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# Asset Allocation
Chart of the Month

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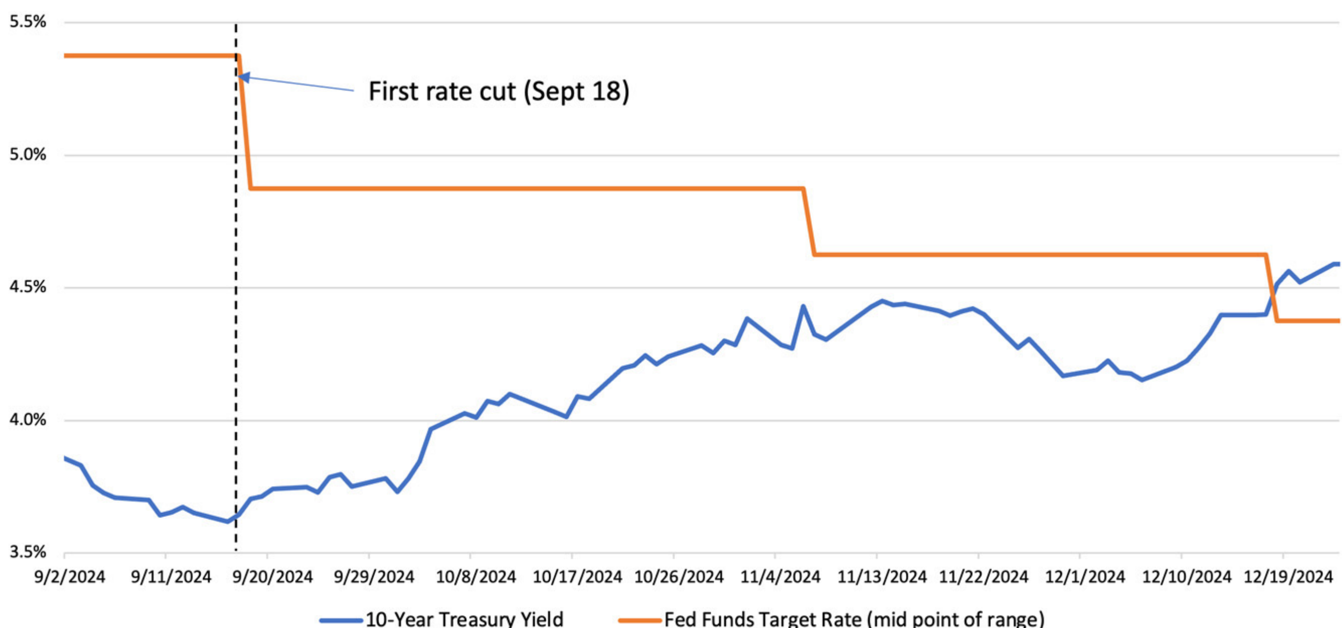
**December 24, 2024**

## Interest Rates: Diverging

- Since the Fed began cutting its Funds rate in September, long-term rates have moved in the opposite direction. While the Fed has lowered its target rate by 100 basis points, the yield on the 10-year Treasury bond has risen nearly the same amount.
- The spread between the 10-year yield and the Fed funds rate has widened by nearly 200 basis points. The speed and magnitude of this spread widening mirrors patterns seen at the onset of the 2001 and 2008 recessions.
- However, few expect a recession, making this situation more unique. In bond parlance, we are experiencing a "bear steepening" of the yield curve. It's called a "bear" steepening because it negatively impacts most participants: short-rate holders lose income, while long-term debt holders face price declines.
- Several factors may explain this bear steepening:
    - Economic resilience: Strong labor market data and other indicators suggest reduced recession risks. Unlike 2001 and 2008, the Fed isn't reacting to an economic downturn.
    - Inflation concerns: Policy proposals from the incoming Trump administration have raised the possibility of inflationary pressures.
    - Government debt worries: Growing budget deficits have sparked concerns about public debt levels, and the incoming administration doesn't appear to want to address them.
    - Productivity gains: If sustained, rising labor productivity could support higher economic growth (and higher interest rates).
- Regardless of the cause, the rising yield on 10-year Treasuries is significant because it influences rates on many other long-term securities, such as mortgages. While these higher rates may reflect a stronger economic outlook, if sustained, they could eventually undermine growth.
- We are currently underweight in duration, for now. However, as long-term rates continue to rise, we are increasingly drawn to their return potential and less concerned about the risk of further rate increases.

## Diverging Interest Rates




*Source: Bloomberg. Daily data, September through December 24, 2024.*

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**Fixed-income securities can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities may be downgraded by a Nationally Recognized Statistical Rating Organization to below investment grade status. Non-investment grade debt securities are considered speculative with respect to the issuers' ability to make timely payments of interest and principal, may lack liquidity and has had more frequent and larger price changes than other debt securities. Equities are subject to market volatility and loss. Growth stocks may be more volatile than investing in other stocks and may underperform when value investing is in favor. Value stocks may not appreciate in value as anticipated or may experience a decline in value. Stocks of large-cap companies may be unable to respond quickly to new competitive challenges. Stocks of small- and mid-cap companies may be subject to more erratic market movements than stocks of larger, more established companies. Investments in foreign, and emerging market securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The risks associated with investing in foreign markets are magnified in emerging markets, due to their smaller and less developed economies.**

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