Intermediate Maturity Taxable

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.

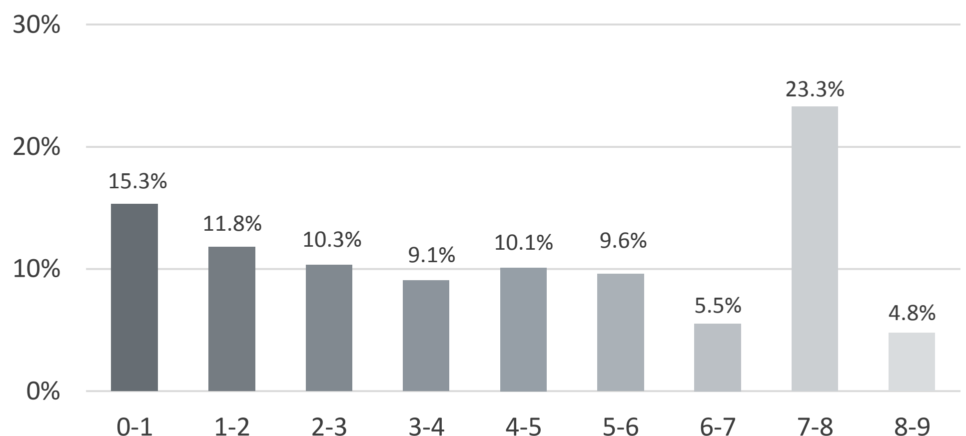
Market Dynamics

A rapid repricing of future Federal Reserve tightening and the invasion of Ukraine pushed investment grade credit spreads wider over much of the quarter. At the same time, corporate borrowers looking to lock in still ultra-low financing brought nearly $450 billion of new debt, likely front-loading 2022 issuance. Spreads rose nearly 45bps through mid-March, with the Bloomberg Aggregate Credit Spread Index reaching approximately 135bps, a level last seen in early '20. Despite the heightened volatility and inversions forming across many tenors of the UST curve, high-grade corporate investors reemerged late in the period with absolute yield levels presenting more attractive entry points. This rebound in demand saw spreads rally tighter by nearly 30bps to close out the quarter, leaving the sector on a bit firmer footing as we move into Q2.

Composite Characteristics

Duration: 4.31 yrs
Yield-to-Worst: 2.42%
Yield-to-Maturity: 2.44%
Maturity: 5.76 yrs

Duration Profile



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Performance Notes

The remarkably swift flattening of the yield curve led to weaker absolute returns for the strategy over the quarter, as short-to-intermediate UST yields rose by 100-150bps. However, the strategy's more conservative maturity position, coupled with an emphasis on higher-quality corporate issuers resulted in outperformance versus the benchmark. Looking forward, we now see attractive investment levels across much of the corporate credit curve, in excess of 3%. Our outlook generally views much of the possible tightening that the Federal Reserve may be able to accomplish with a likely slowing of growth by late '22-early '23 as already priced into market yields. We remain patient and deliberate given the current market environment and are strategically executing opportunities to increase the income profile of client portfolios.

10-YR US Treasury Yield (%)

Source: Bloomberg

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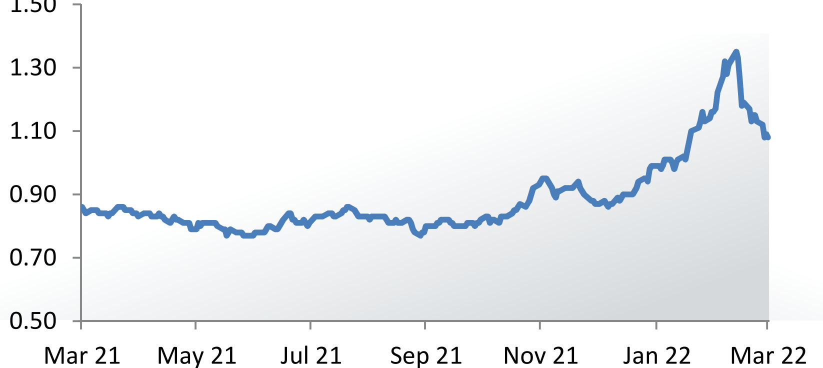
US Credit Index – Spread (%)

Source: Bloomberg



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