Intermediate Maturity Taxable

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.

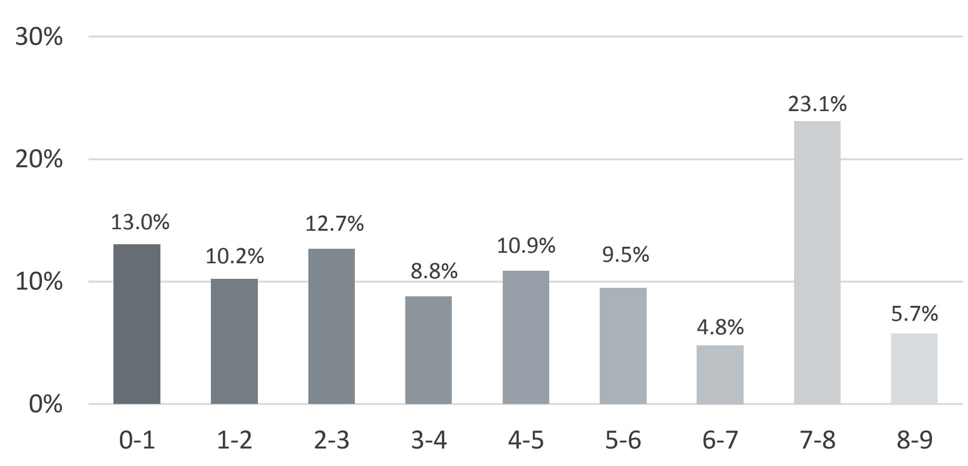
Market Dynamics

Investment Grade corporate spreads saw somewhat heightened volatility as the Federal Reserve abruptly shifted to a more hawkish tone at their November meeting and as omicron variant news began dominating the headlines. Spreads rose approximately 15 bps from their more recent lows as we entered December, with the Bloomberg Barclays Aggregate Credit Spread Index reaching approximately 95 bps. This move quickly reversed, though, with spreads tightening back to 87 bps by the end of the year as investors gained greater clarity surrounding both the path of future monetary policy and the overall severity of the latest covid variant. Looking into 2022, we believe the High Grade Corporate market will continue to be supported by positive improvements in credit metrics and generally lower issuance levels as many corporations have already taken advantage of the historically low interest rate environment.

Composite Characteristics

Duration: 4.47 yrs
Yield-to-Worst: 1.30%
Yield-to-Maturity: 1.37%
Maturity: 5.94 yrs

Duration Profile



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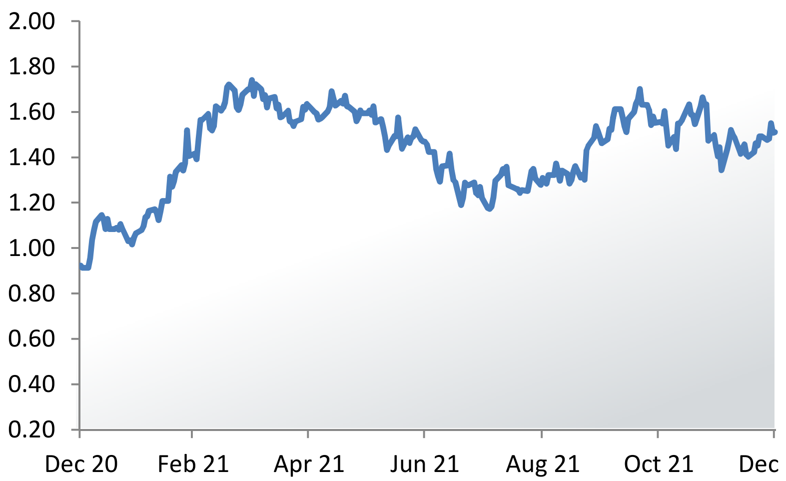
Performance Notes

An overall flattening of the yield curve was the most notable detractor to absolute performance over the quarter. Despite the 10YR UST finishing the year (1.51%) nearly unchanged from the end of Q3, the Federal Reserve's more aggressive posture on current inflation readings saw yields from 5 years and in rise notably. Currently, the market has already priced in much of the forecasted tightening that is expected from the FOMC in the next 12 months. In the shorter-term, we anticipate the flatter curve to persist, however, we do see a scenario by late '22-early '23 where both growth and inflation measures moderate more rapidly, making it more difficult for the Fed to fully realize their forecasted hikes.

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



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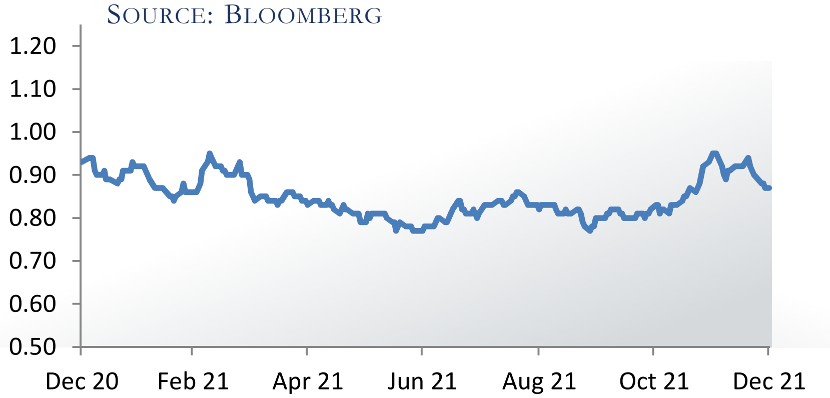
US Credit Index – Spread (%)
Source: Bloomberg



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