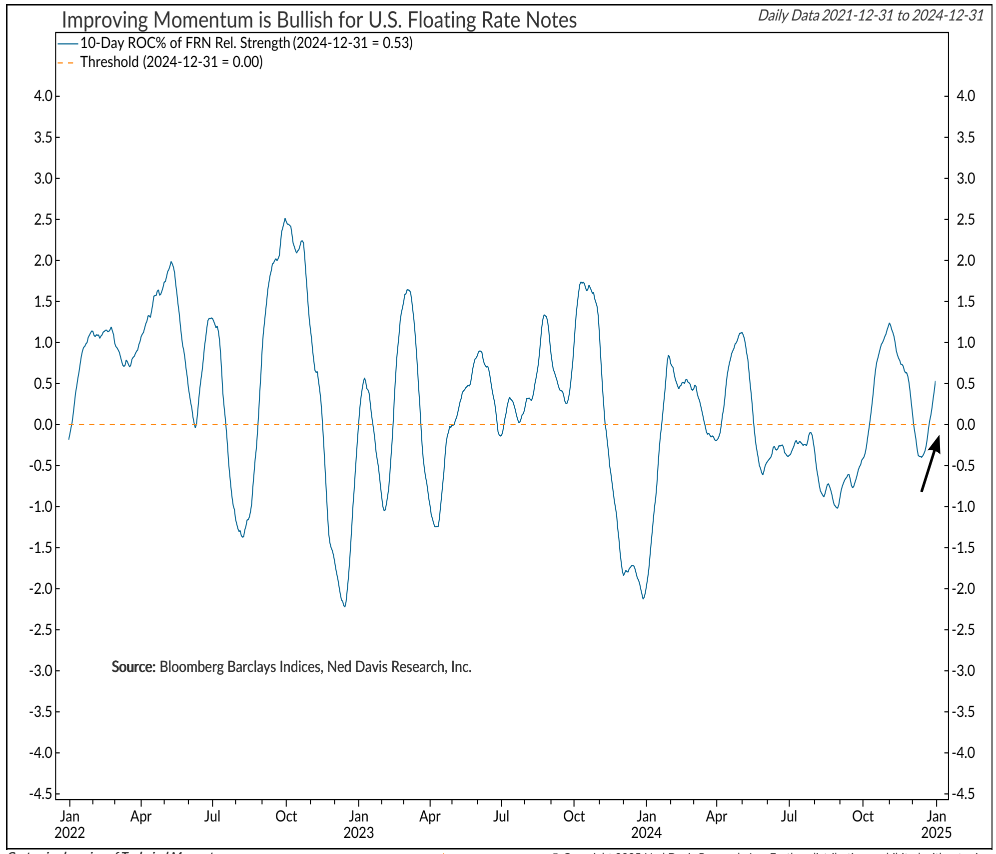
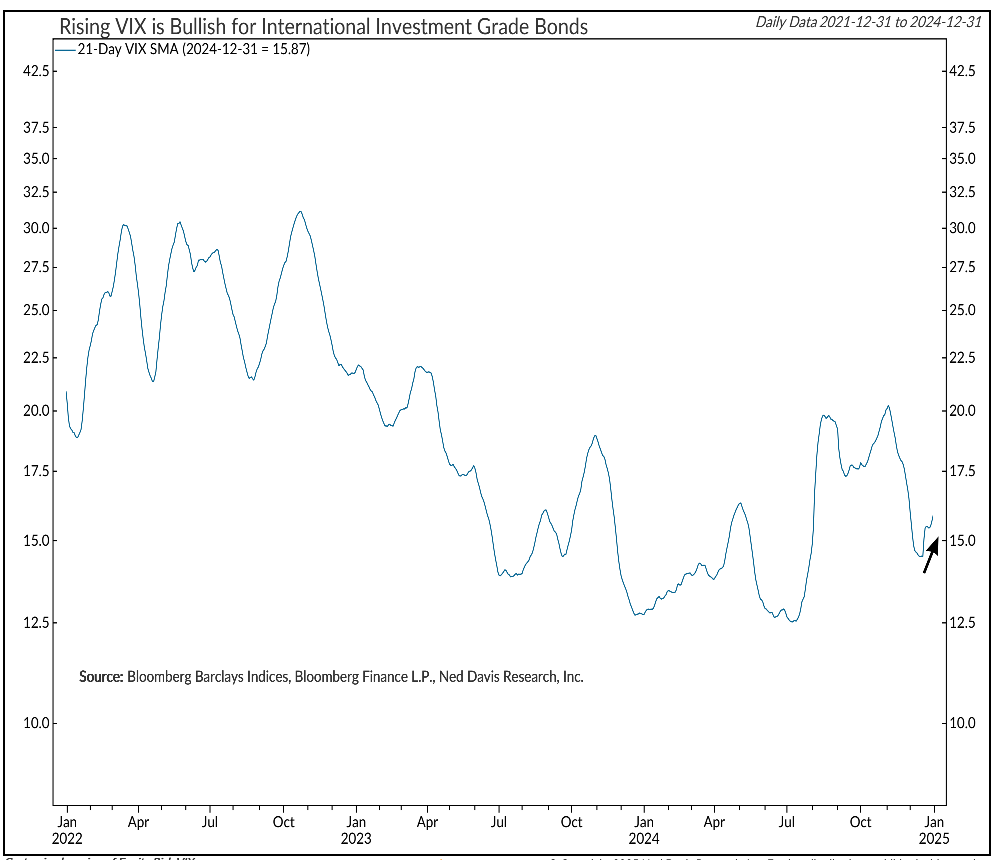
U.S. Floating Rate Notes' allocation is well above benchmark weight. Four of the five indicators are bullish for the sector. The sector tends to outperform with rising rates. Bullish option-adjusted spreads were confirmed by technical measures including relative strength, trend, and momentum (chart right).



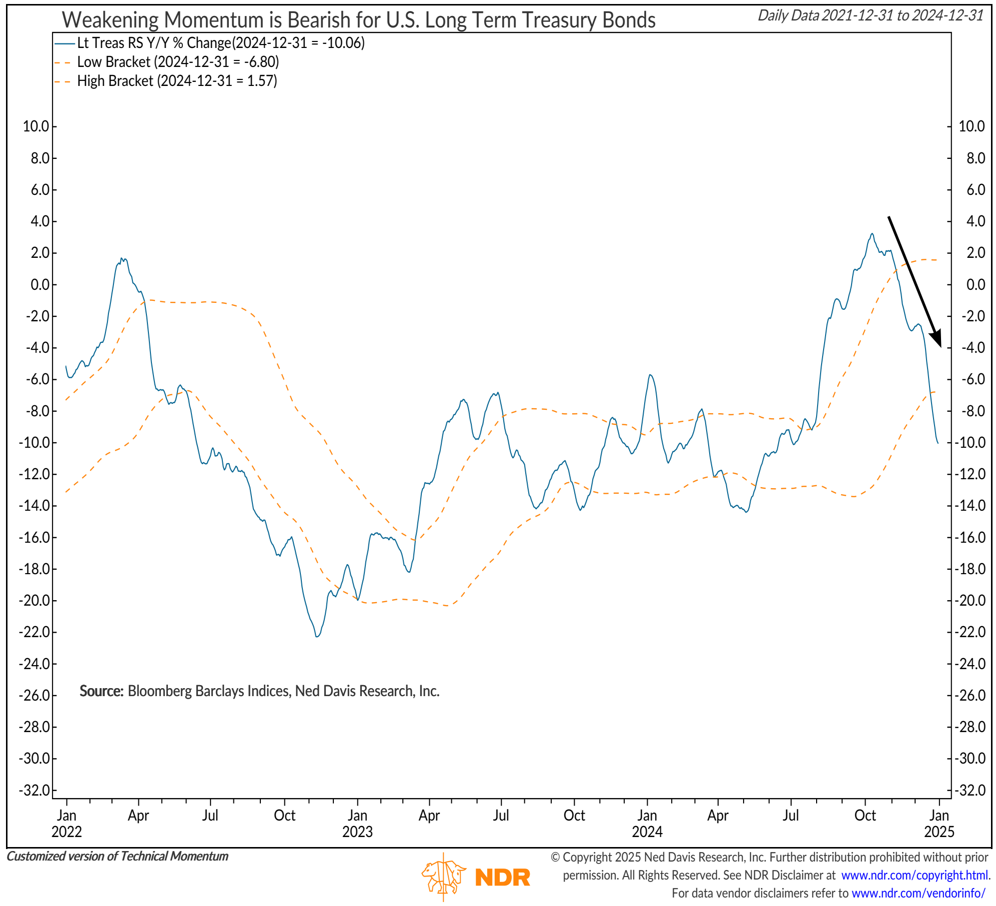
Customized version of Technical Momentum

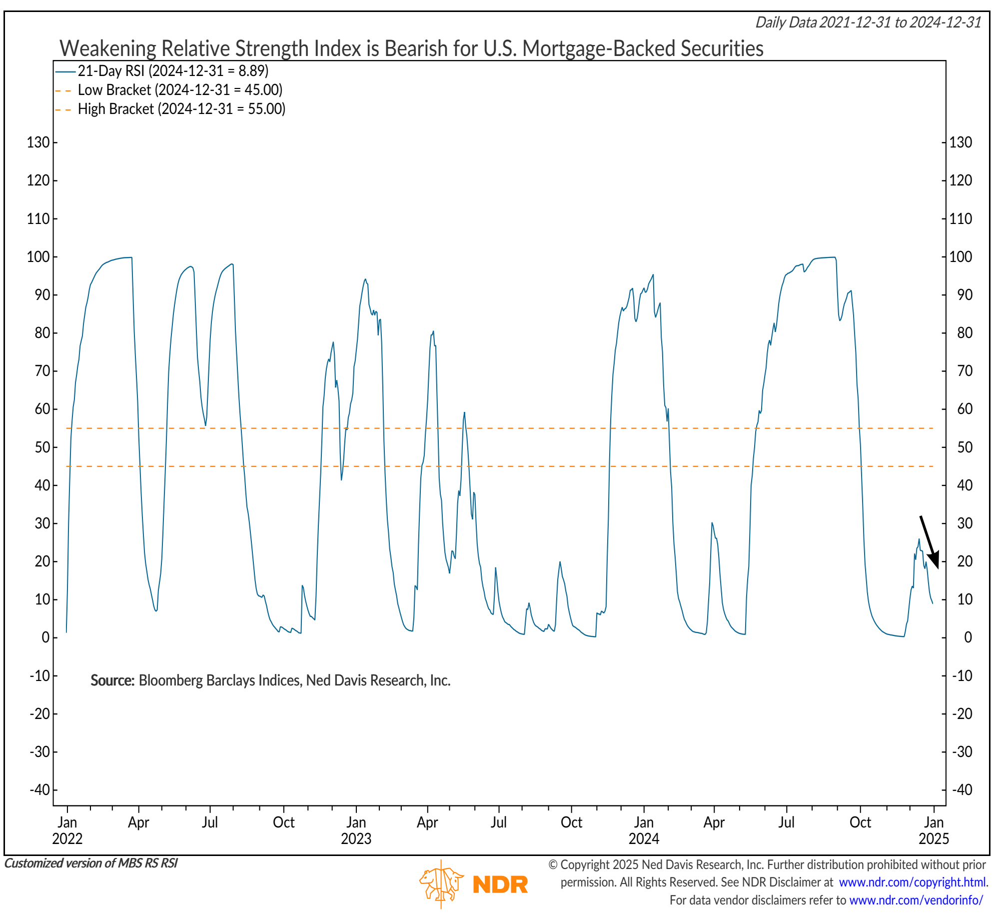


Customized version of Equity Risk VIX

International investment grade bonds' allocation is above benchmark weight. Indicators are mixed. High yield vs. inflation extremes and U.S. swaps extremes are neutral for the sector. But during the month, equity market volatility (as measured by the VIX) moved bullish for the sector (chart left), joining bullish readings from trend measures.

U.S. Long-Term Treasury bonds' allocation is well below benchmark weight. Four of five indicators are bearish. While U.S. stock market performance improved to a bullish level for Treasuries during the month, it was offset by weakening Treasury bond momentum which weakened to a bearish level (chart right). Sector trend, inflation expectations, and U.S. swaps extremes are also bearish for Long-Term Treasury bonds.





U.S. Mortgage-Backed Securities (MBS) allocation is well below benchmark weight. Four of the six indicators remain bearish for the sector including trend, relative strength vs. inflation expectation extreme measures, and the relative strength index (chart left). The 10-year yield and high yield option-adjusted spread remain bullish for the sector.

Summary

The fixed income allocation strategy didn't rebalance this past month. Entering January, Emerging Market bonds, U.S. Floating Rate Notes, U.S. High Yield, and International Investment Grade are above benchmark weight. U.S. Investment Grade Corporate, U.S. Long-Term Treasurys, U.S. Mortgage-Backed Securities, and U.S. Treasury Inflation-Protected Securities are below benchmark weight.

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