Outlook

RJ FI - Monday Market Commentary

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3 attachments (1 MB)
Cash Management.pdf; Corporate Bond Example Portfolio 12.15.25.pdf; NewMoneyProposal-20251215-1.pdf;

Monday Market Commentary

FROM RIA PARTNERSHIP GROUP | FIXED INCOME CAPITAL MARKETS

Intended for Institutional Investors, Do Not Forward

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Let's talk!

As we approach year-end, we encourage every advisor to schedule an one-on-one Zoom call to discuss the market and strategies for your clients.

Rates

Treasury Market Update

The Federal Reserve delivered its third consecutive rate cut as widely anticipated, reducing the target range by 25 basis points to 3.50–3.75 percent. While the median projection in the Summary of Economic Projections still reflects only one additional cut in 2026, the distribution shifted slightly lower, reinforcing a more dovish tone. The Committee also raised its GDP forecast for 2026 while lowering inflation expectations, signaling confidence in growth alongside progress on price stability.

Chairman Powell's press conference underscored this dovish tilt, particularly in his comments on labor market conditions. He noted that payroll gains since April may be overstated by approximately 60,000 jobs per month, implying that actual job growth could be negative during that period. This acknowledgment of labor market softness adds weight to the argument for continued accommodation.

In a surprise move, the FOMC statement addressed reserve balances, indicating they have declined to "ample" levels and announcing plans to purchase shorter-term Treasury securities as needed to maintain sufficient reserves. Powell clarified that these reserve management purchases will begin at roughly $40 billion in the first month and may remain elevated for several months to alleviate expected near-term pressures in money markets, particularly heading into tax season. He emphasized that these operations are technical in nature and distinct from quantitative easing.

The meeting was not without dissent. Goolsbee and Schmid voted against the cut, citing insufficient data rather than inflation concerns, while Miran once again favored a 50-basis-point reduction. Goolsbee's dissent was notable given his longer-term expectation for more cuts in 2026 than the median forecast.
Market reaction reflected the dovish tone. The yield curve steepened significantly, with the spread between two-year and ten-year Treasuries widening by nearly 10 basis points to its highest level in more than three years. This steepening suggests investors anticipate easier policy ahead while longer-term rates remain sensitive to growth and supply dynamics.

Looking ahead, the market faces a backlog of economic data this week, including October and November payrolls and unemployment figures on Tuesday, followed by November CPI on Thursday. While these releases are highly anticipated, Bloomberg Economics argues they are unlikely to provide definitive clarity. Instead, the data will offer both hawks and doves evidence to support their respective views. Over the coming months, however, Bloomberg expects inflation to trend lower and payrolls to weaken, paving the way for the Fed to cut rates by as much as 100 basis points in 2026.

In short, this meeting reinforced a more dovish policy stance than markets expected, introduced technical measures to support liquidity, and set the stage for continued debate as incoming data shapes the outlook. The near-term environment remains fluid, but the trajectory points toward gradual easing as inflation moderates and labor market risks persist.

Treasury Auction Recap
Last Week: Primarily auctioned various long-term notes.

- 3-Year Note: saw a sharp drop in its cover ratio metrics from November's auction but still better than a few summer months subdued results.
- 10-Year Note: As expected performance was better given a smaller auction size (first auction of the quarterly refunding is the largest of the 3).
- 30-Year Note: As expected performance was better given a smaller auction size (first auction of the quarterly refunding is the largest of the 3).

This Week:
The focus shifts to various bills and the often volatile 20-year note auction (Wednesday). The reopening of 912810UQ9 will be for $13 billion after Novembers initial $16 billion launch of the CUSIP.

Money Market Alternative / Cash Management Strategy example statistics
Please see below for the statistics of a portfolio of short term t-bills as a no fee & repo free alternative to money market packaged products.

Taxable Fixed Income

Another light week of corporate debt issuance is expected after last week's total landed at $4.68 billion, well below the $15 billion that the market had forecast. This week, expectations call for roughly $5 billion in new issuance, though some market participants anticipate that we may see no supply at all. This could very well be the final week of the year in which we see any new bond sales, as many market participants begin to step back ahead of the holiday season.

Corporate credit spreads remained relatively steady throughout the week and continue to sit in territory considered tight by historical standards. The current spread on the Bloomberg U.S. IG Corporate Bond Index is 78 bps over Treasuries, reflecting a modest 1 bp widening from the prior week. If these conditions persist, it would be reasonable to expect a meaningful pickup in supply at the start of 2026, as the environment remains favorable for investment-grade issuers.

While the index spread provides a broad view of how risk is being priced across the investment-grade market, it is important to evaluate each credit within your book individually. Each issuer has its own story and may trade very differently from the broader market. As always, we are happy to conduct reviews of any corporate bond portfolios or take a closer look at specific credits you currently hold.

Oracle (Baa2/BBB) is one issuer that has come under pressure recently amid investor concerns surrounding the justification of its elevated AI-related spending. Although the company remains investment-grade rated, its bonds have experienced spread widening and in some cases are trading more in line with high-yield levels. Oracle has been especially active in the debt markets as it ramps up AI investments, including the $18 billion bond deal completed in September — the second-largest issuance of the year at the time.

Management remains confident in the company's trajectory, noting that "there have been no delays to any sites that required contractual commitments, and all milestones are on track." CreditSights, a well-regarded independent credit research firm, also sees long-term opportunity in the credit, despite the near-term uncertainty the company may face.

Corporate Bond IG 5 – 10 year example statistics

Municipal Tax-Free Fixed Income

- AAA muni BVAL yields 2.45% (2Y), 2.38% (5Y), 2.72% (10Y), and 4.13% (30Y).
- Taxable equivalent yields: ~4.6% at 10 years and ~7.0% for longer maturities.
- 4s at par available in 19 years
- The Muni - Treasury ratios are around 65% at 5-years, 65% at 10-years and 86% at 30-years.

Muni Comment: Moody's Outlooks for 2026

We continue the share Muni sector outlooks from Moody's. So far we've shared the outlooks on 1. States, 2. Cities & Counties, 3. Not for profit Healthcare, 4. Higher Education. This week we cover k-12 school districts.

Stable: US States / Cities & Counties / Not-for-profit Healthcare / Toll Roads / Charter Schools
Negative: Higher Education / K-12 School Districts / Ports

Moody's revised their outlook for traditional US K-12 school districts to negative – as the operating environment enters a more challenging "new normal." Districts now face slowing revenue growth, the expiration of extraordinary federal aid, rising labor costs, and persistent enrollment declines driven by demographics and growing competition from school choice alternatives. While most districts are expected to adjust over time, the sector overall will see pressure on operating reserves, greater difficulty aligning expenditures with revenues, and increased fiscal strain, particularly for districts with high needs or declining demographics.

1. Revenue Slows, Costs Rise
Districts' financial flexibility is weakening as ESSER aid expires and state funding growth moderates. Operating reserves are eroding: the median fund balance ratio is expected to fall from 26% to 24% in 2025, though still above pre-pandemic levels.

- Federal aid: ESSER funds—$190B since 2020—end entirely by FY26.
- State support softens: Many states are holding funding flat or near-flat; only a few (e.g., PA) are materially increasing support.
- Labor costs accelerate: Contract renewals and retention pressures are pushing compensation growth. Staffing levels exceed pre-pandemic norms.
- Property tax growth uneven: Expanding tax bases don't always translate into higher revenue due to caps, equalization formulas, and state-specific constraints.

Implication: More districts will draw down reserves or face structural imbalance as expenditure growth outpaces revenue.

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2. Enrollment Declines Heighten Financial Risk
Enrollment is projected to decline 1% in 2025 and 5.5% by 2031, driven by demographics and expanding school choice.

- Birthrates falling; youngest school-age cohort shrinking.
- Regional divergence: Growth in FL/UT/ID; sharper declines in CA/NM.
- School choice expansion: Charters now capture 7% of enrollment (up from 4%); private options supported by new voucher programs; homeschooling rising.
- Funding impact varies: Some states cushion enrollment loss through hold-harmless provisions; others (MI, WA) do not.

Implication: Lower and more volatile enrollment creates budget stress, complicates forecasting, and may weaken voter support for future levies.

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3. Cutting Costs Will Be Challenging
As revenues tighten, many districts will attempt to right-size budgets—yet structural, political, and community factors slow the pace of adjustment.

- ESSER-funded positions (tutors, counselors, specialists) are difficult to eliminate, especially where linked to academic recovery.
- High-need districts face steeper cliffs due to the Title I–based ESSER allocation formula.
- Growing special education needs increase mandated cost pressures.
- School closures politically sensitive: Fewer buildings are closing despite declining enrollment.
- Expectations rising even as resources tighten.

Implication: Expense reductions will be gradual, limiting districts' ability to offset revenue pressure in the near term.

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4. What Could Shift the Outlook

- Back to Stable: Revenue growth accelerates enough to match cost pressures, or districts sustain stable fund balances through effective cost controls.

- Positive Outlook: Districts consistently grow reserves while absorbing higher operating costs — potentially through significant new state support or widespread passage of local levies.

Example Portfolio Statistics:

Municipal Bond - Laddered Calls (Avg Maturity 20 yrs/Duration 5)

Issuance dynamics:

This week's muni new issuance totals approx. $ 6 Billion - Nego - $ 5.7 Bill; Comp - $ .3 Bill

Below are deals Raymond James is bringing or bidding on this week:

Negotiated

Competitive

Have a great week!

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