Intermediate Maturity Taxable

Commentary – Third Quarter 2021

Macro Overview

Eighteen months into the rapid economic recovery off pandemic-related lows, the US economy continued to improve over the quarter, although at a moderating pace. The spread of the Delta variant prompted a slowdown in hiring and consumer spending, while some inflationary pressures persisted for longer than anticipated. At its September meeting, the Fed reiterated its intent to begin tapering asset purchases in Q4 '21, and conclude by mid '22. Fed median forecasts now imply one rate hike in '22, however eight governors still forecast no increases in '22, suggesting uncertainty on the appropriate path for monetary policy. Although there was a quick uptick late in the period, UST yields were largely unchanged for the quarter, while the S&P ended effectively flat driven by a ~5% selloff during September.

- GDP estimates for full year '21 have softened recently, now forecasted around 5.9%. Growth is then expected to steadily decline from there to 4% in '22 and 2.5% in '23.
- Inflation pressures have intensified as the Fed-preferred Core PCE reached 3.6% in August. However, these elevated readings are being disproportionately driven by several sectors still experiencing covid-related supply bottlenecks.
- Meaningfully higher front-end yields are still unlikely in the near-term as the Fed remains committed to employment recovery, is comfortable with higher short-term inflation readings, and has well-telegraphed the upcoming tapering.
- The administration continues to have trouble gathering support for a large infrastructure spending and tax package. It appears a smaller plan will be a more likely outcome, however, a larger social spending agenda could still be passed through the budget reconciliation process.

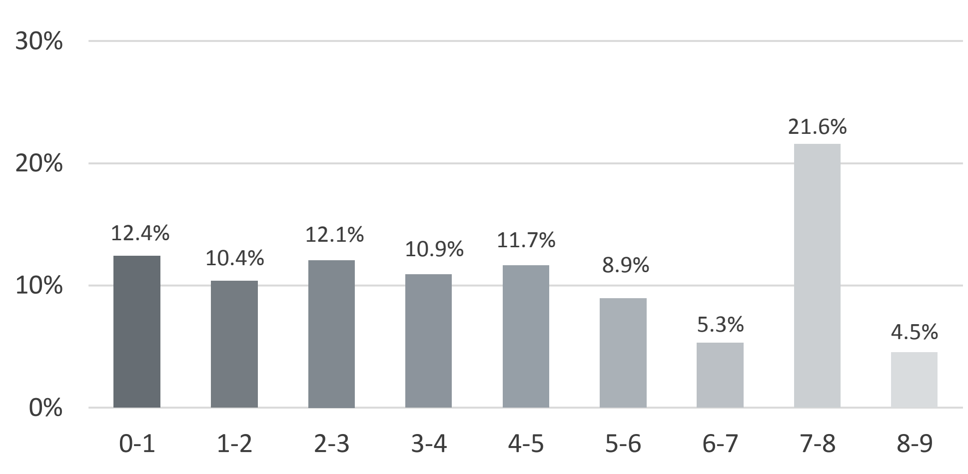
Market Dynamics

Investment Grade corporates saw solid demand over the quarter as investors took advantage of moderately higher interest rates. Credit spreads remained well anchored, despite some weakness in US equities, as the market grappled with fiscal policy uncertainty, a more hawkish tone from the FOMC, and renewed Chinese debt concerns. Despite the uptick in volatility for equities, corporate spreads continued to benefit from a rapid reduction of the balance sheet debt many companies incurred to shore up liquidity during the early stages of the pandemic. This debt reduction has led to improved credit metrics over the year and, combined with a slowing pace of issuance and continued demand, helped High Grade corporates weather potentially higher market volatility as we head into the end of the year.

Composite Characteristics

Duration: 4.47 yrs
Yield-to-Worst: 1.18%
Yield-to-Maturity: 1.26%
Maturity: 6.00 yrs

Duration Profile



INTERMEDIATE MATURITY TAXABLE

COMMENTARY – THIRD QUARTER 2021

PERFORMANCE NOTES

Although intermediate maturity yields made a push higher to finish out the quarter, they finished Q3 only modestly above mid-year levels, with the 10YR UST closing at 1.49% vs. 1.47% on June 30th. Looking ahead, we believe that the Federal Reserve will likely announce a gradual tapering of asset purchases at its November meeting. Unlike the last time the FOMC announced tapering, we see less risk for a sharp move higher in interest rates given the strong forward guidance provided by the committee. Also, while we are monitoring the current price pressures within the economy, we believe supply chain issues should begin to resolve themselves and inflation pressures moderate as we head into '22.

10-YR US TREASURY YIELD (%)
SOURCE: BLOOMBERG

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US CREDIT INDEX – SPREAD (%)
SOURCE: BLOOMBERG

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