American Century Investments®

Market Minute

HIGH INTEREST RATES, LOW JOBLESS RATE: ORDINARY OR ANOMALY?

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History suggests this seemingly odd dynamic is not unusual, but likely won't last and may precede potential market opportunities for bond investors.

KEY TAKEAWAYS

- It may seem contradictory, but the unemployment rate historically has improved or remained stable during Federal Reserve (Fed) rate-hike cycles.
- Over time, though, higher interest rates have led to rising unemployment, a slowing economy and falling bond yields.
- If history repeats, we believe bond investors have an opportunity to capture attractive return potential before the full effects of Fed policy unfold.

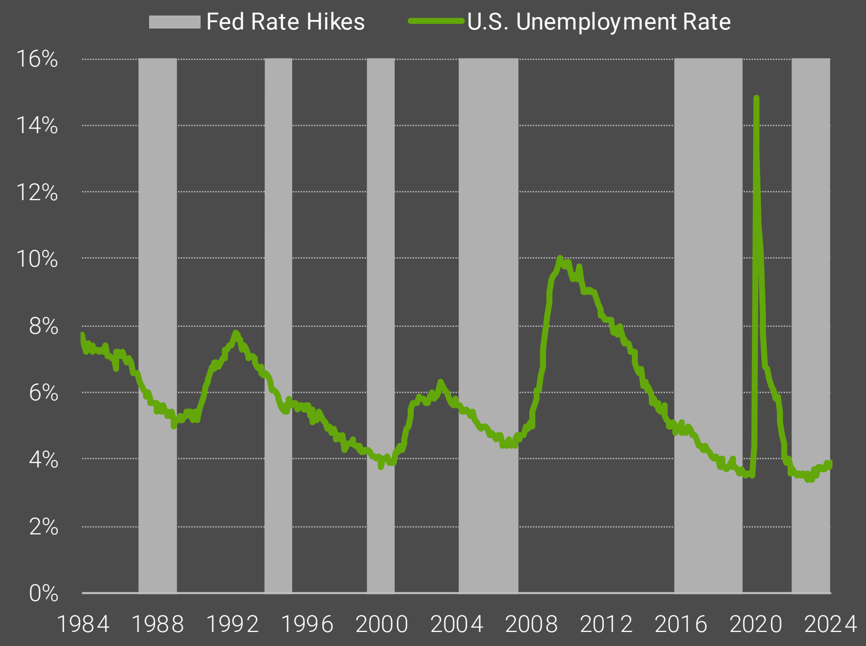
WE'VE BEEN HERE BEFORE

Some claim that today's low jobless rate is unprecedented, given the Fed's short-term interest rate target is sitting at a 23-year high. But history disagrees.

The trajectory of the unemployment rate during Fed rate-hike cycles reveals some common characteristics.

- As the chart highlights, the unemployment rate declined during prior rate-hike cycles and has changed little during the latest phase.
- But following most rate-hike cycles since the 1980s, unemployment generally rose until a slowing economy triggered a downturn.

Unemployment Rate Has Cycled with Fed Rate Hikes



Data from 4/30/1984 – 5/15/2024. Source: FactSet.

TODAY'S JOB MARKET TRACKS HISTORY

None of the Fed rate hike cycles of the past 40 years triggered a rapid rise in unemployment. In fact, during the last four rate-hike cycles, the unemployment rate improved by nearly 1 percentage point.

What happened after the Fed stopped hiking rates?

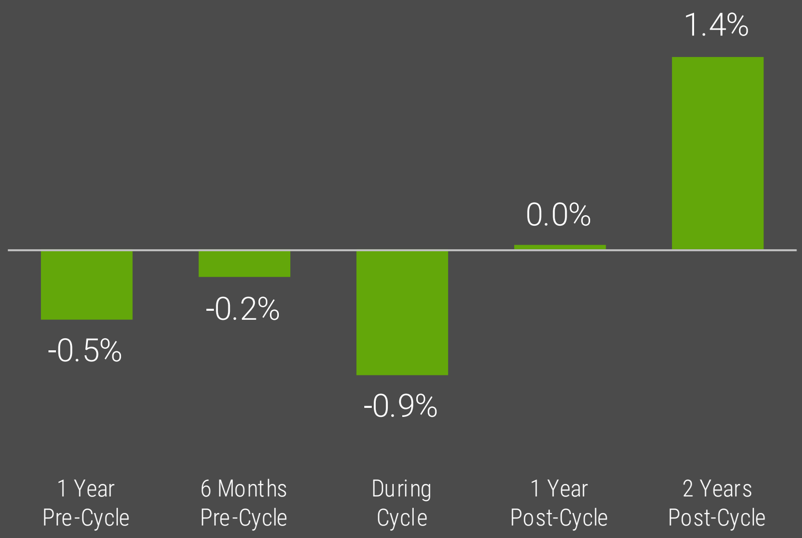
Initially, not much. In prior cycles, unemployment was stable one year after Fed tightening ended.

Recent trends are tracking history. The last rate hike was in July 2023, when the jobless rate was 3.5%. It inched up to 3.9% by April 2024.[1]

We expect the lagging effects of Fed rate hikes to meaningfully affect unemployment by next summer.

Unemployment Fell When Fed Raised Rates, Increased Two Years Later

Average Percentage Point Change in Unemployment Rate, Last Four Rate-Hike Cycles



[1] Source: U.S. Bureau of Labor Statistics

Source: Macrobond. Fed rate-hike cycles: 2/4/1994 – 2/1/1995; 6/30/1999 – 5/16/2000; 6/30/2004 – 6/29/2006; 12/17/2015 – 12/20/2018.

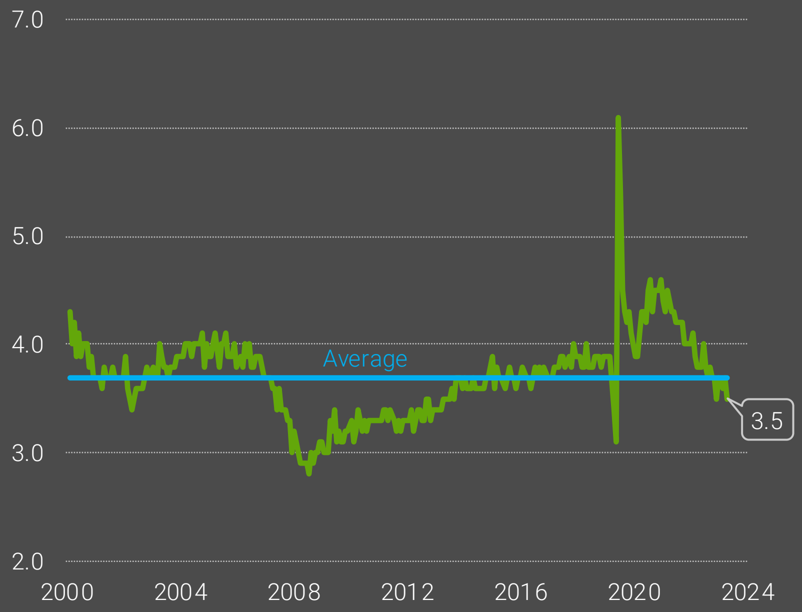
HIRING SLOWDOWN SUPPORTS OUR VIEW

In addition to the jobless rate's historical patterns, current hiring trends support our outlook for unemployment to rise.

The pace of hiring has been on a steady downward path for more than two years. The hiring rate landed at 3.5% at the end of March, below the 21st century average of 3.7%.

The Pace of Hiring Has Been Declining

Hiring Rate (%)



Data from 12/31/2000 – 3/31/2024. Source: U.S. Bureau of Labor Statistics.
Hiring rate = non-farm hires/labor force.

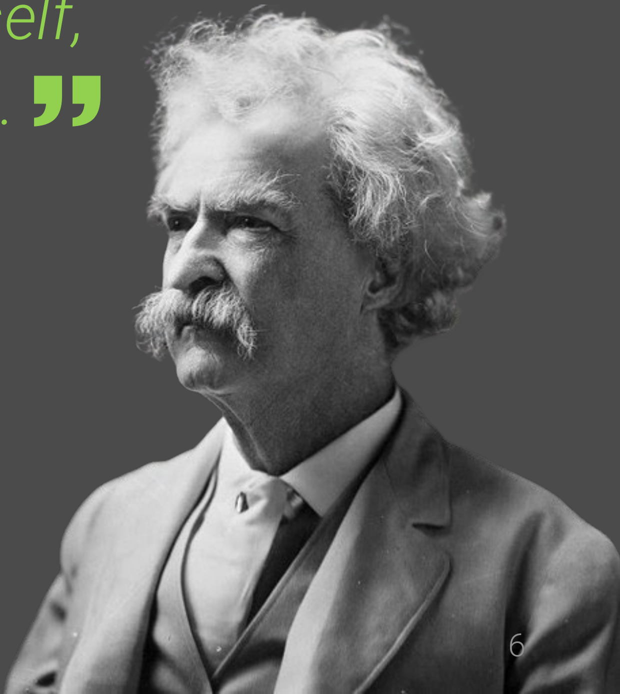
LEARNING FROM THE PAST

We expect history to repeat, or at least rhyme, over the next several months.

In our view, the cumulative effects of the Fed's latest tightening cycle will weigh on employment and the broader economy.

We believe this scenario should push bond yields lower, generating attractive total return potential for bond investors.

> *"The past does not repeat itself, but it rhymes."*
>
> Mark Twain



OPPORTUNITIES FOR BOND INVESTORS

Looking again to the previous four Fed tightening cycles, bond yields generally declined in the two-year period after the Fed stopped raising rates.

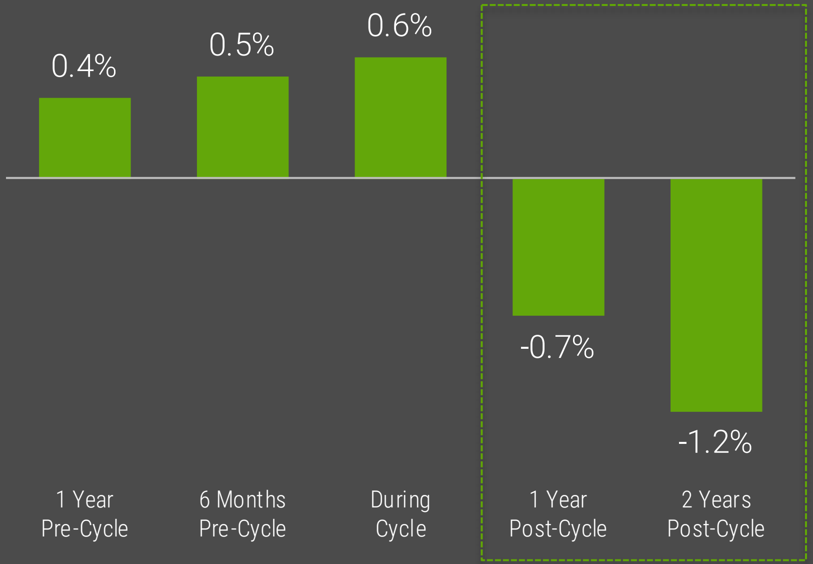
By the two-year mark, the yield on the 10-year U.S. Treasury note dropped an average of 1.2 percentage points.

And when bond yields decline, bond prices typically rise.

These trends drive our preference for investing in high-quality, longer-duration bonds ahead of a broad shift in yields.

Yields Declined After Fed Ended Rate-Hike Campaigns

Average Percentage Point Change in 10-Year Treasury Yield, Last Four Rate-Hike Cycles



Source: Macrobond. Fed rate-hike cycles: 2/4/1994 – 2/1/1995; 6/30/1999 – 5/16/2000; 6/30/2004 – 6/29/2006; 12/17/2015 – 12/20/2018.

ENDNOTES

Duration: A measure of the price sensitivity of a fixed-income investment to changes in interest rates. The longer the duration, the more a fixed-income investment's price will change when interest rates change.

Federal Reserve (Fed): The Fed is the U.S. central bank, responsible for monetary policies affecting the U.S. financial system and the economy.

U.S. Treasury securities: Debt securities issued by the U.S. Treasury and backed by the direct “full faith and credit” pledge of the U.S. government. Treasury securities include bills (maturing in one year or less), notes (maturing in two to 10 years) and bonds (maturing in more than 10 years). They are generally considered among the highest quality most liquid securities in the world.

Yield: For bonds and other fixed-income securities, yield is a rate of return on those securities. There are several types of yields and yield calculations. “Yield to maturity” is a common calculation for fixed-income securities, which considers total annual interest payments, the purchase price, the redemption value, and the amount of time remaining until maturity.
