KINGSVIEW
INVESTMENT MANAGEMENT

Opportunity Income

Q3 | 2024 Commentary

The third quarter delivered the first rate cut in 4 ½ years during last month's September Fed meeting. This rate cut was widely anticipated and telegraphed for some time. Many market participants view the Fed's current trajectory as being closer aligned with the bond market than in recent history. The stark contrast we have seen between consensus expectations and Fed comments seems to be narrowing over the past few months as the Fed has softened their tone a bit. Overall, the first 3 quarters of 2024 delivered a positive, but range-bound and volatile bond market, largely due to some prior misalignment between rate cut expectations and the Fed's prior signaling. Closing out the third quarter, we appear to be headed in the right direction in containing inflation and now have a Fed on board with current inflation and economic trends, too.

Fixed income marched decisively higher in the third quarter, as overall sentiment improved for bond pricing in general and bets on duration and credit were the winners, given the unfolding clarity on the rate and economic picture. Bonds remain historically inexpensive even after last quarter's rally and the bond market outlook continues to improve as inflation measures continue to show successful containment. The Fed's target for short-term and intermediate rates still leaves opportunity on the table for all asset prices, including bonds.

Overall, the current environment tells a story of increasing optimism and confidence with the Fed's handling of their dual mandate. General sentiment persists that lower or stable rates from here will support and spur further economic growth, but doubters remain that this may also re-ignite inflation. Wait and see is the approach the markets have taken thus far and the next few months should bring some clarity as we move past the presidential election next month and push towards the historically favorable and stable year-end market environment.

While the bond market has been pricing in lower and declining treasury rates into 2025 and beyond for some time now, the actual start of easing policy and lower inflation forecasts at this point continue to be supportive of current bond prices and don't appear to be the "fuel" needed for a bond rally just quite yet. Further rate cuts and improved Fed guidance may provide this fuel through the end of next year, and the two remaining Fed meetings in 2024 are vital for continued positive sentiment. An immediate pathway to recovery from recent bond price drawdowns remains murky but the timeline is now a bit clearer than in past quarters as the immediate outlook appears to be favorable to bond prices.

Lead Portfolio Manager
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Chief Trading Officer

Mitch Ehmka is the Chief Trading Officer for Kingsview Partners. Mitch has worked with Kingsview since 2010 and has assumed increasing responsibility during his tenure, serving as Head Trader for 3 ½ years, and then as Director of Trading for five years before being named Chief Trading Officer in 2022. Mitch oversees all trading operations within the firm from Chicago, runs the day-to-day trading operations of Kingsview Investment Management and is a founding member of the Investment Committee.

Mitch helps Advisors, fellow Portfolio Managers and the Investment Committee implement investment strategy, and assists in guiding portfolio implementation within Kingsview's systems. Mitch also spearheads the GIPS efforts of Kingsview Investment Management and oversees its claim of compliance with the GIPS standards in investment performance reporting.

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If the forward 2/10 yield curve holds and comes to fruition, this should support the bond narrative as a return to non-correlation and improve relative attractiveness. As Fed cuts are now in the rearview mirror while economic conditions remain strong, we appear to be in the middle of the highly desired "soft-landing" solution to our previous inflation problems. The Fed continues to play its hand close with the bond market and has continued to simply communicate that they are data dependent and time will determine the course of future monetary easing. This is progress of a sort, as the Fed prior to last month continued to allude that there may be no cuts at all as inflation remained a primary concern over the past 2 years.

As has been the case over the past 2 years, the Opportunity Income portfolio remained in a fully defensive stance throughout the third quarter as the yield curve remained inverted for most of the quarter with short-term yields higher than long-term yields. This inversion, however, has recently ended as the yield curve went positive just after the September rate cut. An upward sloping curve points towards a potentially strong economy over the reference period (2-10 years from now), and this historically means lower forward rates during expansion as opposed to longer-dated yields because of improving growth as well as stable and supportive wages, and possibly even some normal levels of inflation if the economy is expanding at a comfortable pace. This normalization of the yield curve is expected to hold over the next few years as the bond market continues to normalize further.

We remain well off cycle lows achieved over the past few years in bonds as forward rates of return in the bond market continue to improve. We believe the current portfolio is positioned to capitalize on a return to a more "normal" yield curve, and we expect fixed income investors to be rewarded in the coming years as we return to a more normal bond market with longer-dated bonds once again holding a time premium.

Riskier bonds have traditionally performed well in a growing economy. As the economy continues to expand and rates trend lower, budgeting borrowing costs becomes easier for firms and more efficient for those smaller firms that have been struggling to borrow at higher rates. A strong economy also means that corporate bonds may be a safer bet.
We view many different pieces of the bond market collectively when constructing portfolios and we study these separate pieces of the market and their relationships closely. This knowledge is perhaps less helpful for fixed income investors in cycles like this, where duration mechanics have been unrelenting on bond valuations as rates remained elevated. Those mechanics can also be beneficial over a longer total investment horizon that aligns with your capital needs. In the fixed income space, we continually monitor portfolio exposures and forward rates of return appear to be improved from this point over the next few years.

As of quarter end, the forward indicated forecast yield on the portfolio is 3.49% compared to the aggregate bond benchmark of 3.44%. We at Kingsview Investment Management appreciate your continued support of the Opportunity Income portfolio. Should you wish to speak with one of our portfolio managers, please email investments@kingsview.com.

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