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INVESTORS TRUST

A No-Load Mutual Fund

Paying Dividends for Over 70 Years

Why Credit is Once Again Attractive

2022 was a difficult year for many asset classes, from credit to equities. What is the outlook for 2023 and beyond? Our view is that the longer-run outlook for credit is once again attractive and that asset allocators should take a good look.

To start, interest rates have risen across the board in the last year, as the Federal Reserve has raised its policy rate from near 0% to over 4.5%, and most observers believe that the rate will peak out over 5%. While this has pressured bond and stock prices alike, it does mean that entry yields are now much more favorable than they were a year ago.

To that point, the yield on the benchmark 10-year Treasury bond is now approaching 4%. By comparison, the S&P 500 is trading at a Price/Earnings ratio of 18x, which implies an "earnings yield" of 5.6%. On this basis, the Equity Risk Premium --- the extra indicated return on stocks, --- is now only 1.6%. In a nutshell, yields on cash have risen over 4% points, while the earnings yield on stocks has risen only about 1%. We believe asset allocators should take notice of this historically narrow relationship and consider the relative value.

And where are interest rates headed? For those with an ability to look beyond the immediate time-horizon, the Fed has repeatedly communicated its long-run inflation target of 2%. And, whenever the Fed reaches that 2% target, it has signaled it will reduce interest rates from today's restrictive levels to about 2.5%. Compared to today's policy rate of over 4.5%, we believe that this would be good for bonds and credit generally.

Embedded in this favorable scenario is another positive outcome for credit versus stocks: to successfully reduce inflation, the Fed will take action in an effort to reduce prices and, as a result, corporate profit margins. It may be an underappreciated fact that corporate profit margins have been rising for decades, with the most pronounced increase coming during the Covid era. During the last two decades, profit margins on the S&P 500 have doubled from 6% to more than 12%, with over 1% of that 6% increase happening even since Covid began. And the Covid-era increase makes intuitive sense: producers made fewer goods because of the Covid shutdowns, but consumers augmented by stimulus programs wanted to buy the same amount of goods as they always did. This supply/demand imbalance was inflationary, and reversing that is how the Fed will work to roll back inflationary pressures.

For investors accustomed to thinking that stocks always outperform bonds and credit, this might be a surprise. The profit margin tailwind had bolstered the returns on stocks for years, and without that tailwind since 1994, stocks would trade at only half of their current levels, which is a remarkable statement. Looking forward, margins could reverse their gains, putting long-term pressure on stock returns. In an environment like this, the fixed return of bonds and credit could be more attractive than the variable return on stocks' profit margins. Each 1% decrease in profit margins equates roughly to one year's profit growth forgone, and with interest rates and tax rates both moving up, there are obvious non-operating reasons to see this happening.

When we add these two factors together --- the current low level of the Equity Risk Premium and the possibility that corporate profit margins might return to historical levels in the coming years --- we think that credit is attractively priced relative to other asset classes and that asset allocators should take a good look.

Bruce H. Monrad is chairman and portfolio manager of Northeast Investors Trust (NTHEX), a no-load, high-yield fixed income fund whose primary objective is the production of income. Bruce is among the longest-tenured bond fund managers in the industry, having run Northeast Investors Trust for more than 30 years.

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Mutual Fund investing involves risk. The Trust invests in lower rated debt securities which may be subject to increased market volatility based on factors such as: the ability of an issuer to make current interest payments, the potential for principal loss if an issuer declares bankruptcy, and the potential difficulty in disposing of certain securities in a timely manner at a desired price and therefore can present an increased risk of investment loss. Diversification does not eliminate the risk of experiencing investment losses.

Falling Interest rates and bond defaults may negatively impact the Trust's distributable income. In addition, during periods of declining interest rates, higher yield securities may be called and the Trust may be unable to reinvest those proceeds in similar yielding securities. Therefore, shareholders should expect the Trust's quarterly dividend distributions to decline under these circumstances. The Trust is generally for investors with longer-term investment horizons, and should not be used for short-term trading purposes. An investment in the Trust involves risk and should be part of a balanced investment program.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information about the Trust is contained in the prospectus or summary prospectus, either of which may be obtained by calling 1-800-225-6704 or by visiting www.northeastinvestors.com. Please read either one carefully before investing.

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