Intermediate Maturity Muni

Commentary – Fourth Quarter 2021

Macro Overview

Investors faced two dominant themes in Q4: persistently higher inflation readings and an abrupt, hawkish shift by the Fed. On the inflation front, price increases proved to be stickier than previously anticipated. In November, the CPI index rose 6.8% year over year, the highest level in 39 years, and, coupled with a rapidly improving labor market, forced the Fed to react. The committee began tapering asset purchases by $15B/month following their November meeting and quickly doubled that pace to $30B/month after their December meeting. The Fed Dot Plot now forecasts three rate hikes in 2022, up from just one when they last released their projections in September. The result has been a flattening of the UST curve, with front-end rates moving higher by nearly 50 basis points (bps), while the long bond declined by 14 bps during the quarter.

- The Fed downgraded their economic forecast for ‘21 GDP to 5.5% from 5.9%; they see modestly higher growth than previously noted for ‘22 at 4%, but then quickly declining to 2.2% in ‘23.
- Front-end yields likely move higher over the next 6-12 months as the market continues to price in future Fed hikes with more confidence. Forwards curve now showing the 2YR UST ~ 1.12% by mid-‘22.
- Given the prospects for a quicker tapering/tightening in the face of an expected slowdown in growth, it could be difficult for the curve to re-steepen. The market could find itself in another ultra-flat curve environment similar to ’18-’19, over the next 12-24 months.
- Legislation passed since covid began has added $5 Trillion to the economy and has proven to be a powerful accelerant to our overall economic recovery. New stimulus measures have stalled in Washington, however, should additional measures pass, they would likely be stretched out over a decade and at least partially funded by higher taxes.

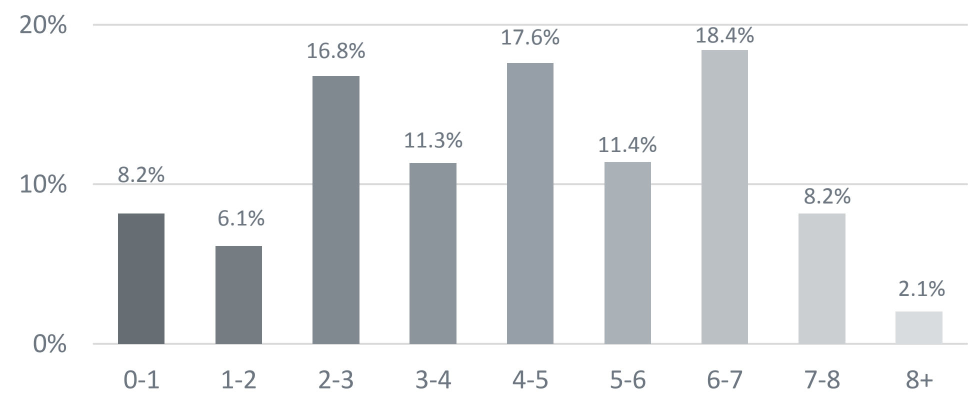
Market Dynamics

Municipal yields were largely steady over the quarter, with the 2YR and 10YR portions of the curve moving higher by just 6 and 8 bps, respectively. The front-end of the muni curve continued to decouple from the UST curve as shorter UST rates rose in anticipation of faster interest rates hikes from the Federal Reserve, while municipal yields remained anchored. This divergence has resulted in historically tight muni valuations for shorter maturities, with the 2YR Muni/UST ratio ending the year at 33%. Strong demand throughout Q4 continued to be the catalyst in keeping tax-exempt rates in check. Despite current valuations, we believe the market will remain well-bid as we move into ’22, as both positive technical and fundamental drivers remain in place.

Composite Characteristics

Duration: 4.32 yrs
Yield-to-Worst: 0.90%
Yield-to-Maturity: 1.38%
Maturity: 6.93 yrs

Duration Profile



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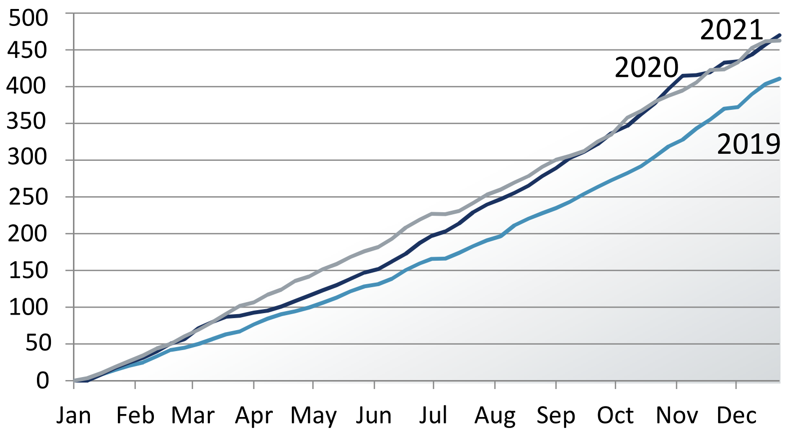
Performance Notes

The Bloomberg Barclays 1-15 Year Municipal Index posted negative returns in October but produced positive returns in both November and December; these moves generated a total return for the period of 0.38%. The Intermediate Maturity Municipal strategy outperformed the benchmark over the course of the quarter: our maturity positioning, particularly in the 10-14 YR portion of the curve, proved additive as these tenors outperformed shorter dated positions. While we acknowledge current valuations are high (most notably for the front-end of the curve), we remain constructive on the market over the near-to-medium term. Upcoming reinvestment income of approximately $44 Billion from maturities, coupons, and redemptions should outpace a historically limited supply to start the New Year and should serve as a driver of positive performance.

Total Municipal Issuance YoY ($Bln)

Source: Bloomberg



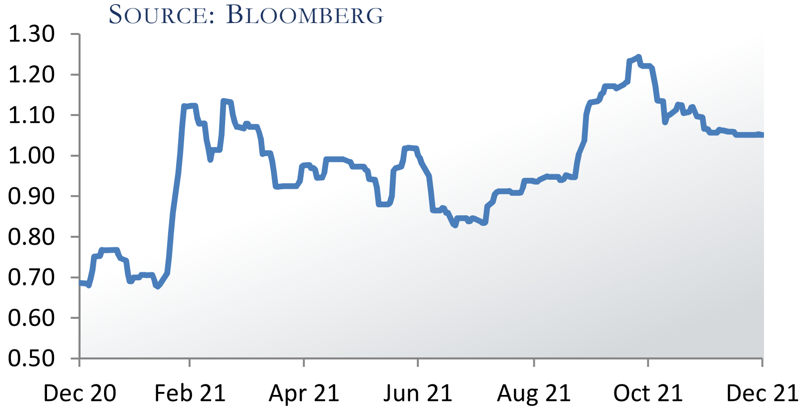
"As we end another year plagued by the pandemic,

we remain constructive on muni credit as a whole.

Most sectors have emerged from the past two years with sound balance sheets and robust liquidity, buoyed by unprecedented federal stimulus measures and still-improving reopening trends."

10 YR MMD Yield (%)

Source: Bloomberg



Contact Us

804.648.3333

WWW.CAPRINBONDS.COM

Media Contact:
aplotkin@caprinbonds.com