Short Maturity Muni and Low Duration 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

While the Federal Reserve remained highly accommodative over the quarter, the committee began to lay the groundwork for the eventual tapering of asset purchases. Additionally, Fed governors began slowly raising their forecasts for near-term growth and inflation but continued to reiterate that inflation will remain well under control as transitory price pressures ease. The market has generally agreed with their messaging, leading to a moderate flattening of the yield curve with maturities inside 5 years rising 10-15 basis points and intermediate maturities declining 15-20 basis points. We view the potential tapering as a positive step in returning to a more normalized monetary policy, and we do not anticipate a disorderly move higher for short-term rates given how well telegraphed and gradual future Federal Reserve actions are likely to be.

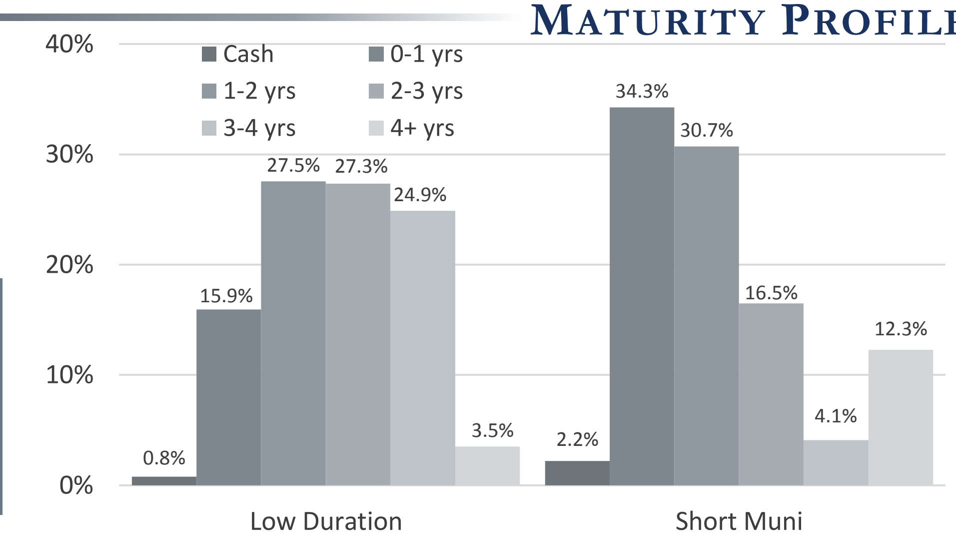
Low Duration

Duration: 2.07 yrs
Yield-to-Worst: 0.47%
Yield-to-Maturity: 0.53%
Maturity: 2.20 yrs

Short Muni

Duration: 1.59 yrs
Yield-to-Worst: 0.34%
Yield-to-Maturity: 0.37%
Maturity: 1.70 yrs

Maturity Profile



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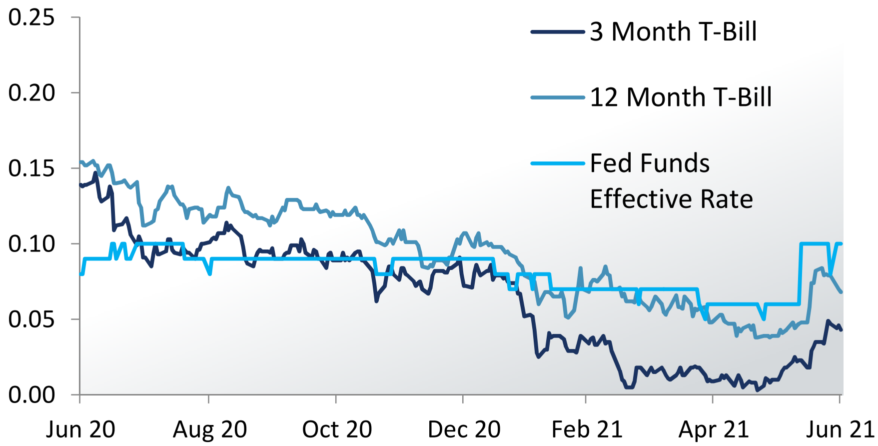
Performance Notes

Though 2 to 4 year bond yields rose over the quarter, the Low Duration Taxable strategy posted positive total returns as the overweight to corporate credit provided both incremental income and saw spreads contract. Looking forward, we expect this trend of tighter spreads and stability to remain in place with an improved US growth outlook for the next 12-24 months. Corporate credit health continues to improve as earnings and margins have expanded, and debt issuance has declined. Also, the fairly uniform maturity distribution found in both Low Duration Taxable and Short Maturity Muni provides portfolios with consistent cash flow that can be reinvested during periods of rising rates. This helps portfolios to gradually increase income levels while still seeking capital preservation and delivering lower volatility.

3M / 12M T-Bill Rates (%)
Source: Bloomberg

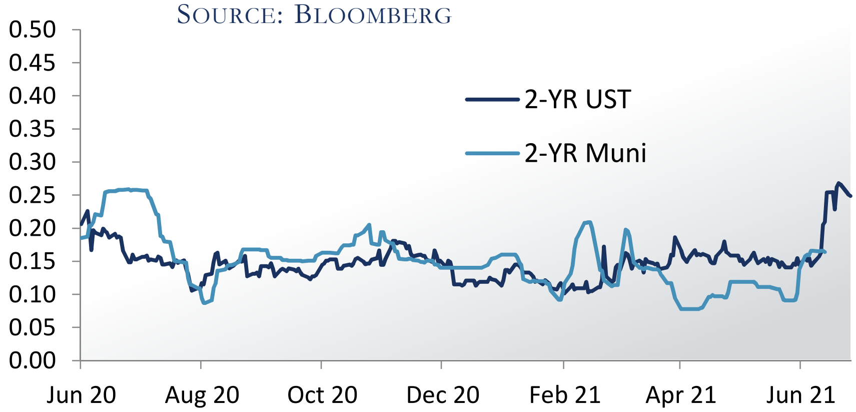


"We view potential asset purchase tapering by the Fed as a positive step in returning to a more

normalized monetary policy

And do not anticipate a disorderly move higher for short-term rates."

2 YR UST vs 2 YR MUNI Yields (%)
Source: Bloomberg



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