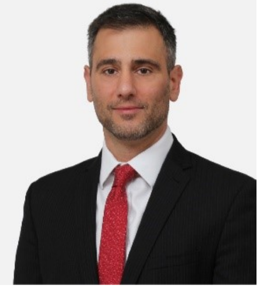
Richard Bernstein Advisors

RBA Fixed Income Insights



February 11, 2025

2022-lite

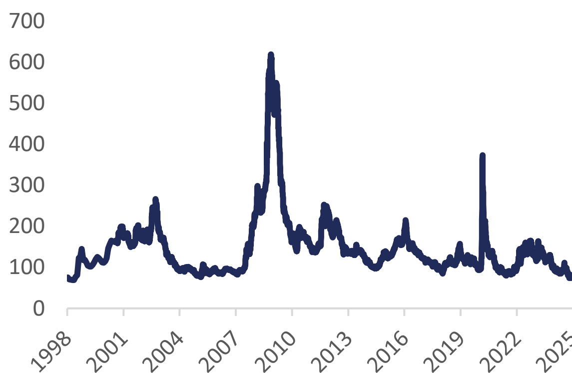
As we begin 2025, there are striking similarities to the start of 2022, though perhaps not as extreme. Consider the following parallels:

2022	2025
Inflation soars near double digits	Inflation stays above the Fed's target
Fed hikes 75bp per meeting	Fed cuts less than market expectations
Profit recession later in the year	Profit growth decelerates later in the year
Tight spreads and lofty mega cap tech valuations	Tight spreads and lofty mega cap tech valuations

We imagine a year where at times the market may look and feel like a "lite" version of 2022 – a year in which rising interest rates and tight credit spreads had a severely negative impact on bond returns – presenting serious challenges for fixed income investors. For this reason, we believe starting the year with a cautious and flexible approach to fixed income is prudent.

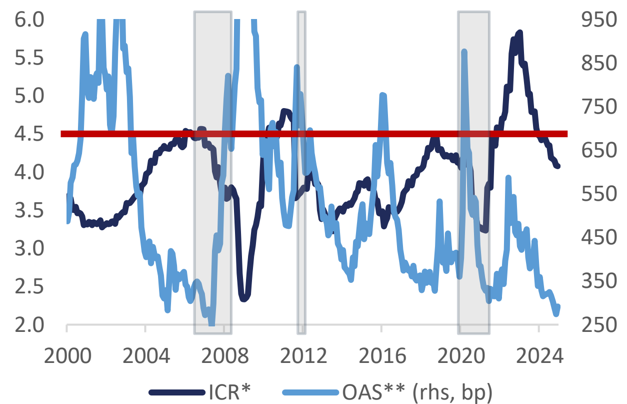
With corporate bond spreads hovering near the tightest in history (Chart 1), and high yield interest coverage ratios approaching what has historically been a danger zone of 4.5x (Chart 2), we're opting to capture credit risk in the more attractively priced CLO market. Here, the structured nature of CLOs provides protection, while the floating rate component helps mitigate interest rate risk.

Chart 1: US IG Corporate bond spreads (bp) are hovering at 27y lows, leaving little room for upside



Source: Bloomberg

Chart 2: When interest coverage falls below 4.5x, US HY Corporate bond spreads tend to widen… but not in 2024



Source: BofA Merrill Lynch Global Research, RBA

With Treasury yields likely to be supported by the backdrop of policy uncertainty, inflation pressures, government debt concerns, and moderate-to-strong economic growth, we maintain an underweight in duration. Like 2022, we expect that the transition from Act 1 to Act 2 could see a period of rising interest rates and the continuation of positive correlation between Treasuries and equities. This

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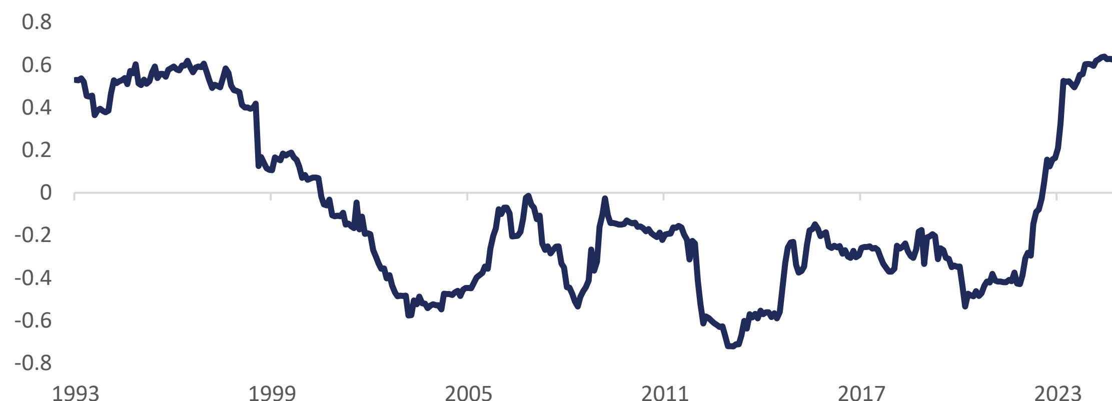
dynamic makes the front of the yield curve particularly appealing, where moderate sensitivity to interest rate movements offers relative safety until we have more clarity on the direction of growth and inflation.

Chart 3: Treasury returns have never been more correlated with equity returns (1m, rolling 3y correlation)



Source: Bloomberg, RBA

At the same time, relative value opportunities in the agency mortgage-backed securities market provide a chance to generate alpha through active ETF management.

History offers lessons for 2025:

Every year brings moments of opportunity in fixed income. History reminds us of the following:

- 2022: The opportunity was in underweighting duration and avoiding credit risk
- 2023: Preferred securities became attractive following the collapse of SVB, with additional opportunities emerging in October's rate sell-off.
- 2024: Fewer opportunities arose, but September offered one of the most compelling setups since 2022 to underweight duration.

We believe 2025 will be no different. A "2022-lite" scenario is likely to create meaningful fixed-income opportunities as volatility persists and we usher in Act 2. Whether it's from corporate bond spread widening or a well-timed move into Treasuries, we expect several chances to deliver value this year.

In the meantime, we remain focused on staying liquid, maintaining high-quality positions, and avoiding asymmetric (to the downside) and overpriced bonds.

Michael Contopoulos
Director of Fixed Income

*Interest Coverage Ratio (ICR): Measures a company's ability to pay interest on its debt, calculated as EBIT (earnings before interest and taxes) divided by interest expense—higher values indicate stronger financial health.
**Option-Adjusted Spread (OAS): The yield spread between a bond and risk-free Treasuries, adjusted for embedded options (e.g., call or put features), reflecting the true compensation for credit and liquidity risks.

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