Morningstar US Fixed-Income Monitor: October–December 2024

Slower rate cuts by Fed drive negative bond market performance.

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Contents

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Executive Summary

The Morningstar US Fixed-Income Monitor 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 fourth quarter of 2024, the Federal Reserve continued its rate-cutting trajectory, implementing 25 basis points reductions in both November and December. These cuts were more modest compared with the 50 basis points reduction during the September Federal Open Market Committee, or FOMC, meeting, reflecting a measured approach. The smaller adjustments indicated the Fed's strategy to lower rates gradually, influenced by low but persistent inflation and economic activity that continued to expand at a solid pace.
- US Personal Consumption Expenditure, or PCE, inflation was still above the 2% target set by the Fed.
- The fourth quarter witnessed lower nonfarm payroll, or NFP, employment, and a marginally higher unemployment rate, indicating a cooling labor market.
- The slower-than-expected pace of monetary easing signaled by the Fed caused the longer maturity rates to increase by 60-70 basis points. The lower maturity rates saw a decline to the tune of 20-30 basis points.
- The Morningstar US 1-3 Month Treasury Bill Index provided the best risk-return characteristics over the fourth quarter of 2024. This was followed by the Morningstar US High-Yield Bond Index. The Morningstar US Treasury Bond Index and the Morningstar US Corporate Bond Index experienced negative returns over the last three months of 2024.
- The option-adjusted spread, or OAS, for US corporate bonds exhibited a declining trend, highlighting an increase in investor confidence in the current economic outlook.
- In the investment-grade corporate bond space, all sectors exhibited negative returns, with healthcare, energy, and utility sectors contributing the most to the negative fourth-quarter returns.
- In the high-yield corporate bond space, real estate and healthcare sectors contributed negatively, while media and telecommunications sectors had a positive impact on the overall fourth-quarter returns.
- Top-rated investment-grade corporate bonds witnessed a negative return of 4.8%. Among high-yield corporate bonds, lower-rated CCC and CC bonds provided high returns on the back of improved confidence in the economic outlook.

Market Update

Federal Reserve Continues the Rate-Cut Cycle Albeit With Lower 25 Basis Points Cut

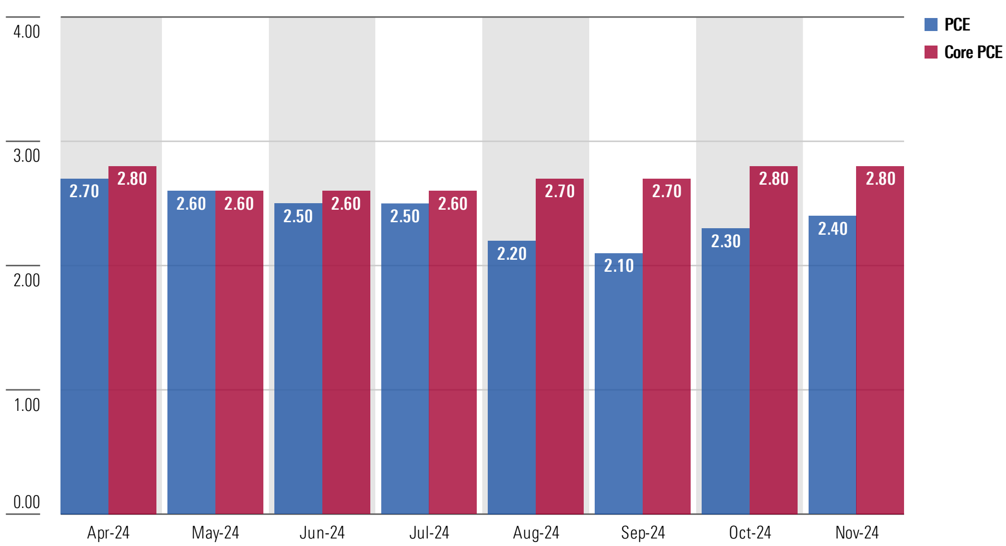
The Fed lowered the target federal-funds rate by 25 basis points in both the November and December 2024 FOMC meetings, bringing the target rate to 4.25% to 4.50%. With inflation remaining sticky, the Fed decided on a milder path for lowering interest rates compared with the 50 basis points cut in the September FOMC meeting.

The third quarter of 2024 recorded the highest real GDP growth rate of the year, achieving a robust 3.10% growth.[1] This marked an upward revision from earlier forecasts, reflecting a stronger-than-expected economic activity. The projection for the annual real GDP growth in 2024 was adjusted to 2.5%, an improvement from the 2.0% estimate in September 2024. Similarly, growth estimates for 2025 were revised upward by 10 basis points to 2.1%, signaling optimism about sustained economic momentum.[2] The stronger-than-expected economic data releases and inflation staying above the target 2% prompted the Fed to signal a slower and measured pace of monetary easing than previously anticipated.

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

US PCE inflation was above the Fed's target of 2%. October and November 2024 witnessed a marginal increase in inflation in both the PCE and Core PCE index. With inflation remaining stubbornly persistent above the target of 2%, the Fed signaled its intention to ease the pace of lowering interest rates.

Exhibit 1 US PCE and Core PCE Inflation Data YoY



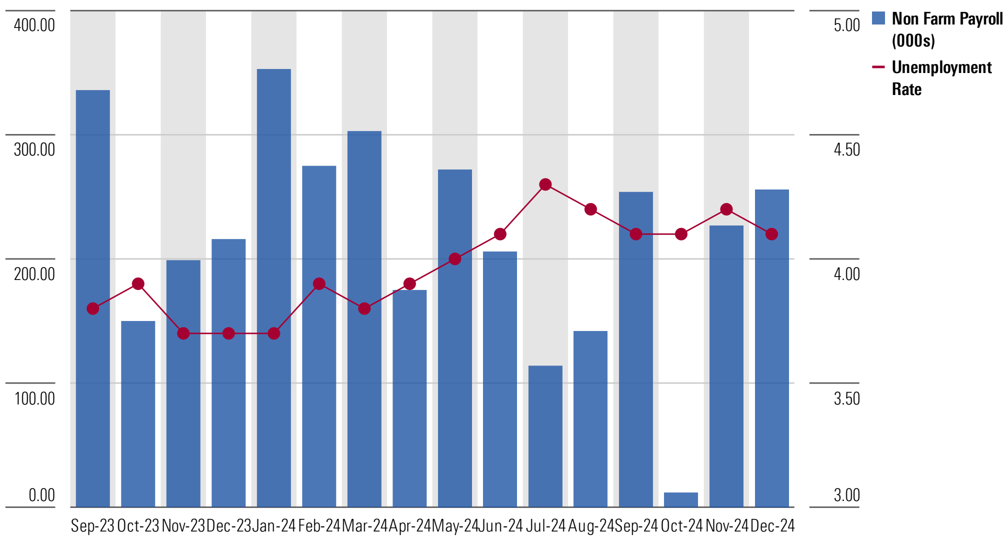
Source: Bureau of Economic Analysis. Data as of Dec. 31, 2024.

1 Data source for GDP growth rates: Bureau of Economic Analysis, US Department of Commerce, released on Dec. 19, 2024.
2 Real GDP growth rates projections data source: FOMC Projection Material, Federal Reserve.

Jobs Data Update

US NFP employment remained stagnant in October 2024, with an addition of 12,000 new jobs compared with 254,000 in the month of September. November and December saw a significant increase in nonfarm payroll employment, with an addition of 227,000 and 256,000 new jobs, respectively. Unemployment remained unchanged at 4.10% in December. The latest NFP data indicates a stronger-than-expected economic performance, providing the Fed with greater incentive to slow down the pace of its rate-cutting cycle.

Exhibit 2 US Jobs Data

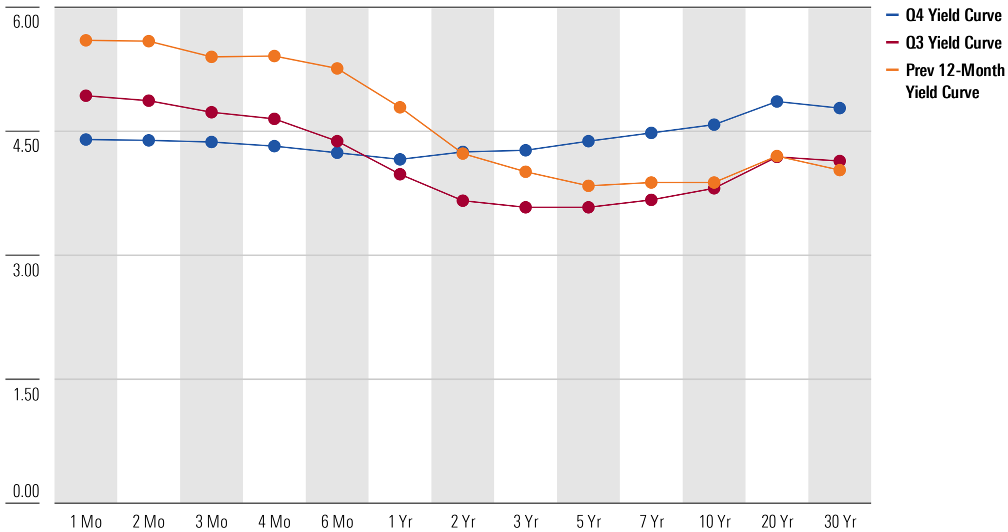


Source: Bureau of Labor Statistics. Data as of Jan. 10, 2025.

US Yield Curve and Interest-Rate Movement Summary

During the fourth quarter of 2024, the Treasury yield curve underwent a notable shift, transitioning from its previous quarter's inverted structure to a flat configuration across tenors. This marked a significant steepening, reflecting a convergence of short- and long-term yields.

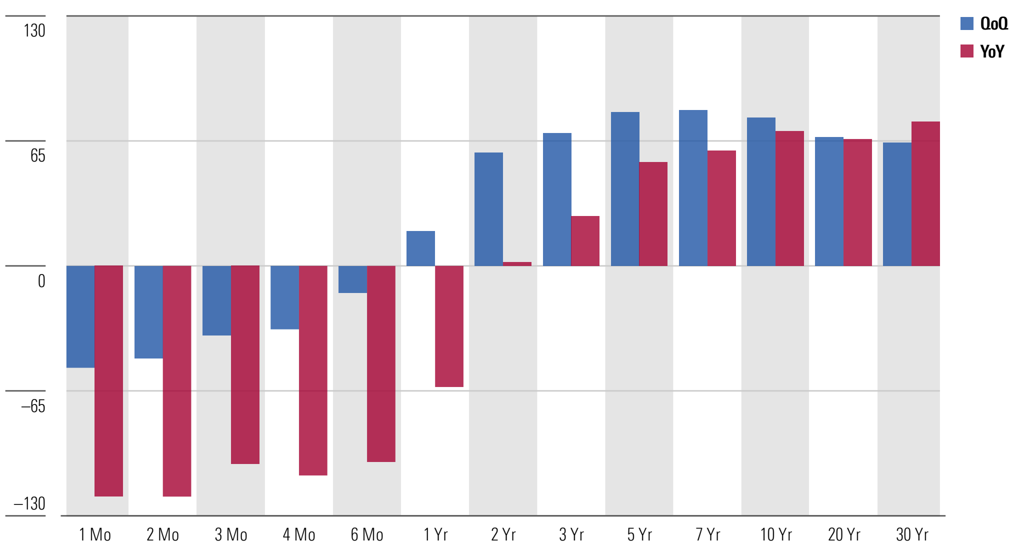
Exhibit 3 Yield Curve



Source: US Department of Treasury. Data as of Dec. 31, 2024.

As can be seen from Exhibit 4, the fourth quarter witnessed a significant steepening in US term rates. While the lower-maturity Treasury rates saw a decline of 20-30 basis points, the longer-maturity rates saw a significant jump of 60-70 basis points. The one-year rate remained practically flat, with an increase of only 18 basis points. The Fed's decision to signal a much more gradual pace of rate cuts than previously expected led to the rise in longer-maturity yields.

Exhibit 4 Change in US Term Rates (bps)

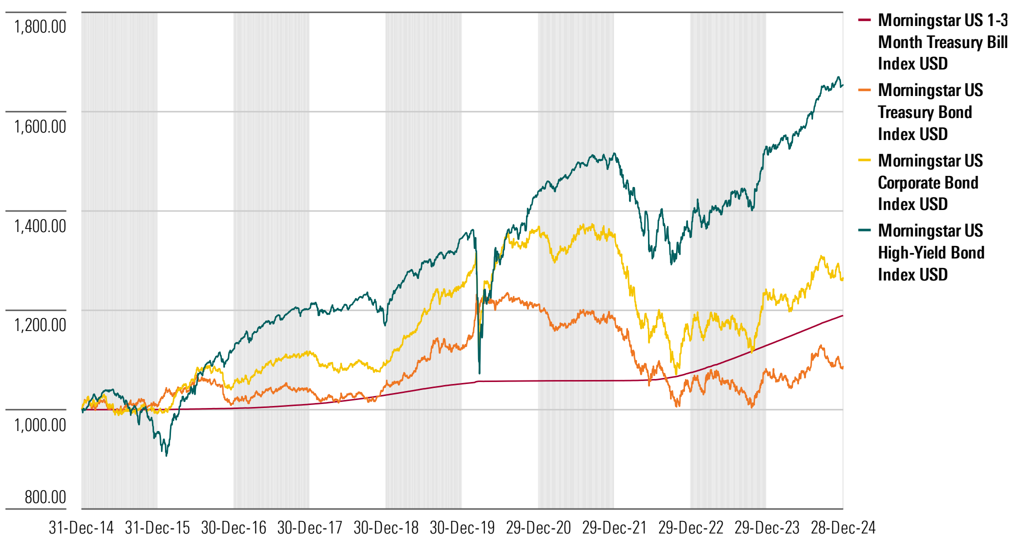


Source: US Department of Treasury. Data as of Dec. 31, 2024.

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 much higher risk, as can be seen in Exhibit 6.

Exhibit 5 Performance Chart of Morningstar US Fixed-Income Indexes



Source: Morningstar. Data as of Dec. 31, 2024.

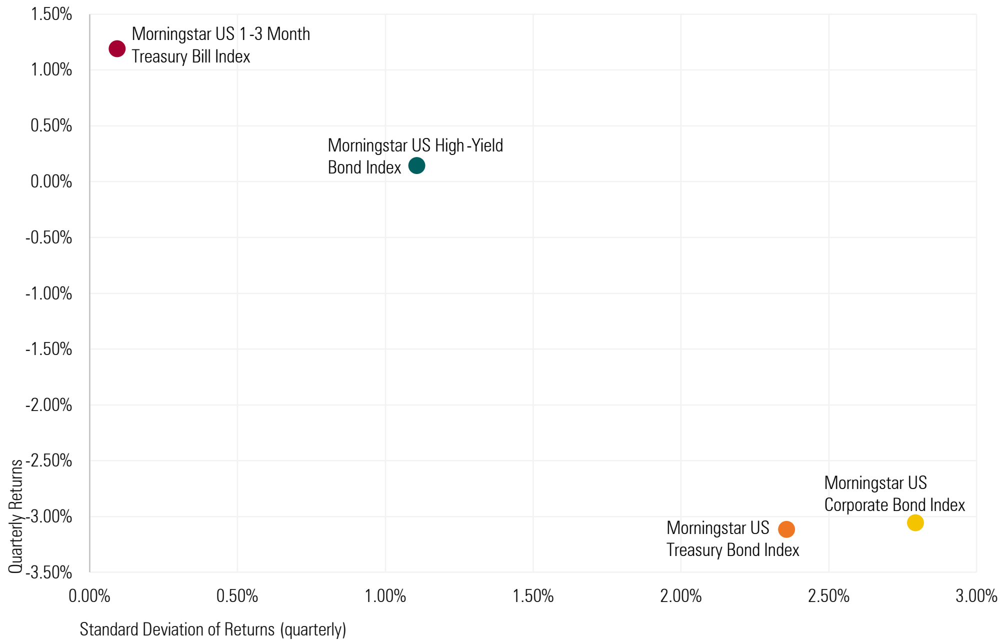
Exhibit 6 Risk-Return Characteristics

Parameters	Morningstar US 1-3 Month Treasury Bill Index USD	Morningstar US Treasury Bond Index USD	Morningstar US Corporate Bond Index USD	Morningstar US High-Yield Bond Index USD
Start Date	2014-09-30	2014-09-30	2014-09-30	2014-09-30
End Date	2024-09-30	2024-09-30	2024-09-30	2024-09-30
Return (%)	1.75	0.83	2.36	5.17
Risk (%)	0.56	4.90	6.92	7.63

Source: Morningstar. Data as of Dec. 31, 2024.

The comparative risk-return performance of the Morningstar Indexes over the last quarter is shown in Exhibit 7. The Morningstar US High-Yield Bond Index has outperformed the Morningstar US Treasury Bond Index and the Morningstar US Corporate Bond Index in terms of both risk and return over the last quarter. The Morningstar US Corporate Bond Index and the Morningstar US Treasury index saw significant declines on account of rising yields in longer maturities. The Morningstar US 1-3 Month Treasury Bill Index provided the best performance in the fourth quarter, supported by the two rate cuts in November and December.

Exhibit 7 Q4 Performance



Source: Morningstar. Data as of Dec. 31, 2024

Exhibit 8 highlights the comparative performance on a year-to-date basis. The Morningstar US High-Yield Bond Index once again provided the best risk-return characteristics. This year 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.

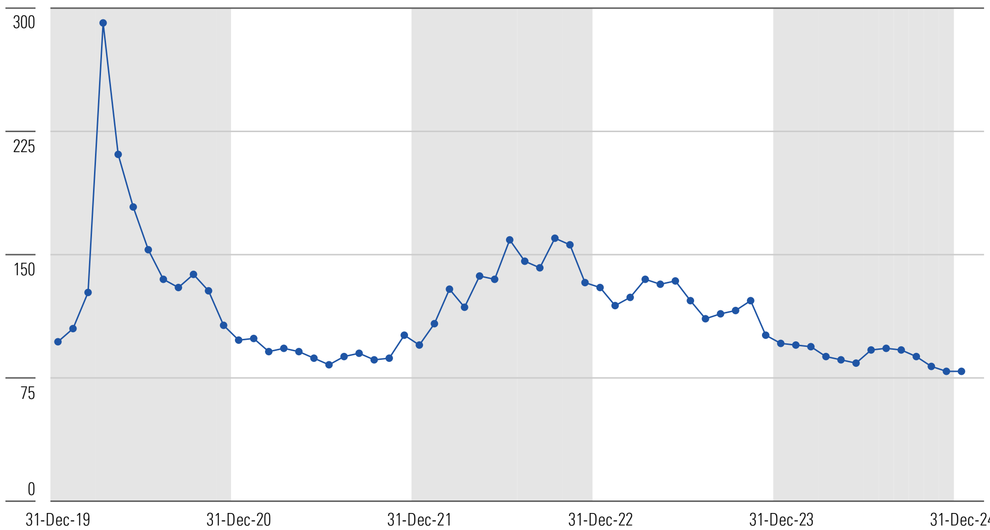
Exhibit 8 YTD Performance

Source: Morningstar. Data as of Dec. 31, 2024.

Narrowing Spreads Indicating Improved Investor Sentiment

As seen in Exhibit 9, the spread between US corporate bonds and US Treasuries has been narrowing over the year, highlighting improved economic conditions and investors' sentiment. In the fourth quarter of 2024, the OAS narrowed to 80 basis points, down from 91 basis points in the previous quarter. This decline is part of a broader trend, as the OAS averaged approximately 118 basis points in 2023 but significantly dropped to an average of 88 basis points in 2024. This marked reduction highlights a substantial tightening in credit spreads over the year, reflecting improved market sentiment and potentially lower perceived credit risk.

Exhibit 9 OAS of Morningstar US Corporate Bond Index



Source: Morningstar. Data as of Dec. 31, 2024.

Sector Spotlight

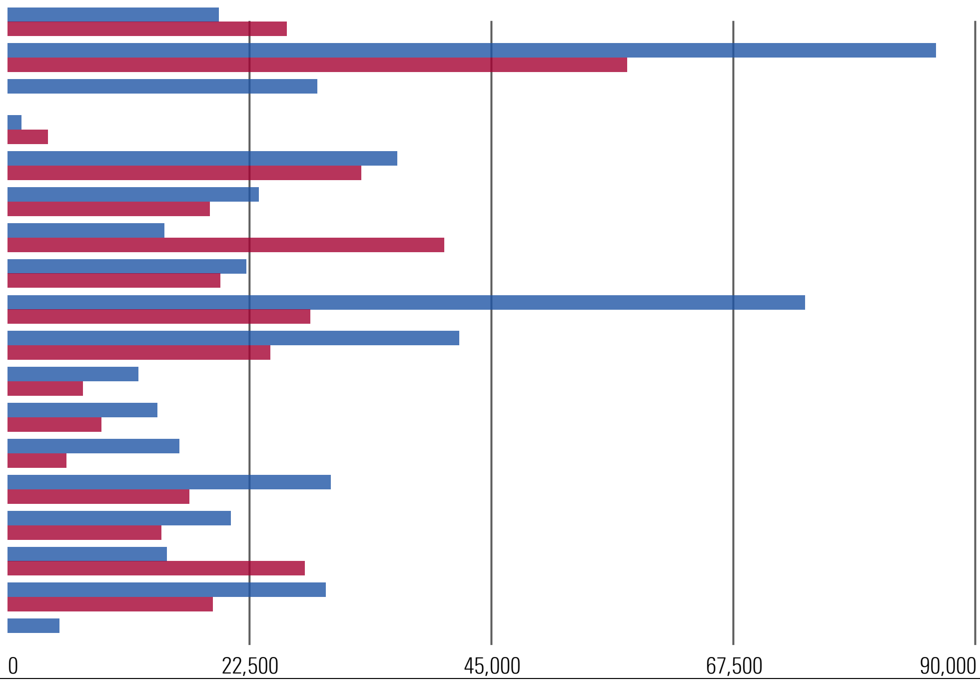
Energy Leads New Investment-Grade Issuances in Q4

According to Morningstar US Corporate Bond Index, the fourth quarter of 2024 witnessed new corporate issuances to the tune of $351 billion being added to the index as opposed to $490 billion in the third quarter. The highest issuances in the last quarter were in the energy sector, as seen in Exhibit 10.

Shell Finance, Accenture Capital, and Broadcom emerged as the leading corporate debt issuers during the period, raising $34.3 billion, $15 billion, and $15 billion, respectively.

Exhibit 10 Sectorwise New Issuances (USD million)

Sectors	Q3	Q4
Utility	19,625	25,960
Energy	86,325	57,629
Media	28,800	0
Transportation	1,300	3,750
Technology & Electronics	36,250	32,900
Consumer Goods	23,350	18,801
Insurance	14,550	40,600
Capital Goods	22,200	19,790
Healthcare	74,150	28,150
Financial Services	41,991	24,443
Basic Industry	12,166	7,000
Telecommunications	13,919	8,700
Real Estate	15,975	5,450
Automotive	30,050	16,900
Retail	20,750	14,300
Services	14,799	27,650
Banking	29,600	19,099
Leisure	4,800	0



Source: Morningstar. Data as of Dec. 31, 2024.

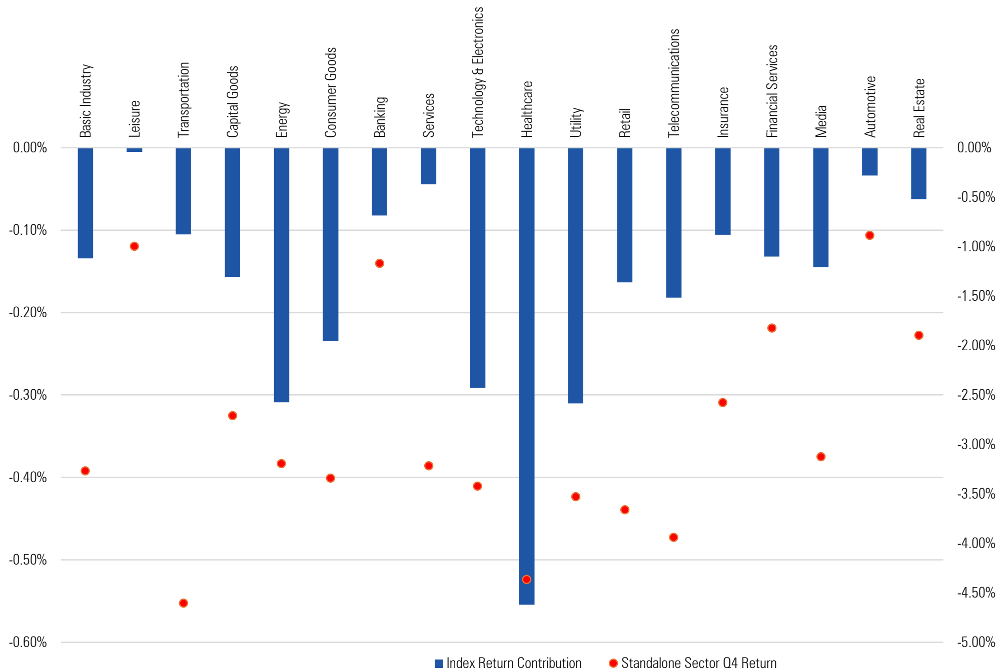
As discussed earlier, the Morningstar US Corporate Bond Index experienced a decline in the fourth quarter, driven primarily by underperformance in the healthcare, energy, and utility sectors, as illustrated in Exhibits 11 and 12. On a stand-alone basis, transportation and healthcare registered the steepest declines.

Exhibit 11 Morningstar US Corporate Bond Index Sectoral Distribution

Sectors	%
Basic Industry	4.11
Leisure	0.50
Transportation	2.29
Capital Goods	5.79
Energy	9.68
Consumer Goods	7.02
Banking	7.03
Services	1.38
Technology & Electronics	8.52
Healthcare	12.70
Utility	8.79
Retail	4.47
Telecommunications	4.63
Insurance	4.10
Financial Services	7.24
Media	4.64
Automotive	3.83
Real Estate	3.29

Source: Morningstar. Data as of Dec. 31, 2024.

Exhibit 12 Morningstar US Corporate Bond Index Sectoralwise Return Contribution



Source: Morningstar. Data as of Dec. 31, 2024.

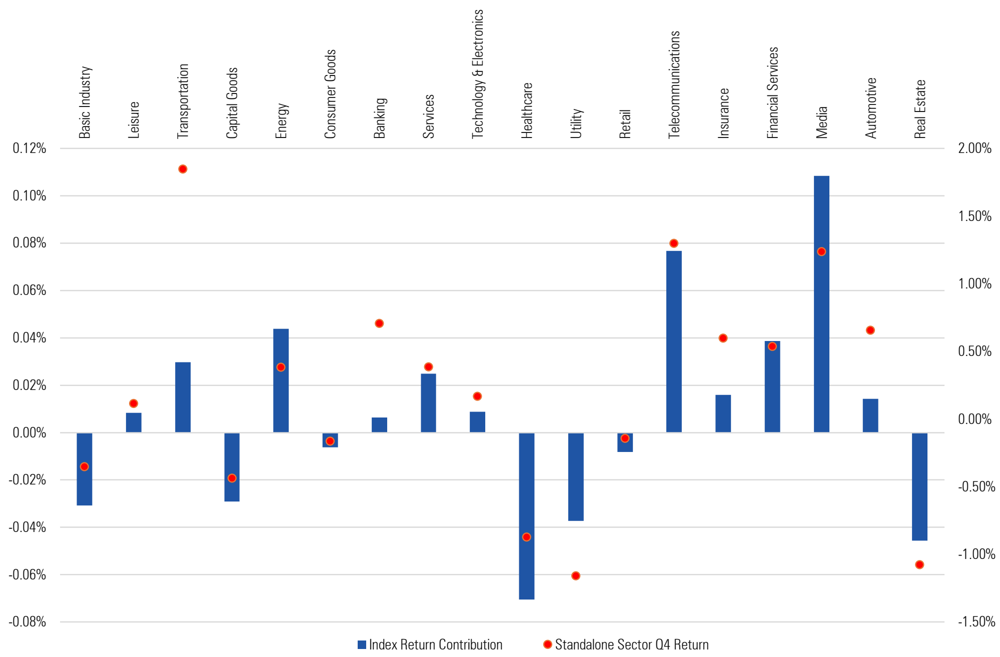
In the high-yield spectrum, media and telecommunications sectors were the major contributors to the Morningstar US High-Yield Bond Index returns in the fourth quarter of 2024. Utility, real estate, and healthcare sectors underperformed on stand-alone basis, while the transportation sector provided the best performance.

Exhibit 13 Morningstar US High-Yield Bond Index Sectoral Distribution

Sectors	%
Basic Industry	8.82
Leisure	7.08
Transportation	1.61
Capital Goods	6.70
Energy	11.38
Consumer Goods	3.88
Banking	0.89
Services	6.43
Technology & Electronics	5.17
Healthcare	8.08
Utility	3.22
Retail	5.82
Telecommunications	5.91
Insurance	2.67
Financial Services	7.19
Media	8.74
Automotive	2.18
Real Estate	4.25

Source: Morningstar. Data as of Dec. 31, 2024.

Exhibit 14 Morningstar US Corporate Bond Index Sectoralwise Return Contribution

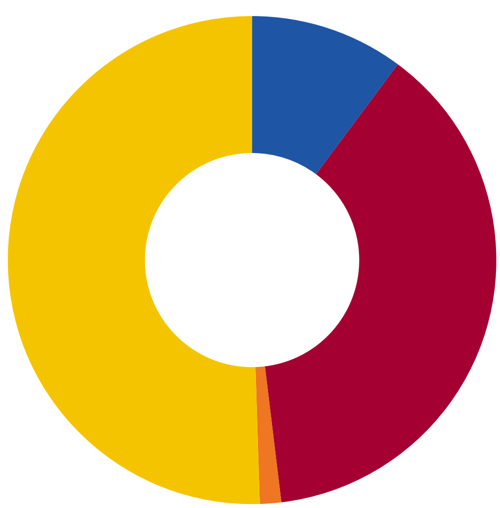


Source: Morningstar. Data as of Dec. 31, 2024.

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 rated corporate bonds witnessed significant decline.

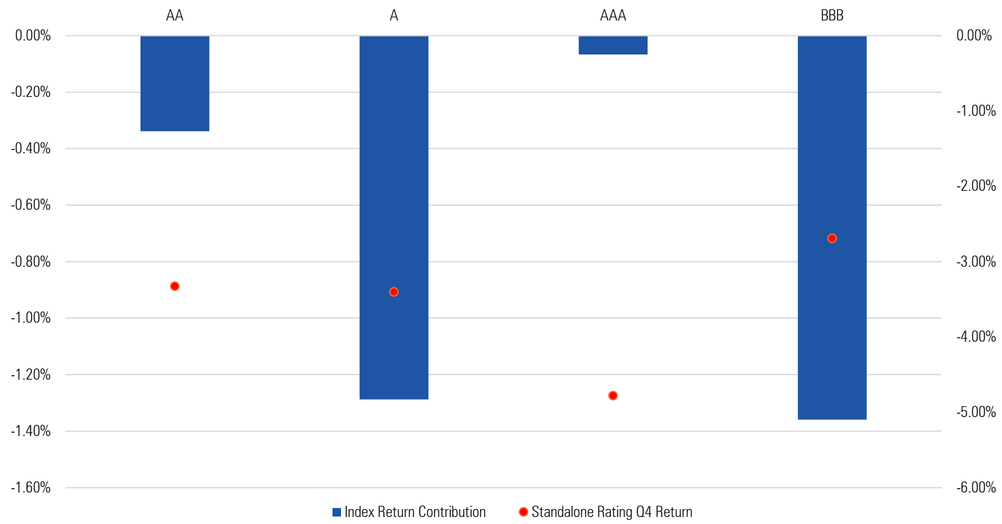
Exhibit 15 Morningstar US Corporate Bond Index Rating Distribution



Rating	%
AA	10.18
A	37.90
AAA	1.41
BBB	50.51

Source: Morningstar. Data as of Dec. 31, 2024.

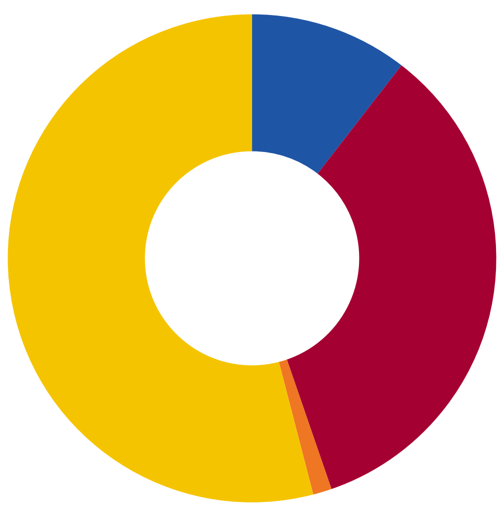
Exhibit 16 Morningstar US Corporate Bond Index Ratingwise Return Contribution



Source: Morningstar. Data as of Dec. 31, 2024.

The Morningstar US High-Yield Bond Index is primarily constituted of BB and B rated corporate bonds. While B rated bonds provided a positive contribution to index returns, BB rated bonds negated those returns. As can be seen from Exhibit 18, the lower-rated CCC and CC corporate bonds had a stellar fourth quarter.

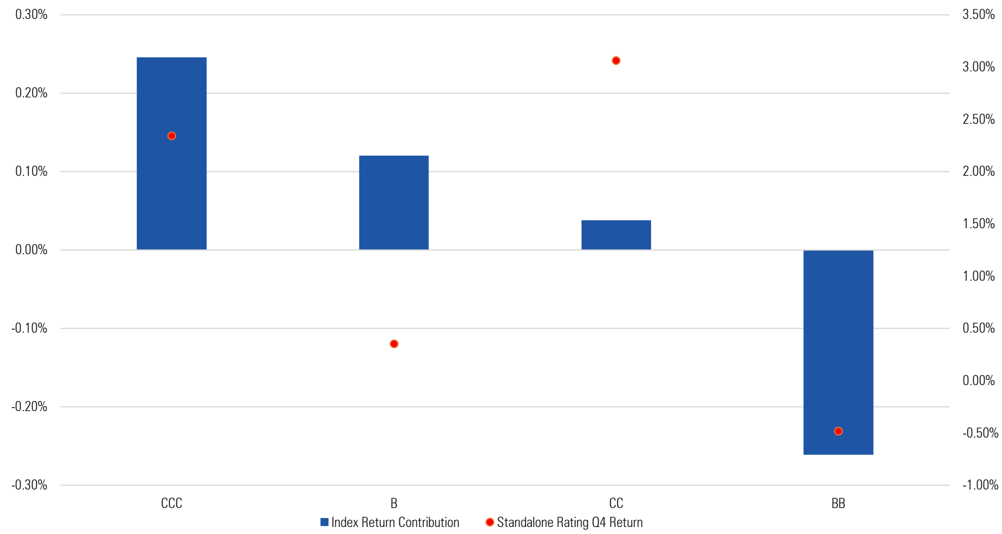
Exhibit 17 Morningstar US High-Yield Bond Index Rating Distribution



Rating	%
CCC	10.48
B	34.25
CC	1.24
BB	54.04

Source: Morningstar. Data as of Dec. 31, 2024.

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



Source: Morningstar. Data as of Dec. 31, 2024.

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.

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