JULY 2024

Fixed Income Observations

HARTFORDFUNDS

Our benchmark is the investor.®

Let the Central Bank Rate-Cutting Party Begin

Most central banks have cut rates at least once. The Federal Reserve has yet to do so.

What's Driving Markets…

1. **Global central banks dialed up policy accommodation**, having gained confidence in the sustainability of easing inflation pressures. The European Central Bank (ECB), Swiss National Bank (SNB), and Bank of Canada (BOC) each cut policy rates during June (**FIGURE 1**). The ECB would not commit to further rate cuts, but effectively validated market pricing of cuts by leaving its longer-term inflation forecasts intact. In a modestly hawkish tilt, the Federal Reserve (Fed) raised its assumption for r* (neutral policy rate)[1] and reduced the number of rate-cut forecasts this year to one from three. The Bank of England (BOE) and the Fed are expected to join the rate-cutting party in August and September, respectively, though each is in the midst of a general-election cycle that could complicate monetary-policy decisions.

Insight from sub-adviser Wellington Management

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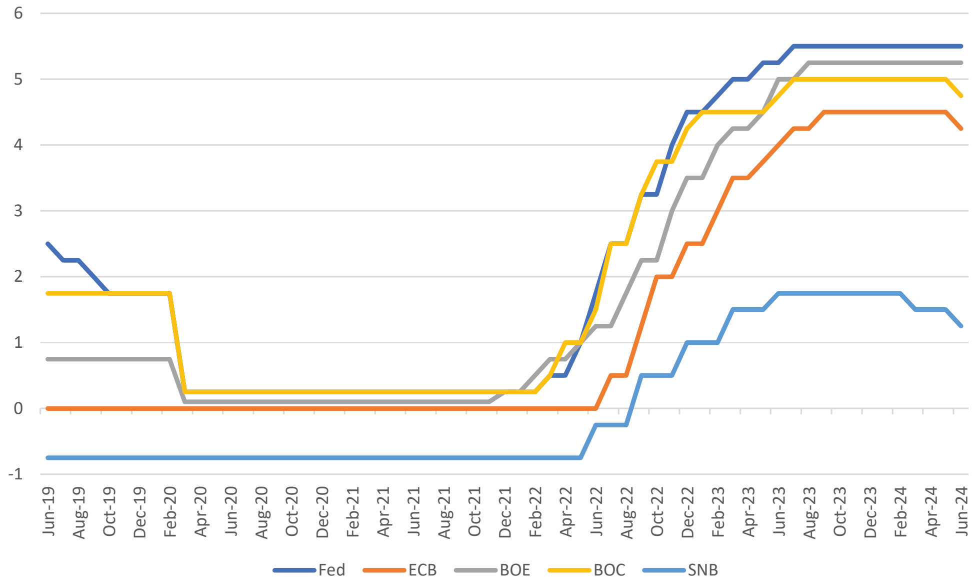
FIGURE 1

Most Central Banks Have Cut Policy Rates, but the Fed Hasn't Made a Move (Yet)

Central-Bank Policy Rates, 2019-2024 (%)



As of 6/30/24. Sources: Bloomberg, Wellington Management, and Hartford Funds.

2. **Across the Atlantic, European elections took place in early June.** Far-right parties made gains in France and Germany in particular, though less than what polls had predicted earlier in the summer. Seeking to upend the dynamic of losses, French President Emmanuel Macron dissolved the National Assembly and called snap elections, hoping to force right-wing parties to the defensive.

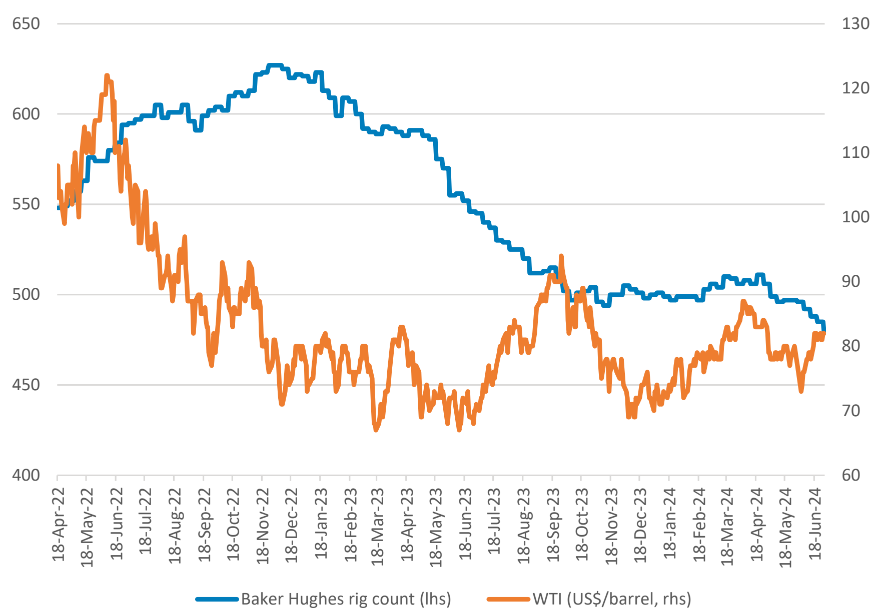
   Reflecting the uncertain outcome ahead of the elections, French sovereign yields rose. The election result may be a "cohabitation" government where the French President and the French Prime Minister are deeply at odds over the direction of the country. Or, as is more likely to play out, we may see an alliance of the centrist Macron party with the left-wing parties in a bid to stop the far right from dominating the assembly. In short, a more divided Europe and a breakdown of political and economic consensus at one of the primary members of the Union will could put renewed strain on the European project.

3. **OPEC+ cut its energy production until at least the end of 2025**, with more modest cuts continuing thereafter. The goal is to stabilize oil prices in light of record US oil output. While oil prices didn't move dramatically on the news, it shows the changing dynamics of global energy producers, with key producers needing somewhat higher energy prices for deficit reasons, while the US has come on stage as one of the world's largest producers.

   It's also worth noting that, despite substantial geopolitical risk, oil prices in the US have been remarkably stable. This is, in part, due to the usage of the Strategic Petroleum Reserve (SPR) to create a *de facto* corridor system: when energy prices move toward US$90 per barrel, there's a release from the SPR; when prices start falling toward US$60, there are forward purchases by the Department of Energy to stabilize prices. The latter is done so that domestic drillers know there's likely a floor price and thus have the confidence to continue producing. What's also interesting is the decline in the Baker Hughes rig count against a backdrop of *increased* production in the US—the result of more productive wells.

It's worth noting that, despite, substantial geopolitical risk, oil prices in the US have been remarkably stable.

FIGURE 2
Despite OPEC+ Production Cuts, Crude Prices Have Stabilized
West Texas Intermediate (WTI) Crude Oil Prices and Baker Hughes Rig Counts



As of 6/30/24. Sources: Bloomberg, Wellington Management, and Hartford Funds.

4. **There's growing evidence of less demand-pull and cost-push inflation pressure in the US.** The Consumer Price Index (CPI) and Personal Consumption Expenditures Index (PCE)[2] each showed decelerating inflation during May, with PCE at 2.6% year-over-year, inching closer to the Fed's 2% objective. Despite the progress, the Fed will likely need to see additional evidence of slowing consumption growth before easing policy, or risk easing financial conditions and driving growth back above trend. Easing wage pressures have helped on the cost-push side of inflation, with both the Employment Cost Index (ECI)[3] and average hourly earnings (AHE)[4] trending lower.

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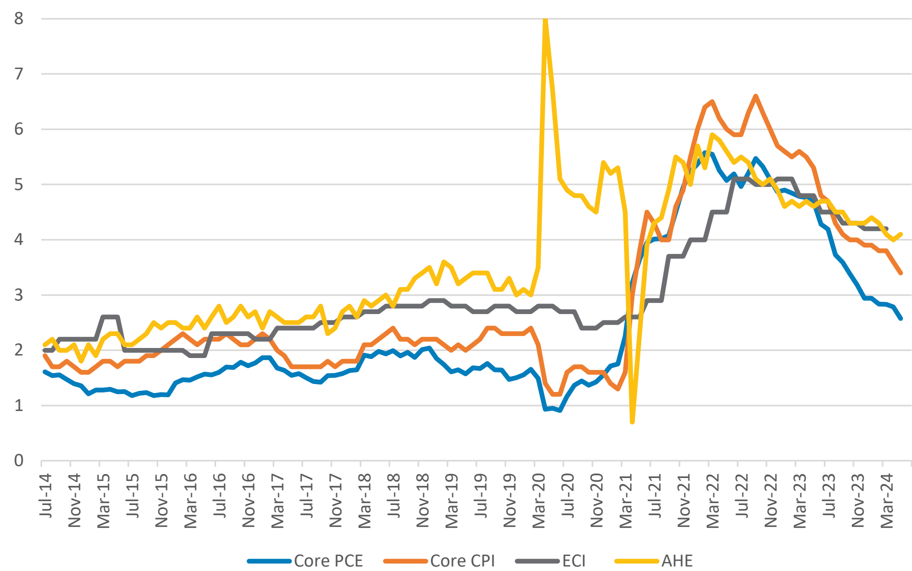
FIGURE 3

US Inflation Pressures Are Continuing to Ease

Core Consumer Prices, Employment Costs, and Hourly Earnings Year-Over-Year (%)



As of 5/31/24. Sources: Bloomberg, Wellington Management, and Hartford Funds.

5. **Venezuela is back in emerging-market debt (EMD)[5] indices** for the first time since 2019. Venezuelan sovereign bonds and state-owned oil giant Petroleos de Venezuela were added back to JP Morgan fixed-income indices over a three-month phase-in period ending 6/28/24. The decision follows the removal of trading sanctions on Venezuelan securities by the US Department of the Treasury's Office of Foreign Assets Control in October 2023 after the ruling Maduro regime agreed to an electoral roadmap with Venezuela's Unitary Platform. The apparent widening of EMD index spreads[6] over the last few months has been driven by the scaled-in addition of higher-spread Venezuelan constituents.

What's Keeping Us Up at Night…

1. **Political risks still rampant:**

    - European elections may continue to cause disquiet within the European Union at a critical time for the Union.
    - The June 27 debate for the US presidential election impacted markets with a notable sell-off and steepening of the US Treasury yield curve[7] as well as a widening of inflation breakevens.[8] In the coming months, we expect to see additional volatility as polls start pointing markets toward the potential impacts of trade, tariffs, taxes, and regulatory changes.

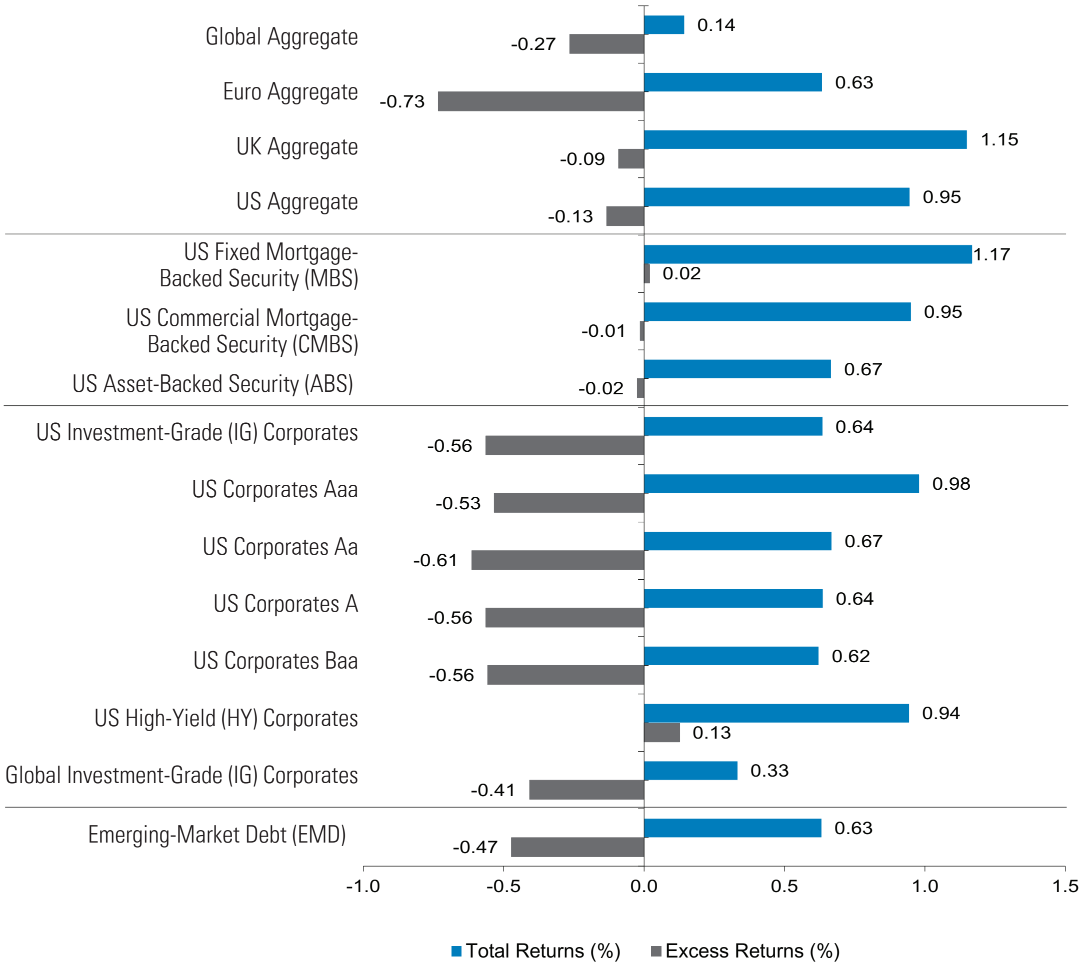
- The US Supreme Court, in *Loper Bright Enterprises v. Raimondo*, effectively overturned the precedent of the Chevron doctrine (*Chevron v. Natural Resources Defense Council*), in which courts defer to the expertise of government agencies when there is ambiguity in statutory authority. It has yet to be seen exactly what the overall impact will be on administrative processes, but this adds substantial uncertainty in the rule-writing process for regulators as well as for the private sector. This is something that we expect to keep a close eye on in the coming months.

2. **Geopolitical risk:** We've noted that while the conflict in Gaza continues, there's a chance of a wider, regional conflict between Israel and other states/groups in the area. We remain concerned about the potential expansion of the conflict into southern Lebanon and Hezbollah.

Investment Implications for Consideration

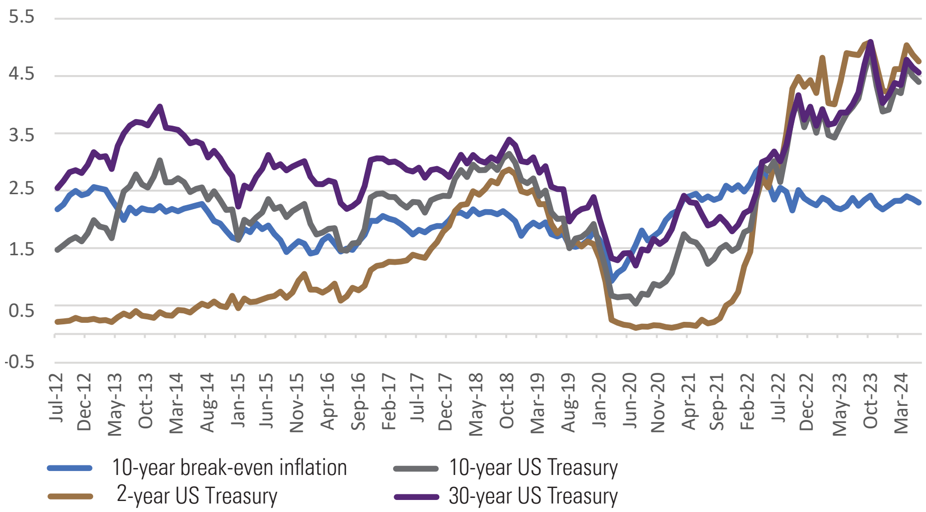
- Given how drawn out and uncertain the rate cycle has been, we still favor total-return strategies that are less constrained by benchmarks. These could include global sovereign and currency strategies that potentially shine during these periods, or "go-anywhere"[9] strategies that may be able to navigate the late cycle. With the US election heating up and creating uncertainty around economic policy, our conviction in less-constrained fixed-income strategies only increases.
- We acknowledge the tumult of rate markets this year. But, given where spread levels are in many sectors, core-bond and core-bond-plus positions[10] could make sense as we approach an easing cycle. The gradual cooling of inflation and slowing of the economy makes higher-quality fixed income potentially attractive from a positive convexity[11] perspective. Moreover, labor-market trends are showing additional softening, increasing the risk of a Fed policy error during the higher-for-longer era.
- Securitized credit[12] could be a potential hedge against rate volatility since it generally offers attractive risk-adjusted spreads. Senior parts of the capital structure, in particular, seem attractive in case the cycle turns faster than expected. For clients looking for higher expected returns, we favor select CLO equity,[13] which allows locked-in, non-recourse, term financing for an actively managed pool of bank loans.
- High yield[14] warrants a cautious approach given how late in the cycle we are and the normalizing of default rates relative to current spreads. However, the robust carry[15] may make high yield a good equity substitute. In particular, we favor senior bank loans[16] and convertible debt[17] with a bias toward "up-in-quality" issuers.

FIGURE 4: Monthly Fixed-Income Sector Total and Excess Returns



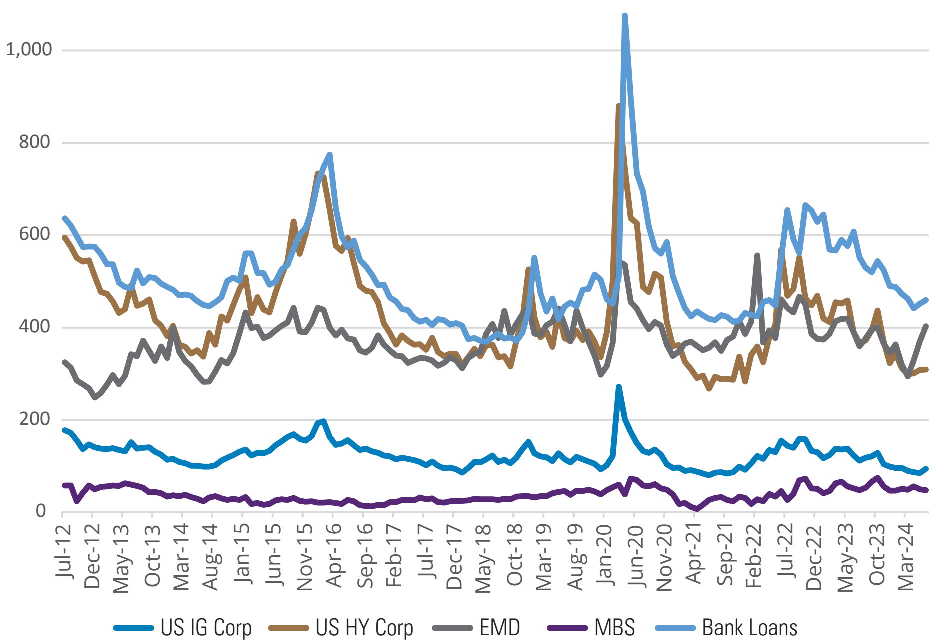
Monthly data as of 6/30/24. **Past performance does not guarantee future results.** Excess returns are defined as investment returns from a security or portfolio that exceed a benchmark or index with a similar level of risk. Indices are unmanaged and not available for direct investment. See last page for representative index definitions. Sources: Bloomberg and Wellington Management.

FIGURE 5: US Yields (%)



As of 6/30/24. Sources: Bloomberg, Wellington Management.

FIGURE 6: Fixed-Income Spreads (basis points[18])



As of 6/30/24. **Past performance does not guarantee future results.** US IG Corp is represented by the **Bloomberg US Corporate Bond Index**; US HY Corp is represented by the **Bloomberg US Corporate High Yield Bond Index**; EMD is represented by the **J.P. Morgan EMBI Global Diversified Index**; MBS is represented by the **Bloomberg US MBS Index**; Bank Loans are represented by the **Morningstar/LSTA US Leveraged Loan Index**. See last page for representative index definitions. Sources: Bloomberg, JP Morgan, Morningstar LSTA, and Wellington Management.

[1] The neutral rate of interest (also called the long-run equilibrium interest rate, the natural rate and, to insiders, r-star or r*) is the short-term interest rate that would prevail when the economy is at full employment and stable inflation: the rate at which monetary policy is neither contractionary nor expansionary.

[2] The Consumer Price Index (CPI) is a measure of change in consumer prices as determined by the US Bureau of Labor Statistics. Personal consumption expenditures (PCE) is a measure of the spending on goods and services by people in the US as determined by the US Bureau of Economic Analysis.

[3] The Employment Cost Index (ECI) is a quarterly economic series published by the Bureau of Labor Statistics that details the growth of total employee compensation. The index, prepared and published by the US Labor Department's Bureau of Labor Statistics, tracks movement in the cost of labor, as measured by wages and benefits, at all levels of a company.

[4] Average hourly earnings (AHE) is a monthly metric that measures the average amount of money a private employee in the US earns per hour, including overtime, late-shift work, and tips. It's an indicator of labor market tightness and labor cost inflation and can also be an early indicator of wage growth. The Federal Reserve uses AHE data to help set interest rates and the federal funds rate.

[5] Emerging-market debt (EMD) are debt instruments issued by developing countries. These bonds tend to offer higher yields than Treasuries or corporate bonds in the US. Emerging-market issues tend to carry higher risks than domestic debt instruments.

[6] The yield curve is a line that plots interest rates of bonds having equal credit quality but differing maturity dates; its slope is used to forecast the state of the economy and interest-rate changes.

[7] Spreads are the difference in yields between two fixed-income securities with the same maturity, but originating from different investment sectors.

[8] The break-even inflation rate is a measurement that aims to predict the effects of inflation on certain investments, by analyzing known market inflation rates from recent years. It can be calculated by comparing the yield of an inflation-based bond (such as Treasury Inflation-Protected Securities, or TIPS) with a nominal bond of the same maturity period. The difference represents the break-even inflation rate, or the rate that inflation would have to be for an investor to “break even”—or earn the same return—between purchasing TIPS or nominal Treasuries.

[9] Go-anywhere strategies are typically benchmark-agnostic and not bound by limits on exposure by sector, quality, currency, or country. Whereas traditional core-bond-plus strategies generally have flexibility to invest across the fixed-income landscape, they generally have upper limits on the amount that can be invested in securities rated below-investment-grade, domiciled outside the US, non-US-dollar-denominated, or reside in a particular sector (e.g., emerging markets).

[10] Core/core plus strategies typically invest in a baseline of investment-grade bonds such as government, corporate, and securitized debt. Core-plus funds can take that baseline and add additional sectors such as corporate high-yield, emerging-market debt, or non-US currency exposures to enhance returns.

[11] Convexity is the relationship between bond prices and bond yields.

[12] Securitized credit involves pooling a large number of loans into an investable asset. Examples include mortgage-backed or asset-backed securities.

[13] A Collateralized Loan Obligation (CLO) is a type of security that allows investors to purchase an interest in a diversified portfolio of company loans. There are two types of CLO tranches: debt tranches and equity tranches. Debt tranches are treated like bonds and have credit ratings and coupon payments. These debt tranches come first in terms of repayment, and there is also a pecking order within the debt tranches. Equity tranches do not have credit ratings and are paid out after all debt tranches. Equity tranches are rarely paid a cash flow but do offer ownership in the CLO itself in the event of a sale. Because equity tranche investors usually face higher risks, they often receive higher returns than debt tranche investors.

[14] High-yield (HY) securities, or "junk bonds," are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

[15] Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

[16] A senior bank loan is a debt financing obligation issued to a company by a bank or similar financial institution and then repackaged and sold to investors. The repackaged debt obligation consists of multiple loans. Senior bank loans hold legal claim to the borrower's assets above all other debt obligations.

[17] With convertible debt, a business borrows money from a lender or investor where both parties enter the agreement with the intent (from the outset) to repay all (or part) of the loan by converting it into a certain number of its preferred or common shares at some point in the future. The agreement specifies the repayment and conversion terms which include the timeframe and the price per share for the conversion as well as the interest rate that will be paid until either conversion or maturity.

[18] A basis point (bps) is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

To learn more about opportunities in fixed income, please talk to your financial representative.

Representative Indices from Figure 4:
Global Aggregate: Bloomberg Global Aggregate Bond Index; Euro Aggregate: Bloomberg Global Aggregate Bond Index - European Euro; UK Aggregate: Bloomberg Global Aggregate Bond Index - United Kingdom; US Aggregate: Bloomberg US Aggregate Bond Index; US Fixed MBS; Bloomberg US MBS Index; US CMBS: Bloomberg CMBS ERISA Eligible Index; US ABS: Bloomberg Asset-Backed Securities Index; US IG Corporates: Bloomberg US Corporate Bond Index; US Corporates Aaa: Bloomberg Aaa Corporate Bond Index; US Corporates Aa: Bloomberg Aa Corporate Bond Index; US Corporates A: Bloomberg A Corporate Index; US Corporates Baa: Bloomberg Baa Corporate Bond Index; US High-Yield Corporates: Bloomberg US Corporate High Yield Bond Index; Global IG Corporates: Bloomberg Global Credit - Corporate Bond Index; Emerging-Markets Debt: Bloomberg Emerging Markets Hard Currency Bond Index.

Index Definitions:
Bloomberg Global Aggregate Bond Index is a broad-based measure of the global investment-grade fixed-rate debt markets.

Bloomberg Global Aggregate Bond Index - European Euro includes fixed-rate, investment-grade Euro denominated bonds.

Bloomberg Global Aggregate Bond Index - United Kingdom includes fixed-rate, investment-grade sterling-denominated bonds.

Bloomberg US Aggregate Bond Index is composed of securities from the Bloomberg Government/Credit Bond Index, Mortgage-Backed Securities Index, Asset-Backed Securities Index, and Commercial Mortgage-Backed Securities Index.

Bloomberg US MBS Index tracks fixed-rate agency mortgage backed passthrough securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bloomberg CMBS ERISA Eligible Bond Index measures the performance of investment-grade commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974.

Bloomberg Asset-Backed Securities Index, the ABS component of the Bloomberg US Aggregate Index, has three subsectors: credit and charge cards, autos, and utility.

Bloomberg US Corporate Bond Index covers all publicly issued, fixed rate, nonconvertible, investment-grade debt.

Bloomberg Aaa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Aaa.

Bloomberg Aa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Aa.

Bloomberg A Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of A.

Bloomberg Baa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Baa.

Bloomberg US Corporate High Yield Bond Index is an unmanaged broad-based market-value-weighted index that tracks the total return performance of non-investment grade, fixed-rate, publicly placed, dollar denominated and nonconvertible debt registered with the Securities and Exchange Commission.

Bloomberg Global Credit - Corporate Bond Index is an unmanaged index considered representative of fixed rate, non-investment grade debt of companies in the US, developed markets, and emerging markets.

Bloomberg Emerging Markets Hard Currency Bond Index includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

Morningstar/LSTA Leveraged Loan Index is a market-value-weighted index that is designed to measure the performance of the US leveraged loan market based upon market weightings, spreads, and interest payments.

J.P. Morgan EMBI Global Diversified Index is a broad-based, unmanaged index which tracks liquid, US Dollar emerging-market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Mortgage-related and asset-backed securities' risks include credit, interest-rate, prepayment, and extension risk. The value of the underlying real estate of real estate related securities may go down due to various factors, including but not limited to strength of the economy, amount of new construction, laws and regulations, costs of real estate, availability of mortgages, and changes in interest rates. • Loans can be difficult to value and less liquid than other types of debt instruments; they are also subject to nonpayment, collateral, bankruptcy, default, extension, prepayment and insolvency risks. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets.

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