Short Maturity Muni and Low Duration 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

The December meeting of the Federal Reserve showed significant, although not completely unexpected, changes to how the committee would look to control mounting price pressures seen across many facets of the economy. Not only was "transitory" removed in describing inflation, they agreed that a faster tapering would be necessary to allow for a potential increase to the Federal Funds rate by the middle of '22. Additionally, revisions to year-end rate forecasts from the governors now show median projections of nearly .90% in '22, 1.63% in '23, and 2.13% in '24. While we are encouraged by the committee's direction to seek a more normalized interest rate policy, Chairman Powell acknowledged that their own longer-term forecasting is subject at best, and may be overestimating the appropriate level for "neutral" policy positioning.

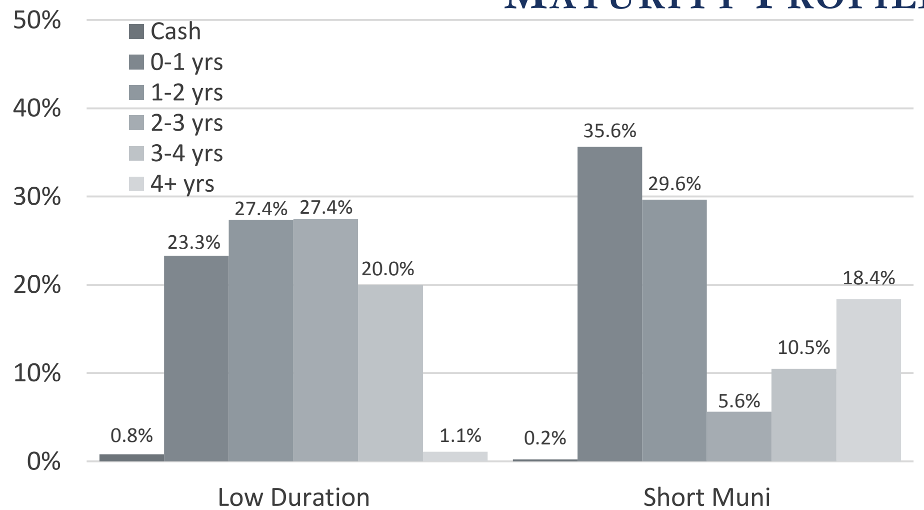
Low Duration

Duration: 1.85 yrs
Yield-to-Worst: 0.82%
Yield-to-Maturity: 0.87%
Maturity: 1.95 yrs

Short Muni

Duration: 1.66 yrs
Yield-to-Worst: 0.45%
Yield-to-Maturity: 0.45%
Maturity: 1.76 yrs

Maturity Profile



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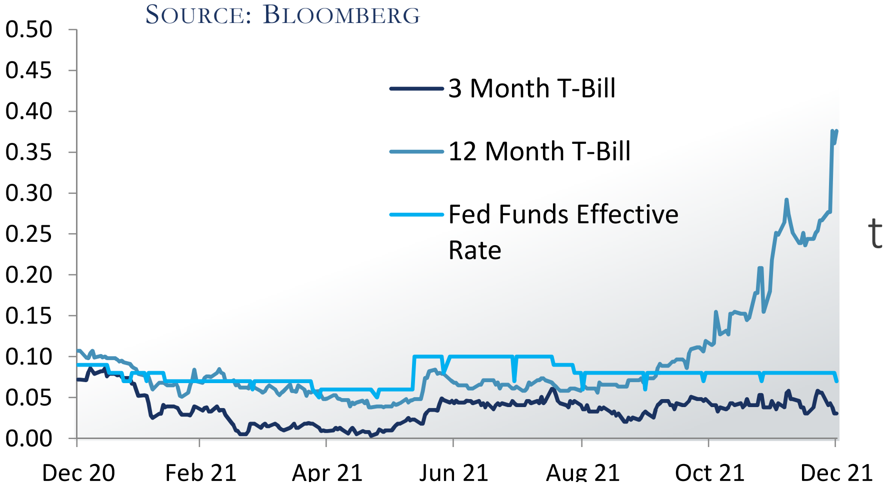
Performance Notes

Shorter maturity bond yields moved notably higher over the quarter as the likelihood of future Fed tightening grew. 2YR and 3YR UST yields experienced the most movement, each rising by nearly 50 bps to end the year at 0.73% and 0.96%, respectively. While this quick move was an overall detractor to short-term performance, the strategies remain well-positioned with consistent maturity structures that will allow for reinvestment into these more favorable current interest rate levels. Longer-term, we do see a scenario whereby in late ’22-early ’23 both growth and inflation measures moderate more rapidly, making it more difficult for the Fed to fully realize their forecasted hikes and putting a cap on the degree to which short-term yields could rise.

3M / 12M T-Bill Rates (%)

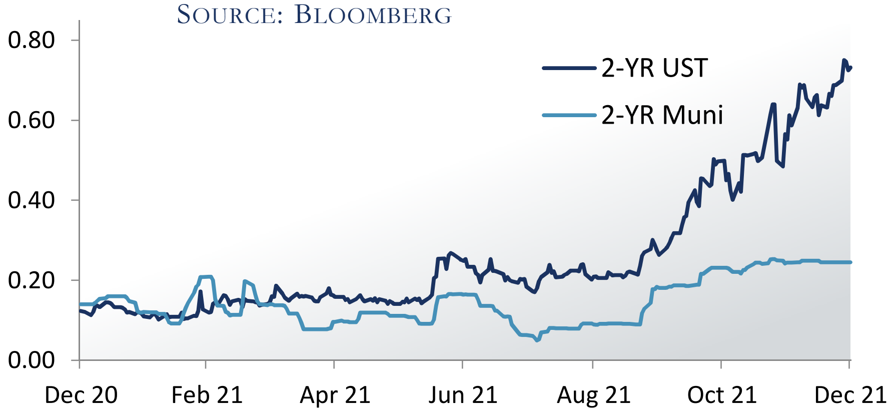
Source: Bloomberg



“While shorter-term yields levels rose notably over the quarter, **the Low Duration Taxable and Short Maturity Municipal strategies remain well-positioned** with consistent maturity structures that will allow for reinvestment into these more favorable current interest rate levels.”

2 YR UST vs 2 YR MUNI Yields (%)

Source: Bloomberg



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