Intermediate Maturity Muni

Commentary – First Quarter 2022

Macro Overview

The first quarter of 2022 saw a confluence of events that led to one of the most rapid increases in interest rates witnessed in the last several decades. Russia's invasion of Ukraine exacerbated already stretched global supply chains, and commodity prices on staples such as wheat and crude skyrocketed. The Federal Reserve, which just months ago forecasted three 25bps hikes in '22, is now projecting a targeted Fed funds rate of nearly 2% by year-end. The committee has now made it clear; inflation is a problem and they must act expeditiously to tame it. The market has responded with a significant upward shift in rate expectations producing an abrupt bear flattening of the yield curve to the point of inversions across many maturities.

- Fed tightening cycles and flattening yield curves generally precede recessions. What is unique about the current environment is how early the curve has flattened relative to expected Fed tightening.
- While the Fed believes they may be able to accomplish a soft landing for the economy, history shows this is unlikely given underlying macro observations.
- The Fed's inflation forecast for Core PCE is now significantly higher for '22 at 4.1%, but the committee still sees a significant easing of price pressures as we move into '23 as supply chains/inventories rebuild and consumption/demand cools.
- Ultimate outcome of Russian invasion of Ukraine remains unclear, and the conflict will continue to pressure commodity prices until either resolution is reached or global demand wanes.

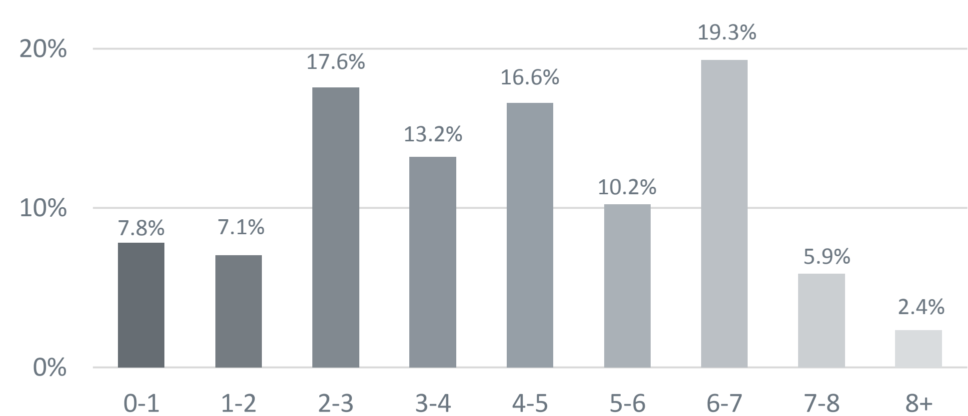
Market Dynamics

Municipals followed taxable fixed income yields higher over the quarter, with benchmark rates rising by 150bps, 140bps and 100bps in the 2yr, 10yr, and 30yr parts of the curve. The rapid shift in yields cooled retail investor sentiment, ultimately resulting in 12 consecutive weeks of mutual fund outflows totaling approximately $21 billion. It was clear some normalization of muni yields was warranted given lower relative value metrics versus taxable counterparts at the start of the year. However, the shift higher in Muni-to-UST ratios was noteworthy with the 10yr ratio moving from 69% to 95% in just 3 months' time. From here we believe fund outflows should gradually reverse as investors now look to capture currently elevated yields, which should help facilitate a more positive tone to the market.

Composite Characteristics

Duration: 4.23 yrs
Yield-to-Worst: 2.02%
Yield-to-Maturity: 2.32%
Maturity: 6.85 yrs

Duration Profile



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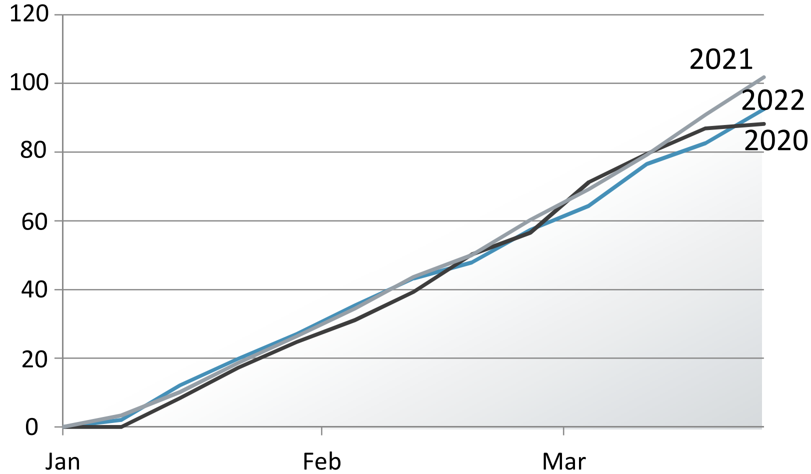
Performance Notes

The Bloomberg 1-15 Year Municipal Index posted negative returns in each month to start the year, bringing total return for the quarter to -5.33%. The Intermediate Maturity Municipal strategy moderately outperformed the benchmark given its more conservative maturity and duration profile, and overweight to higher-quality issuers. In particular, the exposure to highly rated General Obligation credits on the front-end of the curve proved additive as GO's outperformed revenue bonds, and short maturities helped buffer the impact of higher rates on longer positions. The municipal selloff year-to-date has been almost entirely rate-driven as the sector's overall sound credit fundamentals remain intact. We are now more constructive on the market over the near-to-medium term, and believe current yield levels provide investors with attractive entry points for reinvestment.

Total Municipal Issuance YoY ($Bln)

Source: Bloomberg



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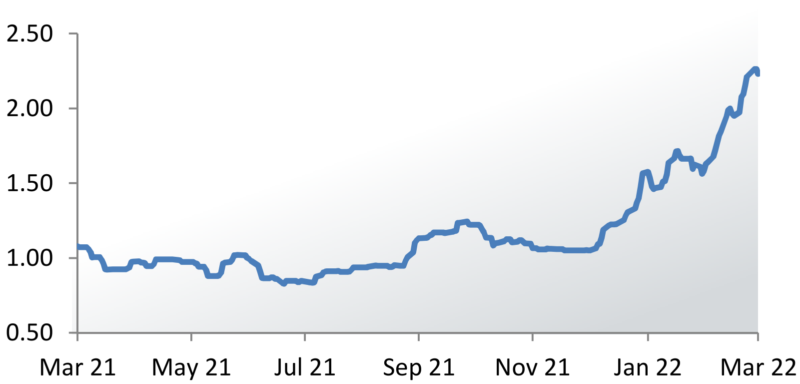
10 YR MMD Yield (%)

Source: Bloomberg



Contact Us

804.648.3333

WWW.CAPRINBONDS.COM

Media Contact:
aplotkin@caprinbonds.com

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