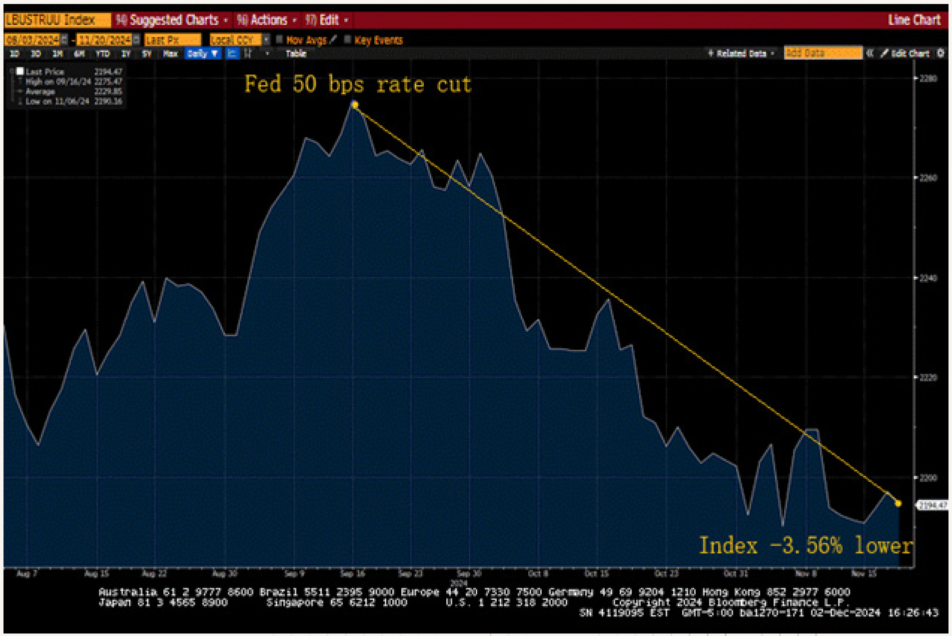
SanJac Alpha

SANJAC ALPHA'S QUICK TAKE

The Fed and Rates

Two months ago, following the first Fed rate cut of 50 basis points (bps)[1], our belief was that investors should avoid the long end of the rate curve. Our reasoning was based on a substantial likelihood that the bond market would not agree with the Fed that both inflation was subsiding and the economy was struggling. This caution proved prescient, with an 80 bps surge in the 10-year Treasury yield contributing significantly to the Bloomberg US Aggregate Index's[2] decline of over 3% since the initial rate cut in mid-September.



The figure charts the time-frame from Aug 3rd, 2024 to Nov 20, 2024 (x-axis) and the price of the LBUSTRUU index over that time-frame (y-axis) with the goldenrod line indicating the decrease in price by approximately 3.56%. The purpose is to show the performance of the LBUSTRUU index from the point of the Fed rate cut of 50bps through November 20th, 2024.

The performance data quoted represents past performance and is no guarantee of future results. Indexes are not managed, and one *cannot invest* directly into an *index.*

Bloomberg USAgg Index (Ticker: LBUSTRUU) Performance - Source Bloomberg

UNDERSTANDING THE MARKET CYCLE

The Fed cut rates by 50bps at the September meeting under uncommon circumstances: First, the meeting was within 60 days of a presidential election and the Fed usually avoids a policy change proximate to such an event. Second, the Fed futures markets were divided as to the Fed's intentions as late as the day of the Fed meeting. This underscores the importance of the communication that accompanies the Fed's actions from here. The November meeting resulted in another rate cut of 25bps and futures markets reflect a roughly 75% probability of a 25bps rate cut in December. All eyes will be on the Fed at the December 18th meeting as to whether the market can continue to price in further rate cuts or if this is truly a mid-cycle adjustment in pursuit of a neutral rate.

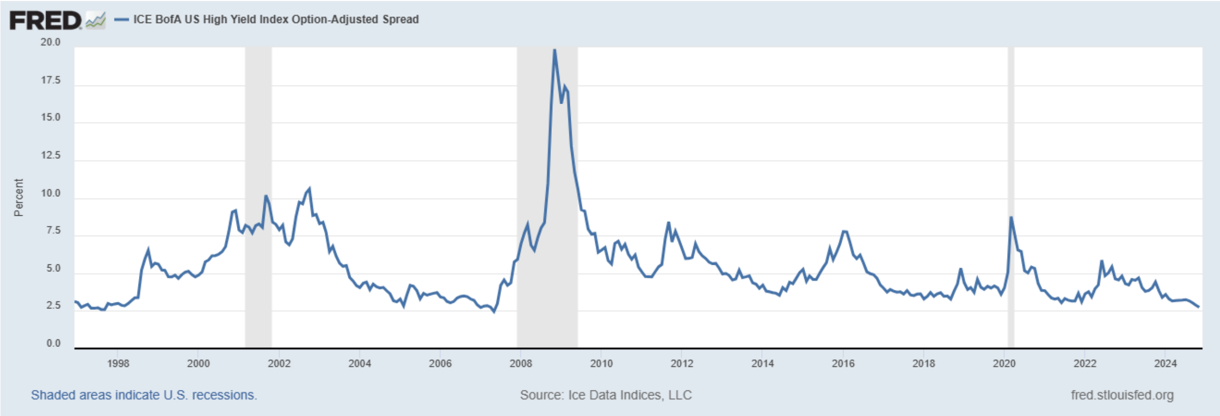
We believe the Fed's restraint earlier this year—avoiding premature or aggressive rate cuts—was prudent. By maintaining a reactive stance, the Fed has aligned its policy with evolving economic data, continuing its recalibration toward a neutral stance.

Interestingly, the market now exhibits characteristics more typical of a mid-cycle phase rather than late-cycle behavior. The Fed itself characterizes these adjustments as mid-cycle recalibrations, not recession-driven easing.

KEY OBSERVATIONS AND ACTIONS

Credit Spreads

Credit spreads[3] in both high-yield and investment-grade bonds are at their tightest levels since the late 1990s. This signals robust investor confidence in corporate credit across the risk spectrum. Unlike frothy metrics like forward P/E ratios[4], credit spreads provide a clearer, less skewed risk assessment. However, the 150 bps spread in mortgage-backed securities (MBS) represents a potential opportunity to achieve additional yield while staying within government agency credit.



High Yield Credit Spreads 1996-Current – Source St Louis Fed

Our action: In this environment we encourage valuation discipline, tactically favoring underpriced areas of the market such as mortgages and mREITs over pricier corporate bonds.

Shape of the Yield Curve

Despite Fed rate cuts in September and November totaling 75 bps, the yield curve has not steepened significantly. The 2/10 curve briefly widened to 20 bps but has since flattened to zero. This parallel movement reflects that sticky inflation is now fully priced into the market. Notably, disinflationary surprises could benefit bonds, although baseline inflation in the 2.5-3% range appears to be the new normal.

Our action: We find the duration[6] trade increasingly more attractive. Yields on short-to-intermediate Treasuries, such as 3- and 5-year notes, hover around 4.2%. These yields are now much more attractive than they were two months ago, and also allow for price appreciation in case rates reverse lower unexpectedly.

IMPORTANT INFORMATION

These market observations are the views of SanJac Alpha as of November 27, 2024, and we undertake no obligation to update these observations. Our views are shared for information purposes only, and should not be considered, or relied upon as, financial advice. SanJac Alpha accepts no responsibility for any loss arising from the use of any information contained herein, and investors should consider their own personal circumstances and, as appropriate, seek professional advice for any investment decisions.

[1]**Basis point** - unit of measurement used in finance to express the difference in interest rates or yields between two financial instruments. One basis point is equal to 0.01%, or one-hundredth of a percentage point. [2]**Bloomberg U.S. Aggregate Index** - a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. [3]**Credit Spread** - the difference in yield between a Treasury security and a corporate bond of the same maturity. [4]**Forward P/E Rati**o - version of the ratio of price-to-earnings (P/E) that uses forecasted earnings to calculate the ratio. [5]**ICE BofA U.S. High Yield Index** - tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. [6]**Duration** - the number of years it takes to recoup a bond's true cost, based on the present value of all future coupon and principal payments.

All investing involves risk, including loss of principal.

SanJac Alpha offers two exchange traded funds. **The funds' investment objectives, risks, and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company. Please read it carefully before investing. A copy of the prospectus can be found here or by calling 1-800-617-0004.**

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