Fixed income perspective *from the Investment Advisory Group*

Truist Advisory Services, Inc.

Recent rise in U.S. yields is recovering value in duration

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Key takeaways

- Since January, **the sharp rise in U.S. Treasury yields has reinstated value** in bonds beyond cash alternatives.
- While the potential remains for somewhat higher yields (i.e., lower prices), **current yields in core fixed income can provide a powerful offset.**

Higher income is critical to performance and creating ballast

Sticky inflation, a resilient economy, and tempered Federal Reserve (Fed) rate cut expectations have pulled 5- and 10-year U.S. Treasury yields more than 80 basis points (0.80%) higher this year. As a result, these yields have retraced roughly two-thirds of their Q4 2023 declines. **Today's higher starting yields have created an improved entry point for deploying cash and adding duration** in portfolios that remain short of their benchmarks.

Over longer periods, approximately 85% of core fixed income's total returns are driven by the income it generates. The "belly of the curve," generally encompassing maturities between 3 and 10 years, are once again approaching levels unseen for more than 15 years. Thus, **core fixed income's total return outlook has improved markedly** since December. Additionally, the higher income stream provides diversified allocations with enhanced portfolio stability in the event of increased equity volatility – a benefit that high quality fixed income lacked during the era of ultra-low rates.

Expect yields to decline from current levels

On top of improved income levels, **we continue to expect yields to fall (i.e., higher bond valuations) later this year.** For one, we suspect the Fed will gather sufficient disinflationary evidence to carefully lower policy rates later this year. Shelter costs – which remain stubbornly high – are the largest component of inflation. Real-time shelter data suggest further cooling is in the pipeline over the next several months. Additionally, in our view, the steep rise in healthcare costs over the past year appears unsustainable. As inflation steps down, we also expect the Fed to decelerate its monthly balance sheet reductions (i.e., quantitative tightening) which should also encourage more rate stability. Lastly, the European Central Bank is now discussing the start of its own rate cuts in response to a more pronounced slowdown for inflation and growth. **Lower rates abroad should support European demand for U.S. debt**, which has already provided a significant source of buyer appetite.

But, as we have seen this year, the disinflationary path will be bumpy. It will also take time for the Fed to achieve its 2% inflation target, which means that yields' path lower will likely be gradual and uneven, barring a major economic or geopolitical shock.

Inflation surprises and budget deficits pose risks to outlook

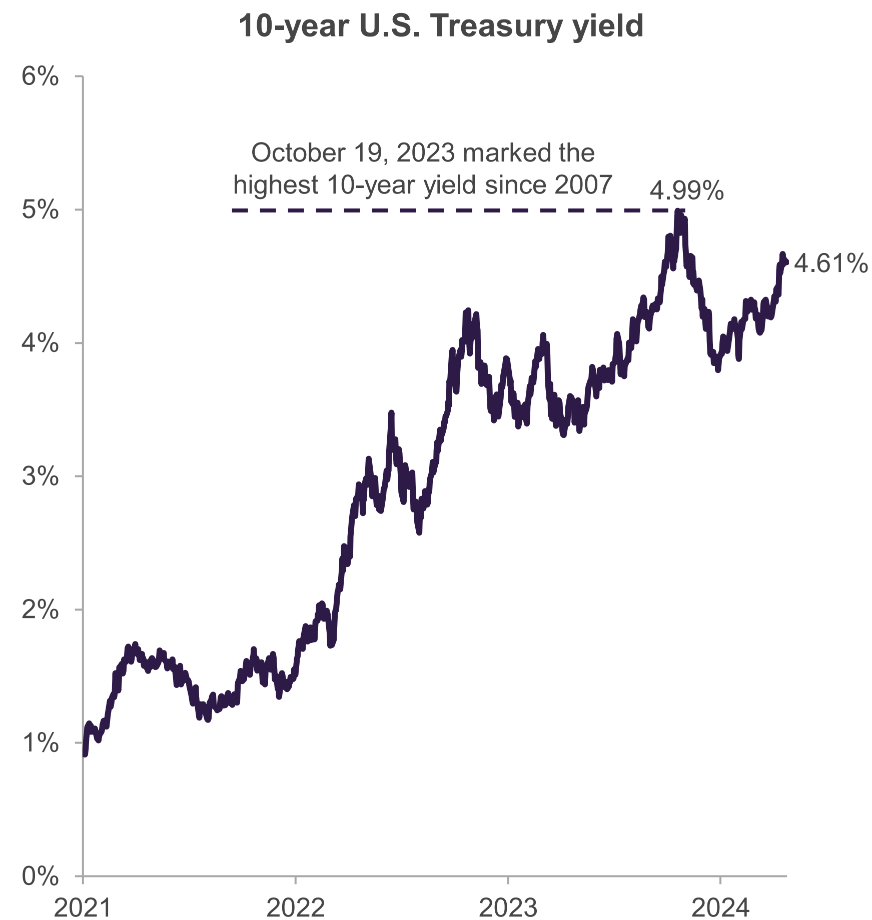
The Fed continues to believe that current policy is sufficiently restrictive and no further hikes will be necessary. However, **upside U.S. inflation surprises that shake policymakers' confidence could force yet another delay in rate cuts and fuel a disorderly move higher in yields.** Additionally, as we saw last fall, concerns around federal debt and spending habits can create "buyer strikes" that impose higher borrowing costs on the U.S. government – and everyone else by association. However, it is notable that the current 10-year yield provides a powerful offset to rising yield environments**. Over the next 12 months, the 10-year yield could rise from today's 4.6% to more than 5.2% and still generate positive returns.**

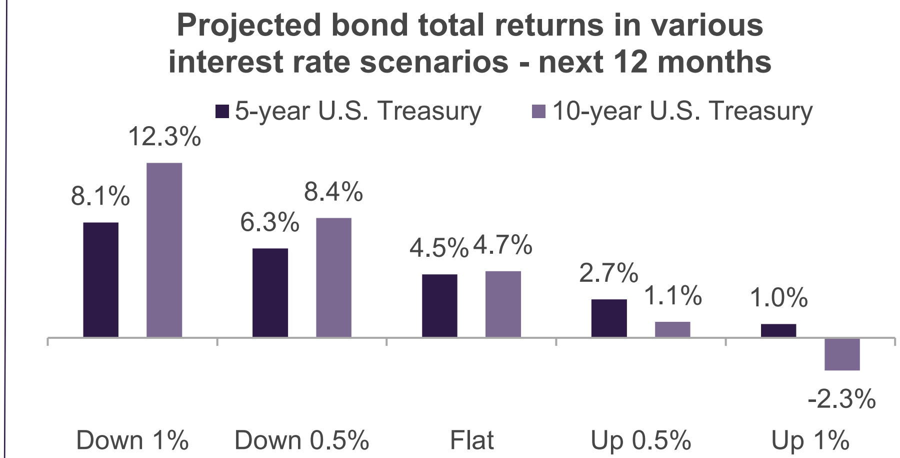
Bottom line

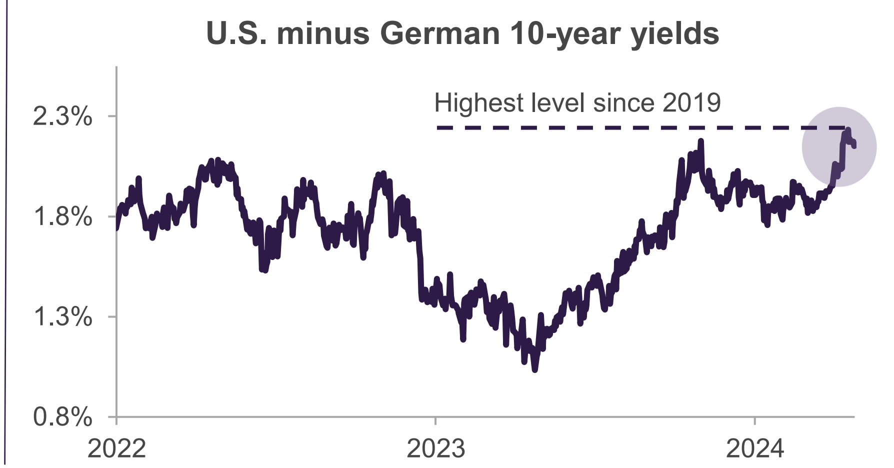
While upside yield risks remain, **the entry point and risk-reward balance in intermediate U.S. yields has improved meaningfully** this year. Current yield levels and our expectation that yields will decline as inflation cools and the Fed eases policy also inform our upgraded view of duration.

See charts on next page

U.S. Treasury charts







Data source: Truist IAG, Bloomberg,

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