Intermediate Maturity Taxable

Commentary – Second Quarter 2021

Macro Overview

As the percentage of US adults with at least one vaccine dose climbed above 67% to end the quarter, the US economy continued its fast-paced reopening. Soaring consumer demand aided by $1.9 trillion in stimulus has fueled the recovery; however, producers are struggling to keep pace, resulting in rising inflationary pressures on goods from building materials to grocery items. The question now is whether these price increases are indeed transitory or more permanent in nature. The Fed's inflation projections increased meaningfully between their March and June meetings, now forecasting headline inflation to rise to 3.4% in '21, but moderate to around 2.0% over the next several years. Intermediate- and longer-term UST yields rallied approximately 30bps over the course of Q2 as market participants seemed to agree with this assessment.

- The Fed's June Dot Plot shows most FOMC participants expect two Fed Funds rate hikes by the end of 2023, with nearly half the governors seeing a single hike in 2022.
- The Fed is confident the recent inflation surge is transitory, though participants are "keeping an eye on" long-term inflation expectations in case they become unanchored.
- Employment recovery continues to lag as job openings hover near record highs. Some are questioning whether Federal supplemental unemployment benefits may be keeping a large percentage of the workforce at home.
- GDP estimates for 2021 are now approximately 6.5%, with the biggest increase in Q2 at nearly 13% yoy. Growth is expected to steadily decline to 4% in 2022 and 2.5% in 2023.

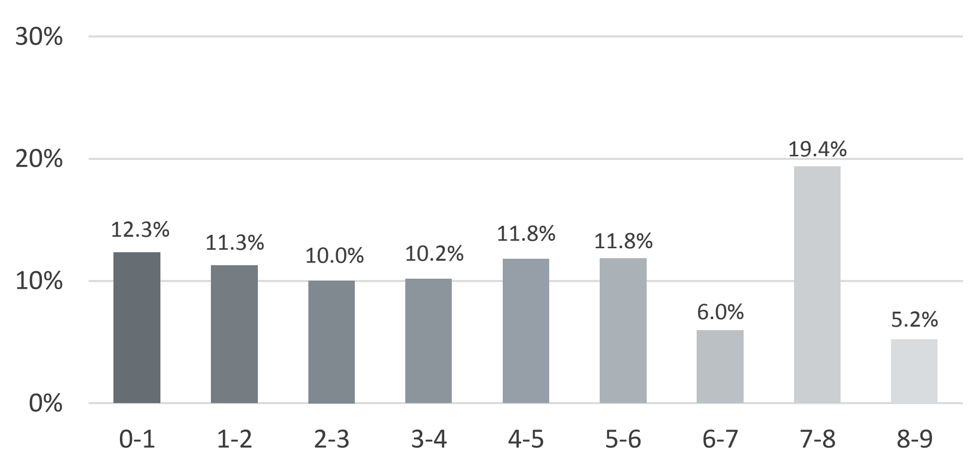
Market Dynamics

Despite heightened interest rate volatility over the first half of the year, Investment Grade credit spreads have rallied alongside most other risk assets. In the second quarter, the Bloomberg Barclays Aggregate Credit index tightened by another 9bps, a combined 16bps move YTD. While spreads now are hovering close to their lows for the last several years, we see little in the near-term that would cause concern. Corporate issuers should still see tailwinds heading into the second half of the year from the historic monetary and fiscal stimulus already in the economy and from the significant progress on the vaccine rollout. Both earnings and profit margins continue to expand, and from a technical standpoint, high-grade issuance is anticipated to drop by nearly 50% this year after historically high volume in 2020.

Composite Characteristics

Duration: 4.42 yrs
Yield-to-Worst: 1.08%
Yield-to-Maturity: 1.16%
Maturity: 5.99 yrs

Duration Profile



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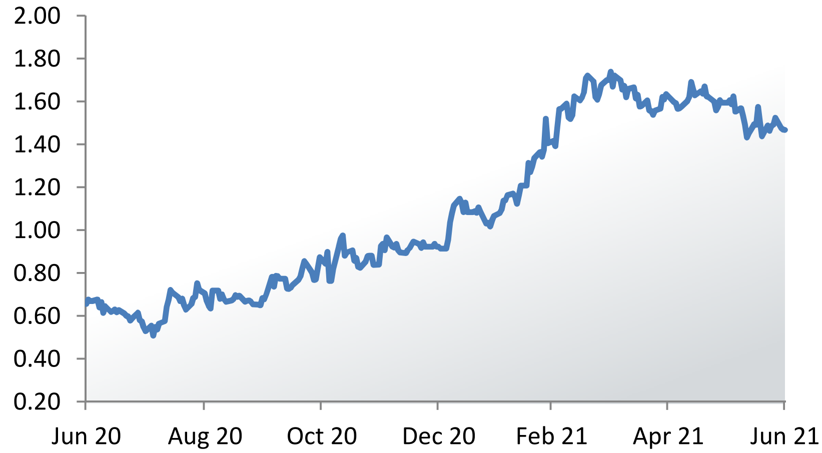
Performance Notes

A flattening yield curve over the quarter benefitted the strategy as intermediate and longer-term interest rates declined on softening inflation expectations. Additionally, the strategy's overweight to Investment Grade credit helped performance given the strong demand, solid fundamentals, and lower supply within the sector. Looking ahead, the Federal Reserve will be in focus this fall as they likely begin to lay the framework for a gradual tapering of asset purchases. While there is certainly volatility risk around the messaging and pace at which accommodation will be removed, we believe the Fed has done a respectable job telegraphing their intentions, guiding the market to be well positioned for this change in policy.

10-YR US Treasury Yield (%)
Source: Bloomberg



"The strategy's overweight to Investment Grade credit

remained additive to performance over the quarter

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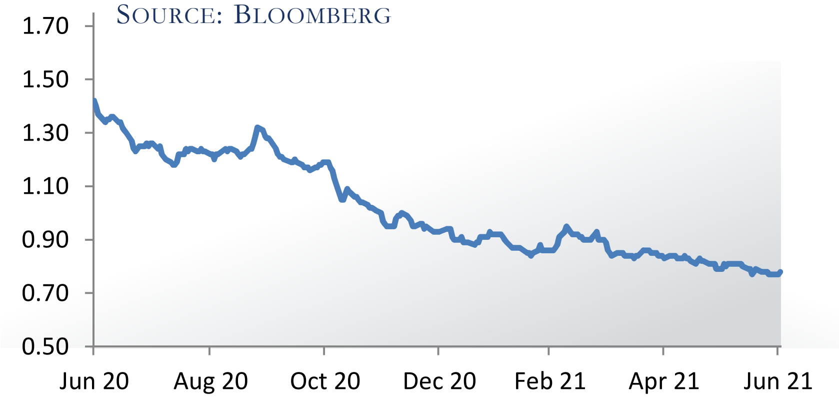
US Credit Index – Spread (%)
Source: Bloomberg



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