FED CUTS, BRACES FOR TRUMP POLICIES & INFLATION

Macroeconomic developments in Q4'24 relieved earlier concerns about the labor market and growth, but the progress on inflation was disappointing. Although the Fed completed its initial phase of reducing its policy interest rate, Donald Trump's re-election added uncertainty in markets and at the Fed to the path for inflation and rates.

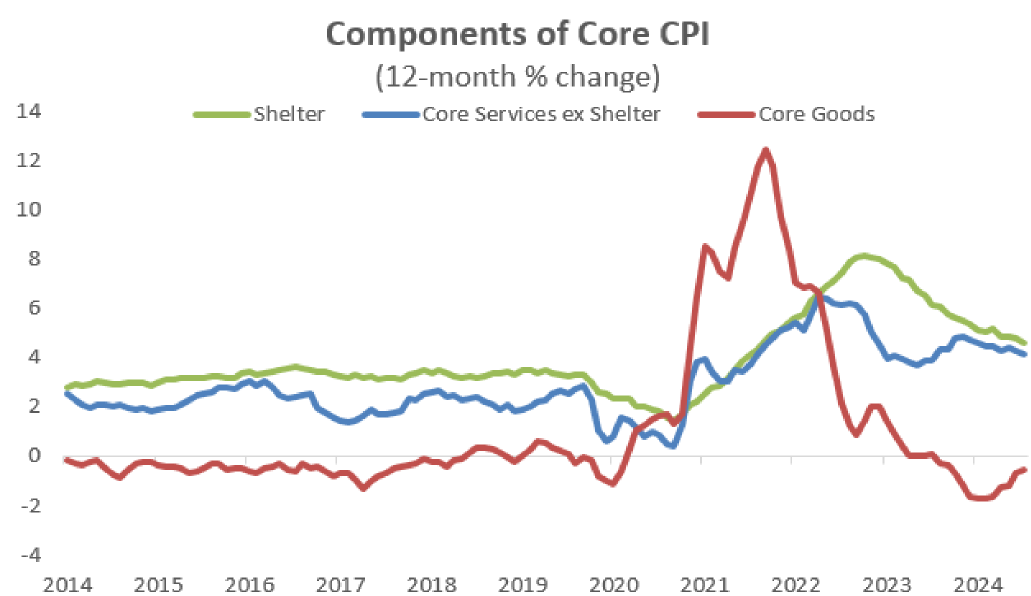
Inflation rose 2.9% YOY in December, up from 2.4% in September, as measured by CPI. Much of the step up was attributable to energy prices, but the core CPI, which excludes the more volatile food and energy prices, was nearly flat at 3.2%. This reignited concerns that inflation was stuck above the Fed's inflation target so interest rates could remain elevated. However, details in the inflation data were somewhat more encouraging. For example, the increase in shelter prices, a key driver of excess inflation, moved down close to the pre-pandemic pace in Q4 and core services excluding shelter slowed (see chart).

The offsetting pick-up in core goods inflation, such as motor vehicles, was likely part of normalization from post-pandemic swings. Even so, Q4 was another reminder that disinflation could remain uneven and gradual.

The labor market surprised with its resilience in Q4. After unemployment rose to a cycle peak of 4.2% in Q3 and fueled worries about further weakening (and possibly a recession), the rate decreased to 4.1% in Q4. Payroll employment rose an average of 170,000, close to a solid, pre-pandemic pace, despite the disruptions from a hurricane and port strike in October. Q4 showed signs that the labor market is stabilizing after years of gradual cooling. However, the decline in rates for firms hiring and workers quitting for new jobs makes the labor market less dynamic so some further cooling remains a risk.

In December the Fed completed its "recalibration" phase that began in September, totaling one percentage point in reductions in the federal funds rate. The cuts reflected substantial disinflation since 2022 and better balance in the labor market with reduced inflationary pressures from wages. In addition, Fed officials viewed the high funds rate as a risk to its employment mandate. With recalibration complete, the solid labor market conditions and firmer inflation in Q4 helped shift the Fed toward a 'wait and see' approach to further easing.

Donald Trump's re-election in November, along with Republican majorities in Congress, set off a shift in policy expectations and heightened uncertainty. Several policies that Trump proposed (e.g. tariffs, mass deportation, and tax cuts) could boost inflation, even if only temporarily. The details will matter, and implementation will take time. The fiscal policy uncertainty reinforced the Fed's switch to a rate pause.



Source: Bureau of Labor Statistics. NCA.

QUARTER IN REVIEW

During the fourth quarter, investor sentiment exhibited significant volatility, beginning with fear and escalating to extreme greed before retreating back to fear. The quarter concluded with an increased number of bearish investors, while bullish sentiment reached its lowest point of the year.

The Aggregate Bond Index returned -3.06%. The Barclays Treasury Index returned -3.14% and TIPS returned -2.96%, outperforming their nominal comparators by 26 bps.

Within the Aggregate, corporate excess return was 82 bps, supported by tightening spreads across the board. IG spreads contracted by 9 bps overall, with similar narrowing across sectors including utilities (10 bps), industrials (9 bps) and financials (9 bps). In structured products, ABS posted an excess return of 61 bps, and CMBS excess return was 66 bps. MBS lagged with an excess return of -13 bps. Sovereign excess return was -61 bps.

The US yield curve bear steepened, with longer dated rates rising more than shorterdated yields. Two year, 10 year, and 30 year yields jumped 60 bps, 79 bps and 66 bps respectively, to end the quarter at 4.24%, 4.57%, and 4.78%. Fed Fund futures ended the quarter pricing ~2 cuts by the end of 2025.

OUTLOOK

The global economy continues to grow, but we anticipate a modest slowdown in growth due to increasing uncertainty, particularly related to U.S. fiscal policies and tariffs. We expect global growth to remain around 2.5-3% in 2025 and anticipate that post-COVID disinflation will persist. However, the uncertainty surrounding our inflation forecasts has increased. The divergence in growth among global economies is likely to lead to uneven policy normalization. Potential deregulation and changes in trade, fiscal, and energy policies in the U.S. may have significant implications for global growth and inflation. Nevertheless, disruptive new trade and immigration policies, along with a deteriorating fiscal outlook, could pose a challenge to global growth.

- **Duration (Overweight)**: Moderating inflation and a Fed committed to gradually normalizing interest rates is supportive of duration in the short-term. While we agree the risk of structurally higher inflation could lead to a slightly higher long-term nominal rate vs. the Fed's 2.875% Summary of Economic Projections (SEP) target, the market implied long-term Fed Funds rate, at 4.0%, is too high and implies restrictive monetary policy for years to come. Yields should fall from current levels to reflect a more neutral policy rate.

- **Yield Curve (Favor intermediate bonds)**: Favor intermediate maturity bonds based on our view the terminal Fed Funds rate is too high. It should decline to reflect the risk of a recession in coming years, which is bullish for intermediate maturity bonds. In addition, overweighting intermediate bonds gains exposure to a steepening yield curve (which we favor), while maintaining a duration overweight.

- **Credit (Underweight)**: Underweight IG credit given tight spread valuations, flat credit curves and attractive relative value opportunities in securitized assets like agency MBS and certain ABS sectors. Overweight 5-10 year maturities. Underweight long credit, primarily in high quality 30-year Industrials. Still like the relative value of well-capitalized banks, aircraft lessors and insurance brokers. Prefer higher rated, liquid issuers in cyclically resistant sectors. Additionally, we like issuers exhibiting credit-friendly capital allocation plan and continue to avoid sectors and issuers that have M&A and re-leveraging risk or a history of shareholder-friendly actions.

- **ABS (Overweight)**: ABS offers attractive carry and better downside protection vs. investment-grade credit. Favor digital infrastructure (data center and fiber securities).

- **Agency MBS (Overweight)**: Mortgages remain cheap relative to investment-grade credit. Favor lower coupon, credit-impaired bonds which have higher prepayments, and will do well if the yield curve steepens. Also favor 5.0-5.5% coupon bonds which offer attractive carry, enough discount to perform well even if rates rally, and limited extension risk.

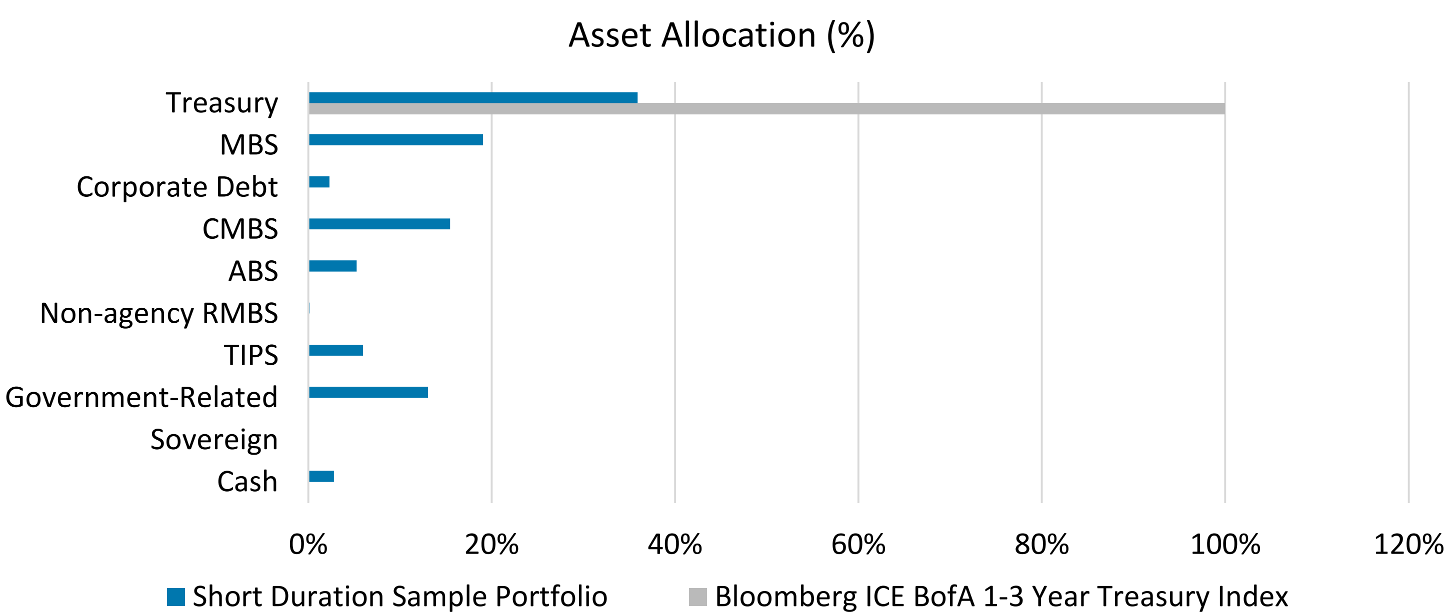
- **Non-Agency RMBS (Overweight)**: Favor AAA-rated, deep discount, positively convex mortgages that will benefit from a rally in short and intermediate yields. Also favor new issue, high coupon securities with limited extension risk.

- **CMBS (Overweight)**: Favor an overweight short and intermediate maturity, AAA-rated CMBS relative to investment-grade credit. Select front-pay bonds trade at maximum extension and will benefit from unscheduled cash flows (defaults). Also favor single-asset CMBS.

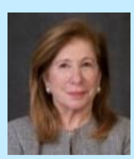
- **Inflation (Overweight)**: At 2.0-2.5%, real yields are too high. TIPS remain an attractive hedge for structurally higher inflation.

STRATEGY HIGHLIGHT – SHORT DURATION

NCA's robust opportunity set for Short Duration Plus accounts provided yields between 4.97% and 5.18%, depending on client guidelines, as of year-end 2024. We increased our duration overweight over the quarter, primarily through an increase in our allocation to agency mortgages and CMOs. We trimmed our position slightly in commercial mortgages and asset-backed securities. We decreased our allocation to investment-grade corporate bonds and added to government-related. We decreased our allocation to TIPS, taking profits as TIPS responded to increased inflation expectations, and added to nominal Treasuries. We favor a more bulleted portfolio in the most attractive part of the yield curve.



Portfolio Manager - Eric Patlovich, CFA
BS, Commerce, University of Virginia
Joined New Century in 2003
20 years of experience



Founder & CIO - Ellen Safir, CFA
MBA, George Washington University
Started New Century in 2002
30+ years of experience

Portfolio Manager - Nils Overdahl, CFA
MBA, University of Chicago
Joined New Century in 2002
30 years of experience

STRATEGY PERFORMANCE

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA Core (Gross)	-3.12%	1.82%	1.82%	-2.47%	0.36%	1.83%	3.89%
NCA Core (Net)	-3.16%	1.63%	1.63%	-2.65%	0.18%	1.64%	3.68%
Bloomberg U.S. Aggregate Index	-3.06%	1.25%	1.25%	-2.41%	-0.33%	1.35%	3.11%
Excess Return (Gross)	-0.06%	0.57%	0.57%	-0.07%	0.69%	0.47%	0.78%
Excess Return (Net)	-0.10%	0.38%	0.38%	-0.24%	0.50%	0.29%	0.56%

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA Intermediate Core (Gross)	-2.15%	2.92%	2.92%	-0.60%	1.15%	1.98%	3.24%
NCA Intermediate Core (Net)	-2.19%	2.76%	2.76%	-0.75%	0.99%	1.81%	3.04%
Bloomberg U.S. Intermediate Aggregate Index	-2.07%	2.47%	2.47%	-0.83%	0.33%	1.45%	2.54%
Excess Return (Gross)	-0.08%	0.45%	0.45%	0.23%	0.81%	0.53%	0.70%
Excess Return (Net)	-0.11%	0.29%	0.29%	0.08%	0.66%	0.36%	0.50%

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA Short Duration (Gross)	-0.52%	4.56%	4.56%	1.63%	2.34%	2.46%	2.98%
NCA Short Duration (Net)	-0.58%	4.32%	4.32%	1.37%	2.05%	2.13%	2.61%
Bloomberg ICE BofA 1-3 Year Treasury Index	-0.02%	4.14%	4.14%	1.52%	1.42%	1.40%	1.93%
Excess Return (Gross)	-0.50%	0.42%	0.42%	0.11%	0.92%	1.05%	1.04%
Excess Return (Net)	-0.56%	0.18%	0.18%	-0.14%	0.63%	0.73%	0.68%

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA Capital Preservation (Gross)	0.33%	5.40%	5.40%	2.79%	2.99%	2.63%	2.88%
NCA Capital Preservation (Net)	0.29%	5.25%	5.25%	2.58%	2.72%	2.32%	2.54%
Bloomberg ICE BofA 1 Year Treasury-Bill Index	0.89%	4.90%	4.90%	3.18%	2.24%	1.77%	1.48%
Excess Return (Gross)	-0.56%	0.50%	0.50%	-0.39%	0.75%	0.86%	1.39%
Excess Return (Net)	-0.59%	0.35%	0.35%	-0.60%	0.48%	0.55%	1.06%

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA MARRS (Gross)	0.41%	7.61%	7.61%	2.17%	3.98%	3.45%	5.02%
NCA MARRS (Net)	0.29%	7.09%	7.09%	1.68%	3.45%	2.85%	4.49%
Bloomberg U.S. TIPS (US ILB)	-2.88%	1.84%	1.84%	-2.29%	1.92%	2.29%	2.89%
CPI	0.68%	2.95%	2.95%	5.00%	4.16%	2.85%	2.43%

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA U.S. TIPS (Gross)	-3.00%	1.75%	1.75%	-2.24%	1.96%	2.46%	3.14%
NCA U.S. TIPS (Net)	-3.03%	1.56%	1.56%	-2.46%	1.70%	2.16%	2.87%
Bloomberg U.S. TIPS (US ILB)	-2.88%	1.84%	1.84%	-2.29%	1.92%	2.29%	2.89%
Excess Return (Gross)	-0.12%	-0.08%	-0.08%	0.05%	0.04%	0.16%	0.25%
Excess Return (Net)	-0.16%	-0.28%	-0.28%	-0.17%	-0.22%	-0.14%	-0.02%

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
NCA Global Credit (Gross)	-4.45%	0.89%	0.89%	-2.88%	-	-	0.42%
NCA Global Credit (Net)	-4.52%	0.58%	0.58%	-3.17%	-	-	0.11%
Bloomberg Global Credit Index	-4.22%	0.71%	0.71%	-2.97%	-	-	-0.39%
Excess Return (Gross)	-0.23%	0.18%	0.18%	0.10%	-	-	0.80%
Excess Return (Net)	-0.30%	-0.12%	-0.12%	-0.20%	-	-	0.49%

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Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. It is calculated and maintained by the US Bureau of Labor and Statistics.

Laura DeMarco
Director of Marketing
858.692.5194 / ldemarco@ncallc.com
www.newcenturyadvisors.com