MORNINGSTAR Indexes

Morningstar Quarterly US Fixed-Income Monitor: January-March 2025

Bonds perform well amid cautious Fed and rising uncertainty.

Morningstar Inc.
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Contents

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Executive Summary

This is the latest installment of the Morningstar US Fixed-Income Quarterly Monitor, which is designed to help investors stay on top of the latest trends in the fixed-income asset space as tracked through the lens of four Morningstar fixed-income indexes: Morningstar US 1-3 Month Treasury Bill Index, Morningstar US Treasury Bond Index, Morningstar US Corporate Bond Index, and Morningstar US High-Yield Bond Index.

Key Takeaways

- In the first quarter of 2025, the Federal Reserve maintained a cautious approach by keeping the target federal-fund rate unchanged, following a cumulative 100-basis-point rate cut implemented in the latter part of 2024.
- The US Personal Consumption Expenditures Price Index, or PCE, inflation was still above the 2% target set by the Fed.
- The first quarter witnessed higher nonfarm payroll, or NFP, employment, and a marginally higher unemployment rate.
- The longer-maturity Treasury rates saw a decline of 30-40 basis points while the lower maturity rates remained fairly unchanged.
- The Morningstar US Treasury Bond Index provided the best risk/return characteristics over the first quarter of 2025. This was followed by the Morningstar US Corporate Bond Index. The Morningstar US High-Yield Bond Index and the Morningstar US 1-3 Month Treasury Bill Index experienced muted returns over the first three months of 2025.
- The option-adjusted spread, or OAS, for US corporate bonds exhibited a slight upward trend in the first quarter of 2025. This rise is indicative of growing uncertainties in the economy due to tariff conflicts.
- The investment-grade corporate bond space exhibited positive returns, with healthcare, energy, and technology sectors contributing the most to the positive first-quarter returns.
- The high-yield corporate bond space exhibited marginally positive returns, with the transportation sector contributing negatively, while the energy, telecommunications, and real estate sectors had a positive impact on the overall first-quarter returns.
- AAA rated corporate bonds witnessed a positive return of 2.6%. Among high-yield corporate bonds, BB and B rated bonds had positive returns while the lower-rated CCC and CC bonds remained unchanged.

Market Update

Federal Reserve Holds Rates Steady Amid Rising Uncertainty

The Fed maintained the target federal-funds rate at 4.25% to 4.50% in both the January and March 2025 Federal Open Market committee meetings in line with the outlook set in the last quarter of 2024. Sticky inflation and stable economic outlook facilitated the Fed's decision to maintain status quo in interest rates.

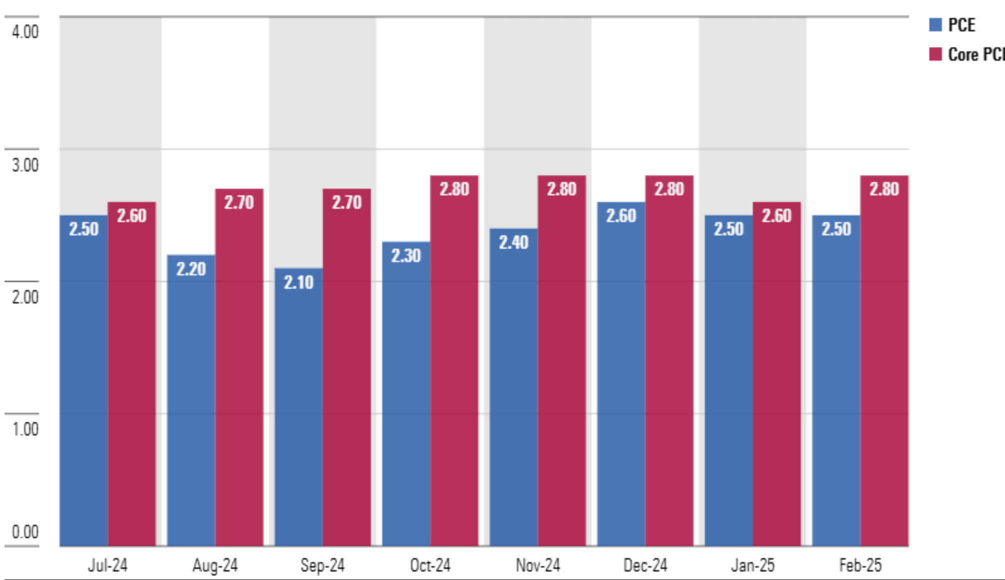
The fourth quarter of 2024 witnessed a robust annual growth in real gross domestic product of 2.4%, albeit a reduction from the third-quarter growth rate of 3.1%. The year ended with a real annual GDP growth of 2.8% on account of increased consumer spending, investments, and government spending.[1]

Projections for 2025, however, indicate heightened economic uncertainty, driven by the rising likelihood of tariff conflicts and their potential to significantly dampen growth. The projections for annual real GDP growth in 2025 was downgraded to 1.7% from the earlier projection of 2.1%. Similarly, PCE inflation projections were raised by 20 basis points to 2.7%.[2]

Inflation's Slow Descent: Nearing the Federal Reserve's Goal but Still Holding Firm

US PCE inflation continued to remain above the Fed's target of 2%. January and February 2025 witnessed stability in both the PCE and Core PCE indexes. With inflation remaining stubbornly persistent above the target of 2%, the Fed signaled its intention to remain cautious with further rate cuts.

Exhibit 1 US PCE and Core PCE Inflation Data Year Over Year



Source: Bureau of Economic Analysis. Data as of March 31, 2025.

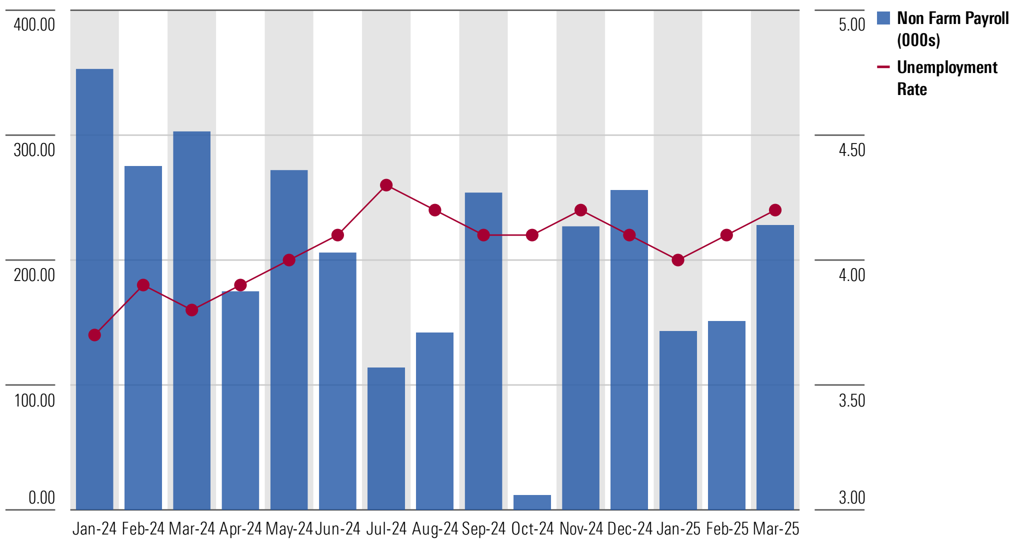
1 Data source for GDP growth rates: Bureau of Economic Analysis, US Department of Commerce, released on March 27, 2025.
2 Real GDP growth rates projections data source: FOMC Projection Material, Federal Reserve.

Jobs Data Update

US NFP employment saw an increase of around 150,000 jobs in both January and February 2025. March witnessed a much higher addition to employment with 228,000 new jobs. The first quarter added an average of 174,000 new jobs compared with 165,000 in the last quarter of 2024.

US unemployment rose marginally to 4.2% in March. The stronger-than-expected nonfarm payroll gains reaffirm labor market resilience. The data supports the Fed's current policy stance, providing room to hold rates steady amid broader economic uncertainty.

Exhibit 2 US Jobs Data

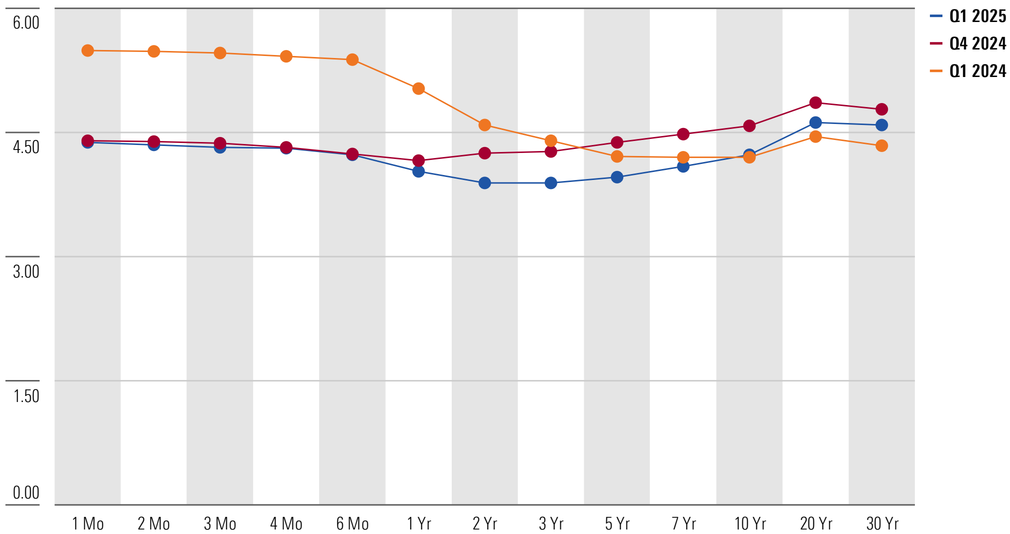


Source: Bureau of Labor Statistics. Data as of April 10, 2025.

US Yield Curve and Interest-Rate Movement Summary

The first quarter of 2025 saw no significant movement in short-term rates. Longer maturity term rates saw a marginal decline of 30-40 basis points. The term structure has witnessed significant steepening compared with that of 12 months ago.

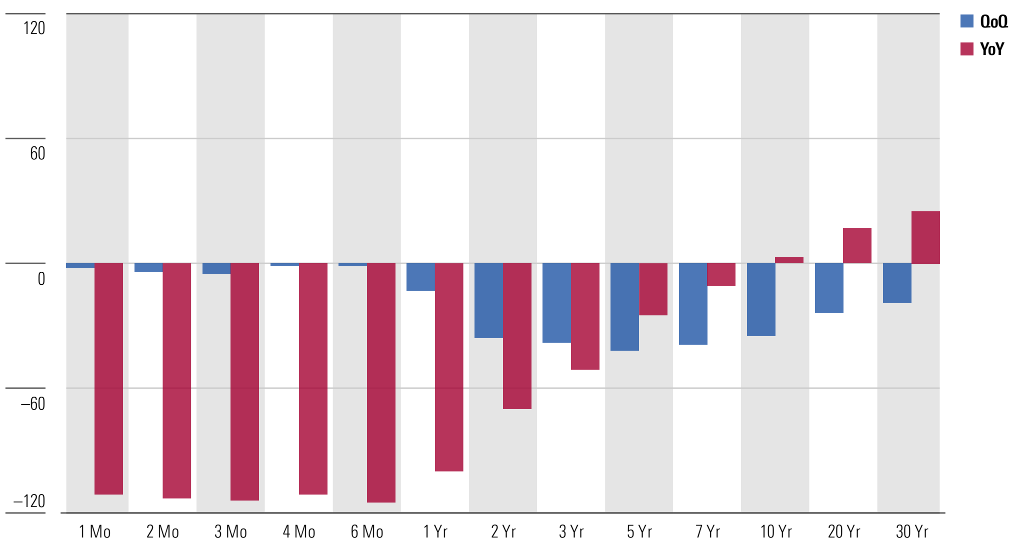
Exhibit 3 Yield Curve



Source: US Department of Treasury. Data as of March 31, 2025.

As can be seen from Exhibit 4, the first quarter witnessed a marginal flattening of the curve. While the lower-maturity Treasury rates remained unchanged, the longer-maturity rates saw a drop of 30-40 basis points.

Exhibit 4 Change in US Term Rates (bps)

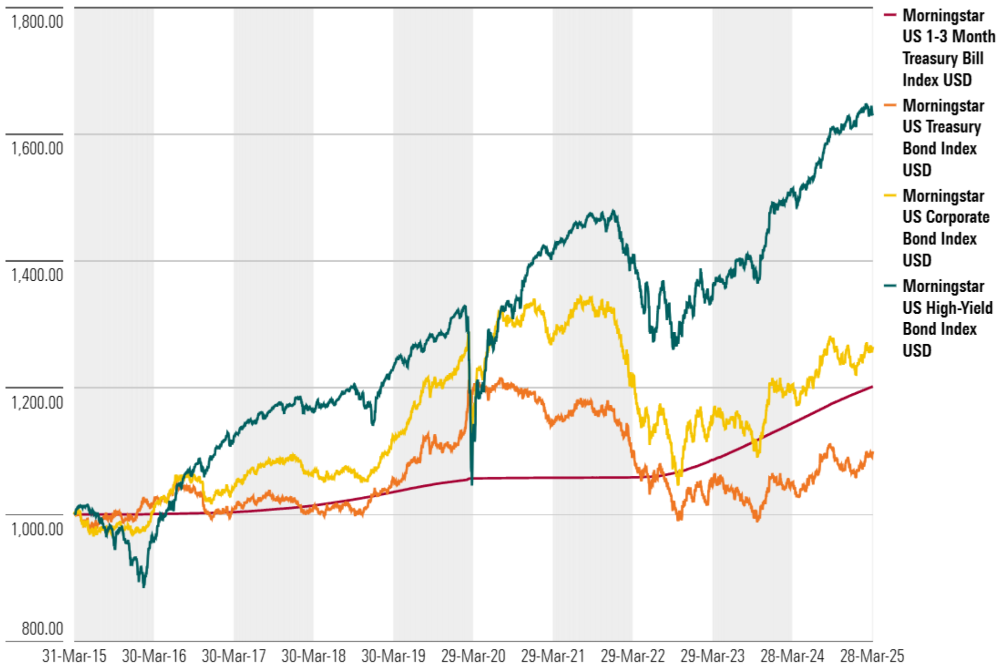


Source: US Department of Treasury. Data as of March 31, 2025.

Morningstar Fixed-Income Index Performance Summary

Exhibit 5 highlights the performance of Morningstar Fixed-Income Indexes. As expected, over the last 10 years, the Morningstar US High-Yield Bond Index has provided the best overall returns, albeit at a higher risk, as can be seen in Exhibit 6.

Exhibit 5 Performance Chart of Morningstar US Fixed-Income Indexes



Source: Morningstar. Data as of March 31, 2025.

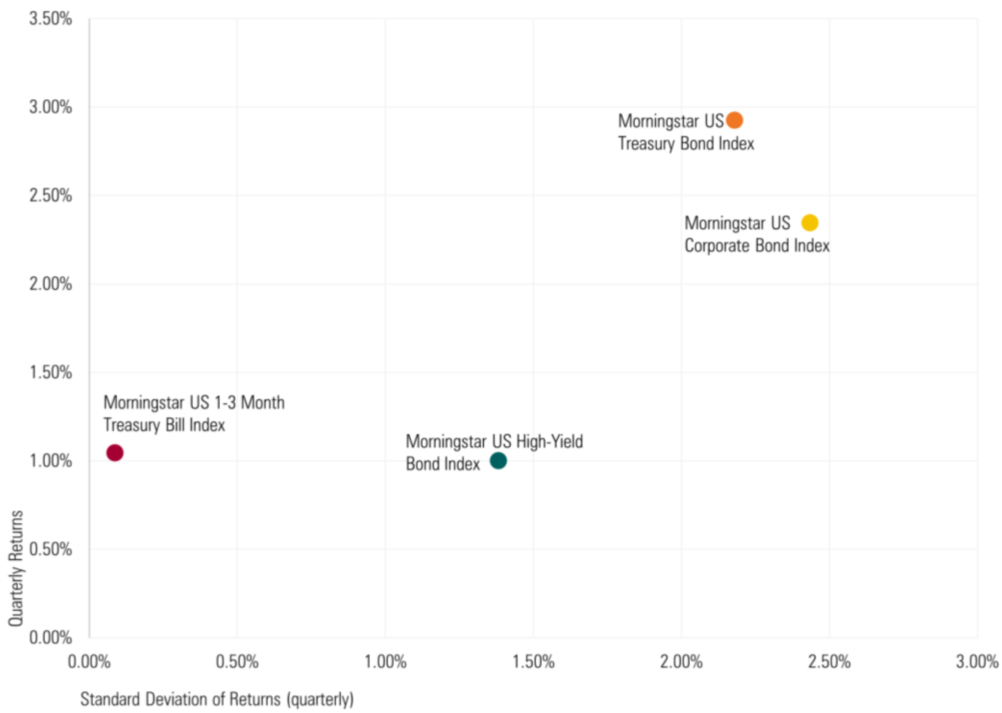
Exhibit 6 Risk/Return Characteristics

Parameters	Morningstar US 1-3 Month Treasury Bill Index	Morningstar US Treasury Bond Index	Morningstar US Corporate Bond Index	Morningstar US High-Yield Bond Index
Start Date	2015-03-31	2015-03-31	2015-03-31	2015-03-31
End Date	2025-03-31	2025-03-31	2025-03-31	2025-03-31
Return (%)	1.86	0.96	2.38	5.01
Risk (%)	0.56	4.86	6.9	7.62

Source: Morningstar. Data as of March 31, 2025.

The comparative risk/return performance of the Morningstar indexes over the last quarter is shown in Exhibit 7. The Morningstar US Treasury Bond Index led performance in the first quarter of 2025, followed by the Morningstar US Corporate Bond Index. Gains were primarily driven by the longer-duration profiles of both indexes, which benefited from a decline in long-term Treasury yields during the quarter. The Morningstar US High-Yield Bond Index posted subdued returns in the first quarter of 2025, reflecting investor caution amid rising economic uncertainty. Meanwhile, the Morningstar US 1-3 Month Treasury Bill Index remained flat, as short-term interest rates held steady throughout the quarter.

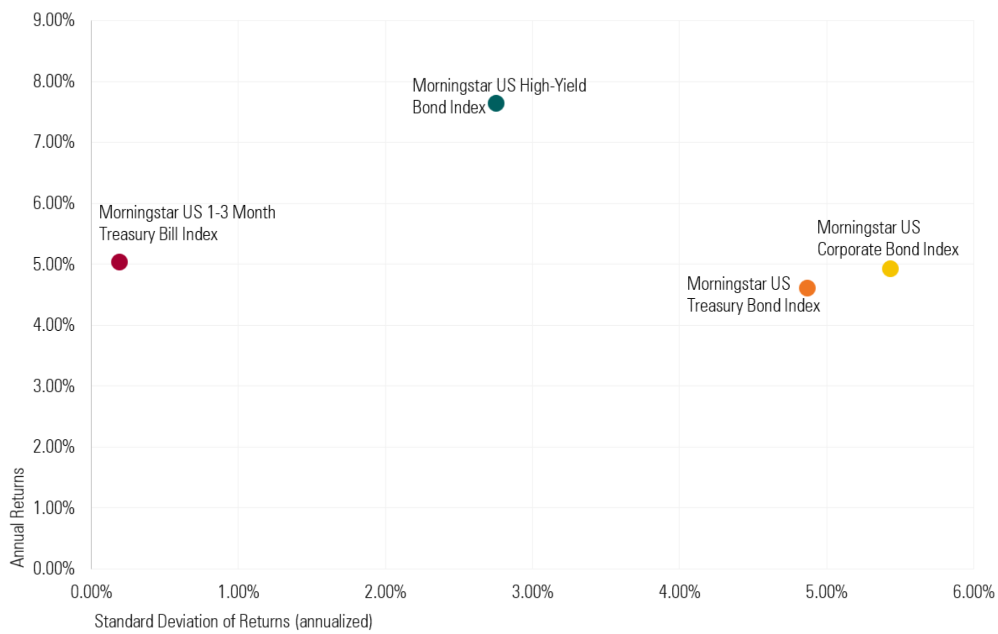
Exhibit 7 Q1 2025 Performance



Source: Morningstar. Data as of March 31, 2025.

Exhibit 8 highlights the comparative performance over the previous 12 months. The Morningstar US High-Yield Bond Index provided the best risk/return characteristics. The previous 12 months has, however, proved to be quite volatile for US Treasury bonds, as showcased by the higher risk and lower returns of the Morningstar US Treasury Bond Index. The Morningstar US Corporate Bond Index has outperformed the US Treasury Bond Index while exhibiting marginally higher volatilities.

Exhibit 8 12-Month Performance ending March 31, 2025

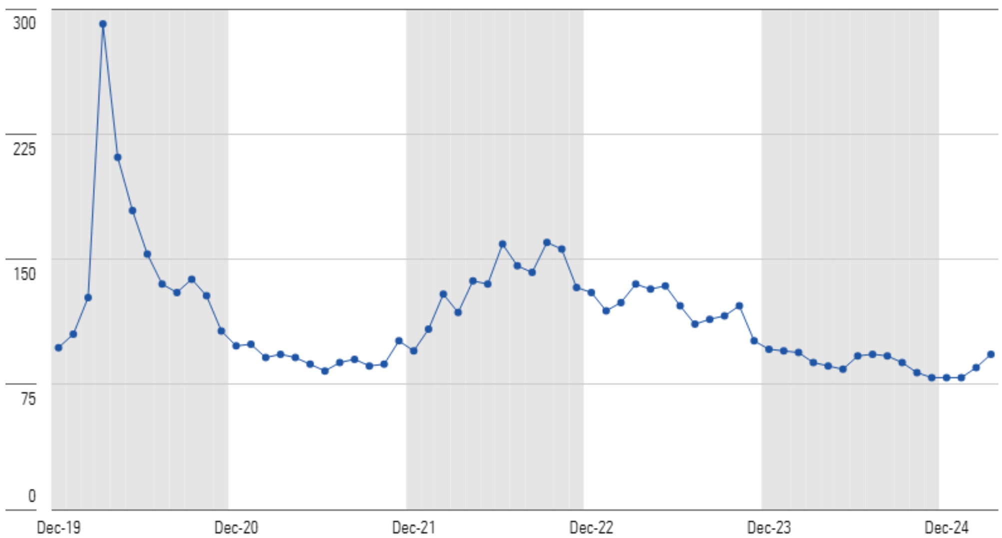


Source: Morningstar. Data as of March 31, 2025.

Spreads Remain Compressed, But Upward Momentum Builds

As seen in Exhibit 9, the spread between US corporate bonds and US Treasuries has been narrowing over the year. However, the first quarter of 2025 has seen an uptick in OAS. The spread has increased to 93 basis points in March 2025 from 80 basis points the previous quarter. While the OAS is still much lower than its elevated levels in 2022, the rise in recent months indicate a growing uncertainty in the economy due to the tariff conflicts.

Exhibit 9 OAS of Morningstar US Corporate Bond Index



Source: Morningstar. Data as of March 31, 2025.

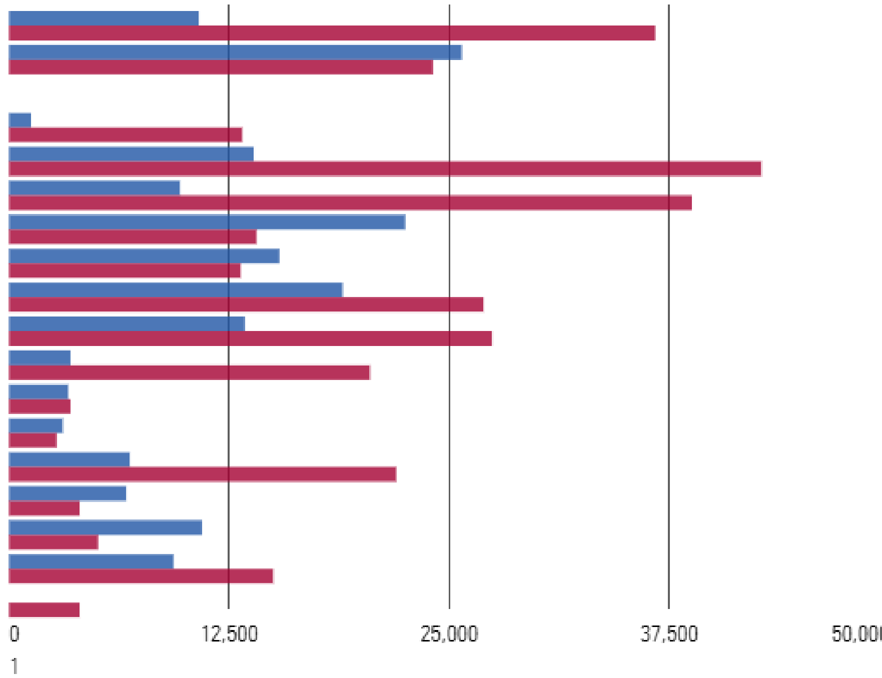
Sector Spotlight

Technology & Electronics Leads New Investment-Grade Issuances in Q1

According to Morningstar US Corporate Bond Index, the first quarter of 2025 witnessed new corporate issuances to the tune of $314 billion being added to the index as opposed to $175 billion in the fourth quarter of 2024. The highest issuances in the last quarter were in the technology and electronics sector, as seen in Exhibit 10. Mars Inc., Synopsis, and Rio Tinto Finance emerged as the leading corporate debt issuers during the period, raising $24 billion, $10 billion, and $8 billion, respectively.

Exhibit 10 New Issuances (USD million)

Sectors	Q4 2024	Q1 2025
Utility	10,770	36,700
Energy	25,713	24,080
Media	0	0
Transportation	1,250	13,248
Technology & Electronics	13,900	42,740
Consumer Goods	9,701	38,800
Insurance	22,500	14,050
Capital Goods	15,353	13,145
Healthcare	18,943	26,950
Financial Services	13,393	27,436
Basic Industry	3,500	20,500
Telecommunications	3,350	3,500
Real Estate	3,050	2,700
Automotive	6,850	22,000
Retail	6,650	4,000
Services	10,950	5,050
Banking	9,349	15,000
Leisure	0	4,000



Source: Morningstar. Data as of March 31, 2025.

As shown in Exhibit 11, the healthcare, technology, energy and utility sectors represent the largest exposures within the Morningstar US Corporate Bond Index, collectively accounting for approximately 40% of the index's total market value.

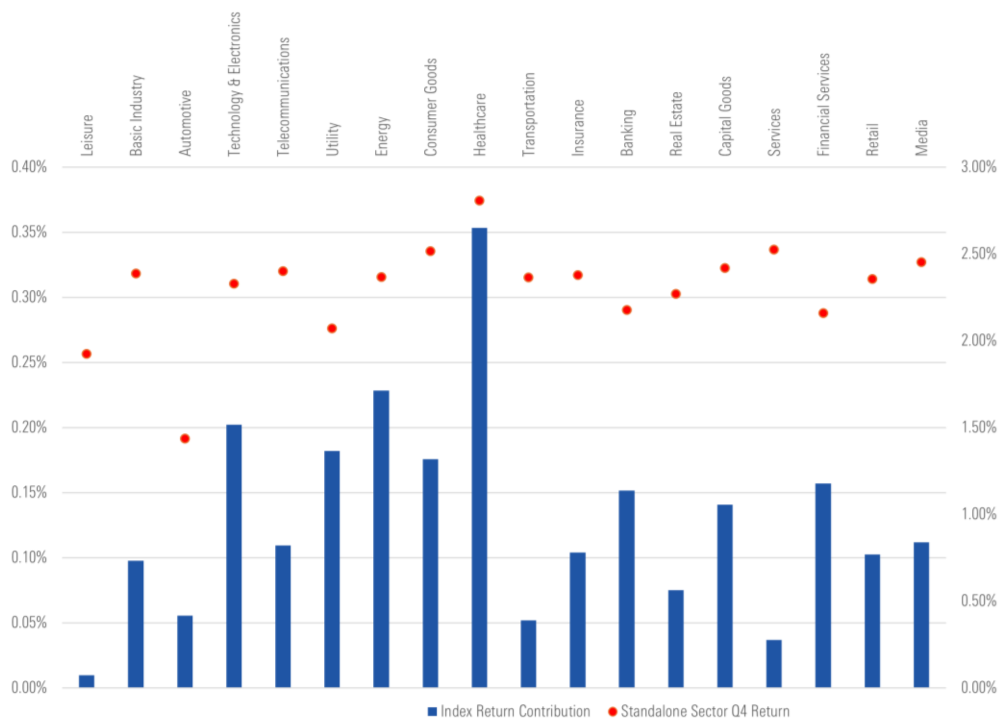
Exhibit 11 Morningstar US Corporate Bond Index Sector Distribution

Sector	%
Leisure	0.51
Basic Industry	4.09
Automotive	3.86
Technology & Electronics	8.68
Telecommunications	4.56
Utility	8.78
Energy	9.64
Consumer Goods	6.98
Healthcare	12.59
Transportation	2.20
Insurance	4.37
Banking	6.96
Real Estate	3.31
Capital Goods	5.81
Services	1.46
Financial Services	7.27
Retail	4.35
Media	4.56

Source: Morningstar. Data as of March 31, 2025.

The investment-grade corporate bonds represented by the Morningstar US Corporate Bond Index experienced a significant positive return in the first quarter, driven primarily by overperformance in the healthcare, energy, and technology sectors, as illustrated in Exhibit 12. On a stand-alone basis, healthcare, services, and consumer goods registered the highest returns.

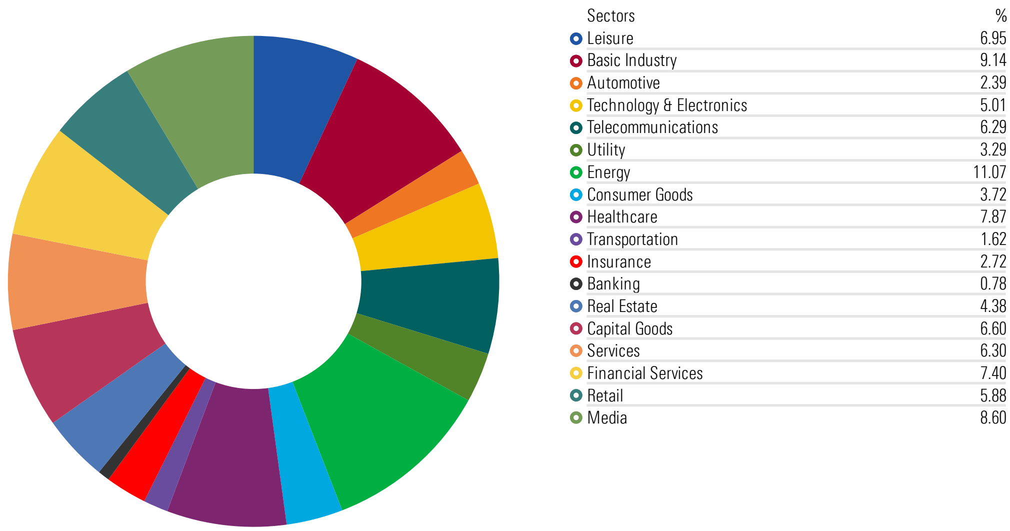
Exhibit 12 Morningstar US Corporate Bond Index Sector Return Contribution



Source: Morningstar. Data as of March 31, 2025.

As shown in Exhibit 13, the energy and basic industry sectors remain key components of the Morningstar US High-Yield Bond Index, together accounting for approximately 21% of the index's total market value.

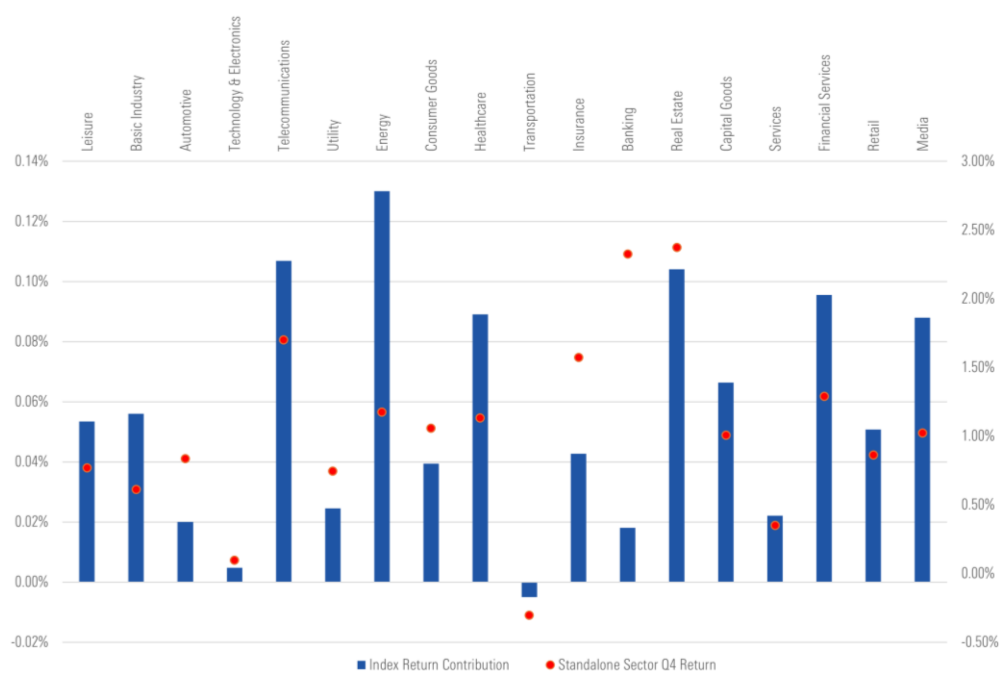
Exhibit 13 Morningstar US High-Yield Bond Index Sector Distribution



Source: Morningstar. Data as of March 31, 2025.

Energy, telecommunications, and real estate sectors were the major contributors to the Morningstar US High-Yield Bond Index returns in the first quarter of 2025 as seen in Exhibit 14. Transportation and technology underperformed on a stand-alone basis, while the real estate and banking sectors provided the best performance.

Exhibit 14 Morningstar US High-Yield Bond Index Sector Return Distribution



Source: Morningstar. Data as of March 31, 2025.

Credit Ratings Radar

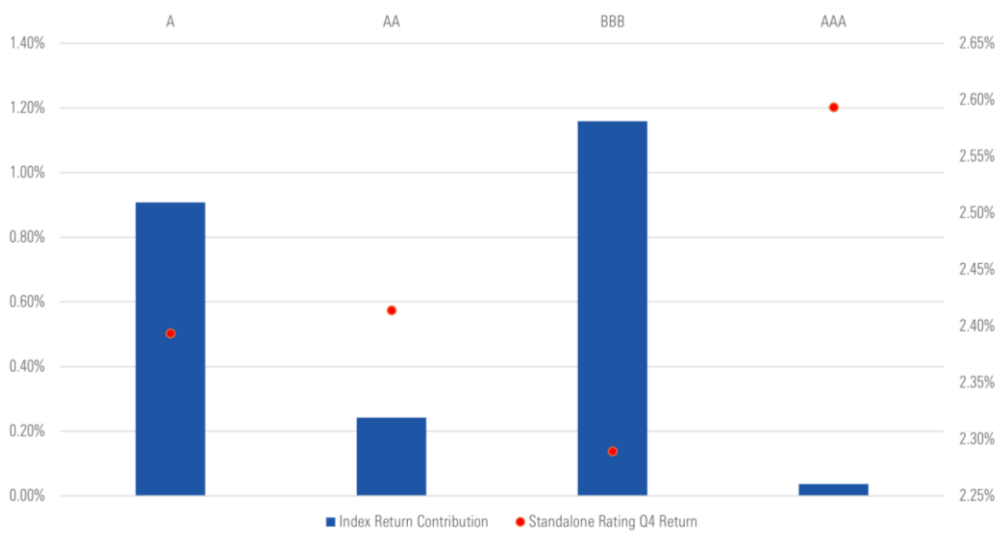
Per Exhibit 15, the Morningstar US Corporate Bond Index is primarily constituted of BBB and A rated corporate bonds, and hence, these two sectors have the highest contribution to the index returns. As can be seen from Exhibit 16, on a stand-alone basis, AAA and AA rated corporate bonds witnessed the highest returns.

Exhibit 15 Morningstar US Corporate Bond Index Rating Distribution

Rating	%
A	37.94
AA	10.01
BBB	50.64
AAA	1.40

Source: Morningstar. Data as of March 31, 2025.

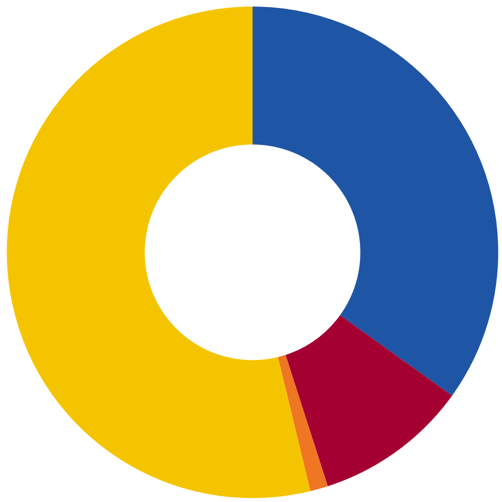
Exhibit 16 Morningstar US Corporate Bond Index Rating Return Contribution



Source: Morningstar. Data as of March 31, 2025.

The Morningstar US High-Yield Bond Index is primarily constituted of BB and B rated corporate bonds and therefore contribute the most to the index returns. As can be seen from Exhibit 18, the lower-rated CCC and CC bonds had a lackluster quarter.

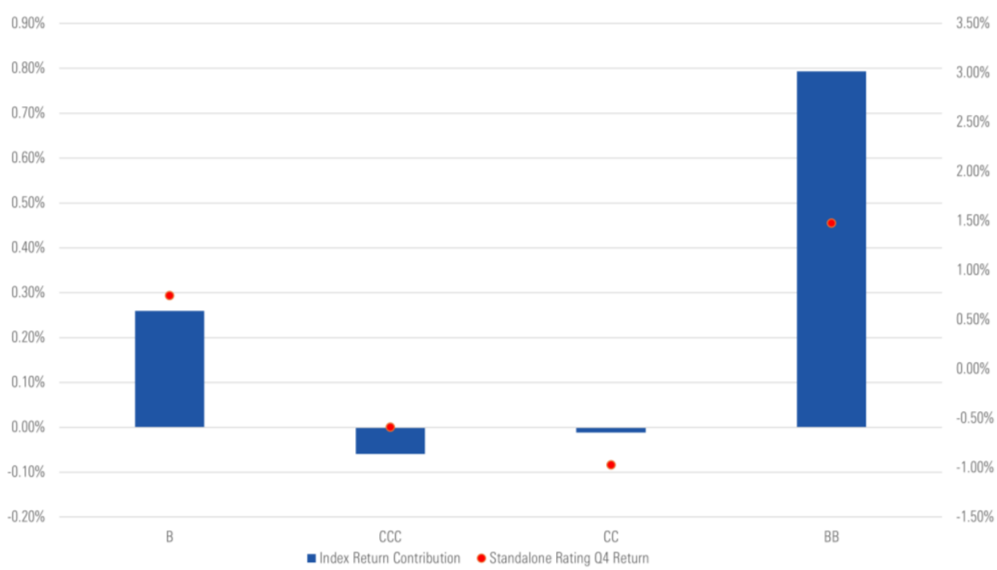
Exhibit 17 Morningstar US High-Yield Bond Index Rating Distribution



Rating	%
B	34.91
CCC	10.13
CC	1.17
BB	53.79

Source: Morningstar. Data as of March 31, 2025.

Exhibit 18 Morningstar US High-Yield Bond Index Rating Return Contribution



Source: Morningstar. Data as of March 31, 2025.

About Morningstar Indexes

Morningstar Indexes was built to keep up with the evolving needs of investors—and to be a leading-edge advocate for them. Our rich heritage as a transparent, investor-focused leader in data and research uniquely equips us to support individuals, institutions, wealth managers and advisors in navigating investment opportunities across major asset classes, styles and strategies. From traditional benchmarks and unique IP-driven indexes, to index design, calculation and distribution services, our solutions span an investment landscape as diverse as investors themselves.

Please visit indexes.morningstar.com for more information.

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