Elections, the Fed, and Uncertainty: Navigating the Fixed Income Market

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Navigating the fixed income market is becoming increasingly complex due to a range of unpredictable factors. With upcoming presidential elections and interest rate cuts [finally] a reality, the fixed income markets face significant challenges in the months ahead. In times like these, a flexible approach to investing can be the key to weathering the storm. At Weitz, we aim to construct portfolios that are resilient rather than try to predict the future.

COULD THE 2024 ELECTIONS DISRUPT THE MARKETS?

As the 2024 election draws near, it's natural to worry about potential market disruptions. While election outcomes can impact domestic and foreign policies, historical evidence shows that political changes generally have a limited effect on long-term market performance. Despite the heightened political noise in recent years, markets have remained resilient. For example, the surprising result of the 2016 election, where Donald Trump won the presidency against many expectations, led to immediate market volatility. Many analysts anticipated a more dramatic market reaction, but the initial jitters were relatively short-lived, and the market settled into a more stable trajectory.

Market returns after US presidential elections, 1980-2020

Election	US Stock Market					US Bond Market				
Year	1 day	1 mo	3 mos	6 mos	1 year	1 day	1 mo	3 mos	6 mos	1 year
1980	1.82	6.39	0.05	3.13	1.01	0.00	-0.19	2.59	-0.64	4.29
1984	-0.68	-4.08	7.78	8.72	19.16	0.00	1.79	5.63	7.76	19.49
1988	-0.55	3.28	8.15	7.39	14.13	0.00	-1.21	0.71	2.49	12.49
1992	-0.55	3.28	8.15	7.39	14.13	-0.02	0.49	3.69	7.13	11.22
1996	1.53	4.49	9.23	15.93	34.11	-0.04	0.77	1.05	1.68	8.10
2000	-1.86	-6.97	-7.45	-12.51	-22.53	0.06	2.63	5.21	7.25	15.30
2004	1.17	5.76	6.45	4.51	11.25	0.08	-0.82	0.88	1.18	1.04
2008	-5.22	-16.06	-16.10	-7.12	8.38	0.49	3.03	4.53	6.28	11.71
2012	-2.24	-0.56	7.06	14.96	27.76	0.33	0.54	-0.34	0.82	-1.19
2016	1.16	5.61	8.13	13.35	23.70	-0.98	-2.23	-1.33	-0.86	1.25
2020	2.23	9.83	15.72	26.41	40.99	0.61	0.76	0.14	-1.45	-0.59
Average	**-0.29**	**1.00**	**4.29**	**7.47**	**15.65**	**0.05**	**0.51**	**2.07**	**2.88**	**7.55**
Median	**-0.55**	**3.28**	**7.78**	**7.39**	**14.13**	**0.00**	**0.54**	**1.05**	**1.68**	**8.10**

Source: MorningstarDirect. U.S. Stock Market represented by the Russell 1000 Index. U.S. Bond Market represented by the Bloomberg US Aggregate Bond Index.

This reaction to the 2016 election can be seen as an anomaly rather than a predictor of long-term trends. Just as the markets experienced short-term fluctuations during the tech bubble burst in 2000 and the global financial crisis in 2008, elections may prompt immediate volatility. However, broader economic fundamentals and trends often drive long-term market behavior. So, while the 2024 elections might stir some short-term market reactions, history suggests that these effects are typically fleeting in the context of broader market performance.

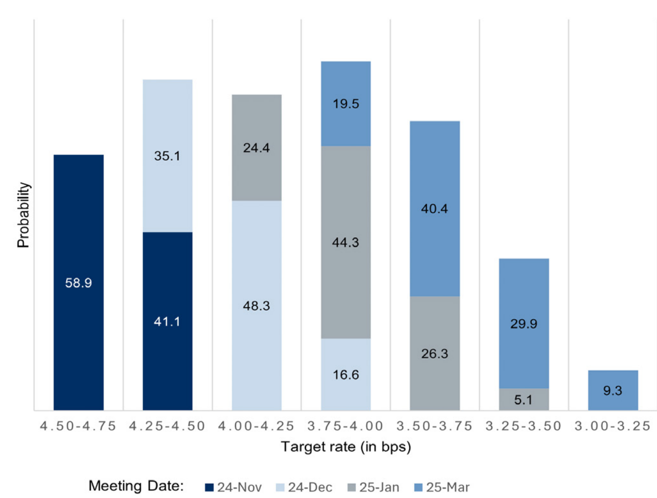
THE FED, INTEREST RATES AND THE END OF THE "CASH PARTY"

For the past two years, cash has accumulated in money market funds, driven by the Federal Reserve's decision to raise short-term interest rates to their highest levels since the 2008 financial crisis. With the Fed's target rate now between 4.75% and 5.00%, money market yields have hovered around 5.00% for over a year, contributing to a surge in assets in this sector, which have grown to $6.3 trillion (9/18/2024).

Forecasts about the Fed's future actions have been notoriously uncertain. Late 2023 predictions anticipated multiple rate cuts in 2024, but the Fed didn't make its first cut until September.

CME Target Rate Probabilities

Current Rate as of September 2024 - 4.75-5.00%

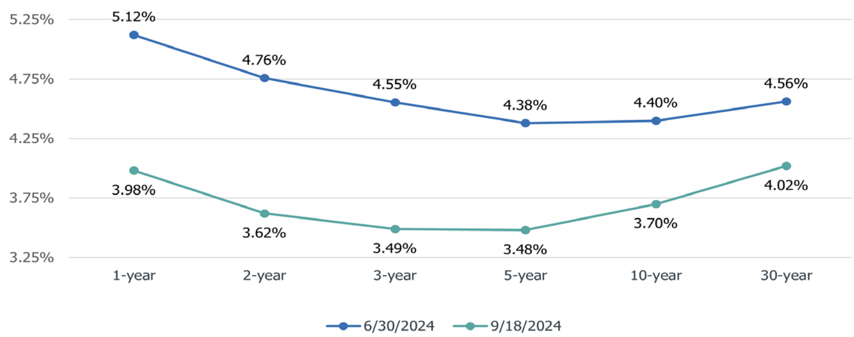


Source: CME's Fed Watch Tool as of 9/20/2024

With the recent fed rate cut of 50bps, the 1-year U.S. Treasury yield has dropped by 114bps since the end of June. Whether this decline signifies a genuine trend or is merely transient noise, it indicates that the era of risk-free cash may be coming to an end.

Feds Rate Cut Has Led to a 114bp Decline Since End of June

U.S. Treasury Yields



Source: Bloomberg

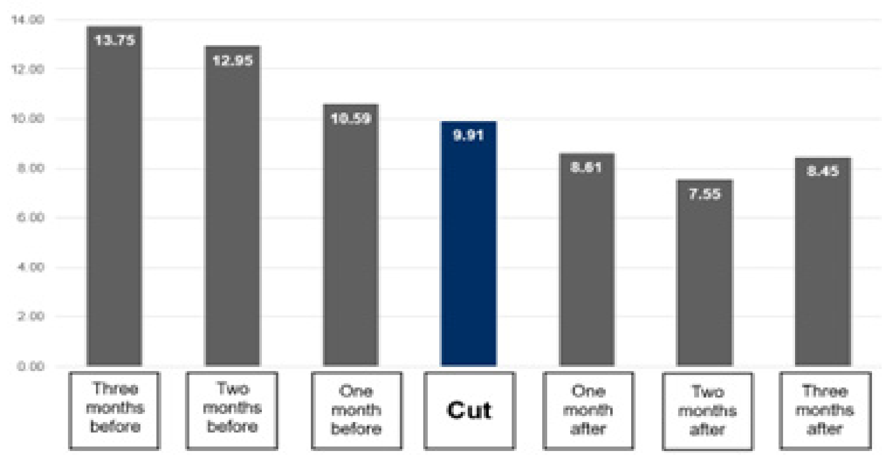
SEIZING THE OPPORTUNITY— EXTENDING DURATION MAY PAY OFF BEFORE RATE CUTS

Money market yields have typically moved in tandem with the fed funds rate. With rate cuts now a reality, it’s expected that money market yields will decline accordingly.

Given this, extending duration and investing in a diversified bond fund could be more beneficial than simply holding cash. By investing in bonds with longer maturities, investors could potentially achieve higher income levels and benefit from rising bond prices as rates decline—benefits that cash investments do not offer.

Of course, time is of the essence as investors have historically benefited from acting early. In the three months preceding the first rate cut of a cycle, the yield on the 10-year Treasury has typically dropped by an average of 90 basis points. Therefore, investors have often gained by moving from cash investments to high-quality bonds ahead of the first rate cut.

Average 12-Month Forward Returns for the U.S. Bond Market in Proximity to Fed Rate Cuts



Source: Morningstar. Data as December 31, 2023. Bond market is represented by the Bloomberg U.S. Aggregate Bond Index. Average is based on the following dates of first Fed rate cuts: Sept. 20, 1984; July 6, 1995; Jan. 3, 2001; Sept. 18, 2007; and Aug 1, 2019.

PREDICTION-PROOF FIXED INCOME INVESTING

At Weitz, our goal is to construct resilient portfolios by evaluating current risk/reward opportunities, rather than predicting the future. We diversify across the yield curve, investing in a range of high-quality assets like asset-backed securities, commercial mortgage-backed securities, and floating-rate bonds. By emphasizing fundamental analysis and diverse investments, we aim for strong risk-adjusted returns, preparing our investors for both opportunities and challenges.