NORTHEAST
INVESTORS TRUST

A No-Load Mutual Fund

Paying Dividends for Over 70 Years

Where are the Lags?

In predicting the likely path for the United States economy and for stock and bond prices as well, we as financial analysts are necessarily called upon to evaluate the impact of the sudden and pronounced rise in interest rates that has taken place in the last 18 months. Indeed, the Federal Reserve has raised interest rates by 5% since it started to do so, all in an effort to reduce inflation pressures. Where does that leave us now?

Actually, to answer that question, a better place to begin is, "Why aren't we already in a recession?", given the substantial rise in interest rates and the generally received wisdom on the topic. Indeed, had one asked market observers in March 2022 to predict the outcome of such a substantial change in monetary policy, they would have almost universally predicted a recession. In June 2022, for example, the stock market tumbled on fears of an incipient recession. But that never happened.

Many observers (nearly 50%, by one count of Wall Street firms) continue to believe that a U.S. recession is around the corner. To get there, they typically rely on the well-oiled phrase that monetary policy operates "with long and variable lags". These words have been directly quoted by Fed Chair Jerome Powell on numerous occasions, and, over at the European Central Bank, Christine Lagarde has made a similar point, using recent press conferences to remark among other things about the amount of monetary restraint that "is in the pipeline." That wording has clear implications: we have not felt the full impact of the rise in interest rates and economic softness may be around the corner.

Here at Northeast, we take a slightly different view. We believe that the majority of the impact of rising interest rates has already been felt now 18 months after the Fed began its tightening campaign and that the impact is therefore less than the pessimists had predicted. In turn, we believe that we can discount the likelihood of a recession in the next twelve months caused by the monetary tightening already in the system. **Another way of phrasing this is that we don't believe that the Fed or other central banks have overshot at this point.**

This is good news for spread products like high yield bonds. If investors can and will increasingly remove recession scenarios from their forecasts, this lessens the chance that high yield spreads would flare out to higher levels. If it is safer than expected thus to lock in the extra yield premium in the high yield market, that is good news for high yield investors.

This is our central forecast here at Northeast. We believe that the impact of rising rates upon the economy will be less than forecast and that the high yield market offers attractive yields. And, to put a finer tactical point on the issue, short-term high yield bonds offer better interest rate protection should base interest rates creep higher as recession fears abate. We are invested accordingly to take advantage of this view.

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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