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RSW's Q3 2024 Fixed Income Newsletter

A Manufactured Crisis

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With only 35 days remaining until the election, both presidential candidates are continuing to trade barbs over the best policies to manufacture manufacturing jobs. It's no wonder why! Rust Belt states, such as Wisconsin and Pennsylvania, are critical for a path to the 270 electoral college votes needed to win the race to the White House. Relax, like you, we are Fed-Up (Yeah, of Chairman Powell too) of being pelted with election news, so fear not, this musing will not be about the polls.

Build It and They Will Come

Throughout the 20th century, a manufacturing renaissance enabled thousands of plants to be constructed in small Midwest cities. When these plants were built, communities were formed, affording people the opportunity to enjoy a high paying job. In the 1980's there was a movement to connect and integrate governments, people and companies worldwide. At the time, it was thought that globalization could act as an accelerant to the manufacturing sector by expanding the growth in poor and rich countries alike. It all made sense. Multi-national corporations could create assembly line jobs in emerging market countries by using a cheaper source of labor to expand the middle class in those regions.

With the benefit of hindsight however, the pros and cons of globalization have become clear. While developing countries can better compete with developed nations and more products are available at cheaper prices, it has ushered in socioeconomic upheaval. As jobs in the U.S. have been redirected to countries with lower labor costs it has caused slower growth, put downward pressure on wages and less job security. In fact, just over the last three decades:

- Four million fewer people are employed in the manufacturing sector, a 31% decline (Source: FRED).
- Manufacturing's share of GDP has experienced a staggering 45% decline; falling steadily from 1997's peak of 16% to today's 11% (Source: World Bank Group).
- In 1997, manufacturing wages were 6% higher than the broad-based national average and today those producers are earning 8% less (Source: FRED).
- For the last 15 years, after accounting for inflation, there has been no gain in wages for the average manufacturing employee.

Now that you have digested the data above, what's the point? The fact is not every job counted by the Bureau of Labor Statistics, nor its impact on GDP, is of equal economic consequence. For instance, as of August, the average weekly hours worked in the **Leisure & Hospitality** sector was just 25 hours, with average wages of $22.18 per hour (Source: FRED). This equals an annual pay of ***$28,834*** (25 x 22.18 x 52 weeks).

In contrast, if we applied the same calculation for those employed in the **goods-producing** sector and assumed a 40.6 hour workweek, with pay of $27.96 per hour (Source: FRED), their annualized gross salary equals ***$59,029*** (40.6 x 27.96 x 52 weeks). Thus, in terms of economic umph, the Leisure and Hospitality job is equal

to only 49% of a goods-producing "job". Interestingly, from January 2024 through August of this year, the number of employees in each of these two sectors is largely unchanged.

Sometimes Things Don't Add Up!

While we're on the topic of jobs--RSW's Q1 2024 report states, "The employment statistics should not be communicated as a cock-and-bull story, but instead be firmly rooted in reality". Interestingly, on August 21 we learned that for the twelve months ending March of this year the employment report overstated the number of jobs by 818,000; a 28% downward revision.

And Sometimes They Do!

As discussed in RSW's intra-quarterly commentary entitled "Trouble With the Curve", it says "Please be mindful that the Federal Reserve, led by Chairman Powell, doesn't lead but instead follows the rate levels of three-month U.S. Treasury Bills." With the decline in the yield of three-month bills nearing 50 basis points, on September 18, Powell seized the opportunity to likewise slash their overnight rate by the same.

How Much is too Much?

As the populace perceives themselves to be negatively impacted by globalization, people tend to lash out. This explains some of today's toxic environment. While it doesn't matter that the winners in this construct have done nothing wrong, it's human nature for the downtrodden, with little left to lose, to look for a target who is assumed to be the cause of their difficulties. This is how political movements start.

When those who are in a tight spot outnumber those who are living comfortably, they turn to the federal government to address their inequities. With tax receipts falling short of expenditures, the growth in economic security programs explains some of the rise in our exorbitant level of national debt. Since 1997, federal debt as a percentage of our country's GDP has mushroomed from 63% to 120% (Source: FRED). No, this does not include debt's evil cousin, unfunded liabilities, which currently totals $220 trillion (Debtclock.com). This is truly the elephant in the room and there might not be a large enough pooper scooper to clean up this mess.

Can a Solution be Manufactured?

The challenges described above are hefty and present formidable headwinds to sustainable "trend" economic activity. For years, our nation has been issuing vast amounts of debt to provide various lifelines and stimulus measures to boost growth. In effect, it's the equivalent of a parent teaching a kid how to ride a bike. You run alongside your child while keeping a firm hand under his bicycle seat. With our country currently running an annualized budget deficit of $2 trillion, aren't they doing the same thing? Against a challenging economic forecast, we remain confident that market rates will continue to work their way lower. RSW's target for ten-year U.S. Treasury bonds remains 3.25%.

Municipal Commentary

During the third quarter, following the lead of the U.S. Treasury bond market, tax-exempt securities produced strong returns. The rally was led by shorter-maturity bonds as their yields declined at a faster pace than longer-maturity securities. For example, using "AAA"-rated bonds as a proxy, 5-year tax-exempt yields declined by 58 basis points, while debt in the 10-year sector only fell by 24 basis points (Source: Municipal Market Data).

This shift caused the yield curve to steepen and return to an upward slope or more normalized shape. While it's been over two years, rates on shorter-maturity debt obligations are once again beneath yields on longer-maturity bonds.

Despite the strong performance of tax-exempt bonds, they failed to keep pace with comparable maturity U.S. Treasury securities. One key reason for this was the unrelenting pace of new issuance in the municipal bond market. With greater amounts of securities to digest and distribute, rates remained relatively elevated. Specifically, on a year-to-date basis, when compared to last year's pace, supply is up 35% (Source: BOA). This month the volume of debt has been particularly heavy, as issuance is 52% (Source: BOA) higher than September 2023.

As was stated in RSW's 2024 Outlook, "Periods of price declines will be viewed by our team as an opportunity to further extend the duration (interest rate sensitivity) of our client portfolios to lock in relatively high yields and maximize price appreciation." With this shift having been accomplished earlier this year, for now, we are watching and waiting for the next market opportunity, albeit in duration (measure of interest rate sensitivity), yield curve positioning etc.

I hope everyone had a great summer. Many thanks for reading and all your continued support!

Robert S. Waas
Chief Executive Officer/Chief Investment Officer

Robert S. Waas Chief Executive Officer / Chief Investment Officer	Matthew T. Werner Senior Portfolio Manager	Mark J. Tenenhaus Director of Municipal Research	Mark A. Scott Senior Trader	Randy J. Fox Portfolio Manager	Hernando S. Montero Municipal Bond Credit Analyst	Marites V. Pasturan Director of Software and Technology	Jeffrey S. Thompson Investment Reporting Analyst	Anthonio Bacchetta Client Service Associate	Andrew P. DeCeglie Trade Desk Support

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