Short Maturity Muni and Low Duration 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

Through the quarter, the Federal Reserve quickly pivoted to a notably more hawkish stance while signaling that controlling the current high inflation readings is now the primary objective. Their forecasts for Fed Funds at the end of 2022 rose from approximately 0.87% at the end of last year, to nearly 2.00% at the most recent meeting. Despite the Fed raising rates only 25bps thus far, the market has responded by sending short maturity UST and municipal yields higher by more than 150bps, effectively pricing in all of the forecasted Fed increases for the year in a matter of months. Looking forward, the question now becomes to what degree will the Fed need, or be able, to tighten before slower growth and potentially weaker employment forces the policy to pause or even reverse course.

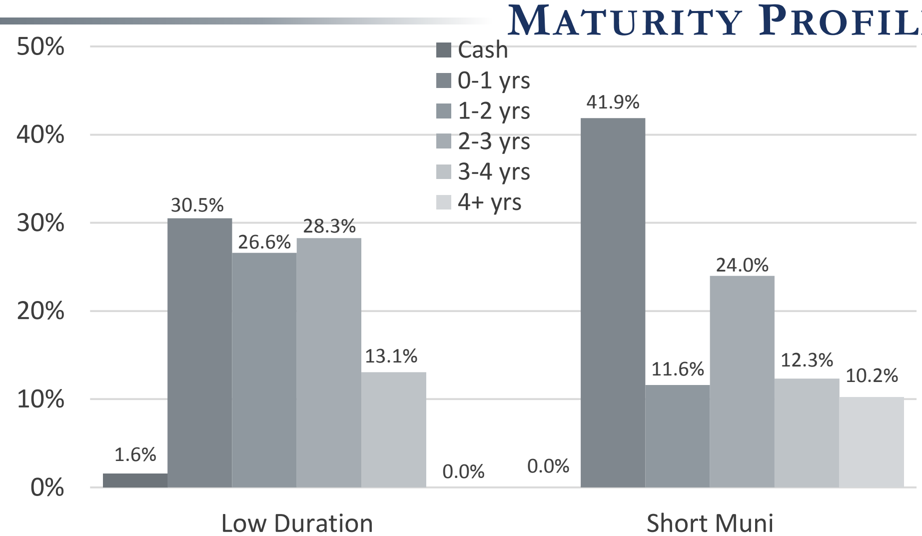
Low Duration

Duration: 1.59 yrs
Yield-to-Worst: 2.08%
Yield-to-Maturity: 2.11%
Maturity: 1.70 yrs

Short Muni

Duration: 1.70 yrs
Yield-to-Worst: 1.75%
Yield-to-Maturity: 1.75%
Maturity: 1.82 yrs

Maturity Profile



Short Maturity Muni and Low Duration Taxable

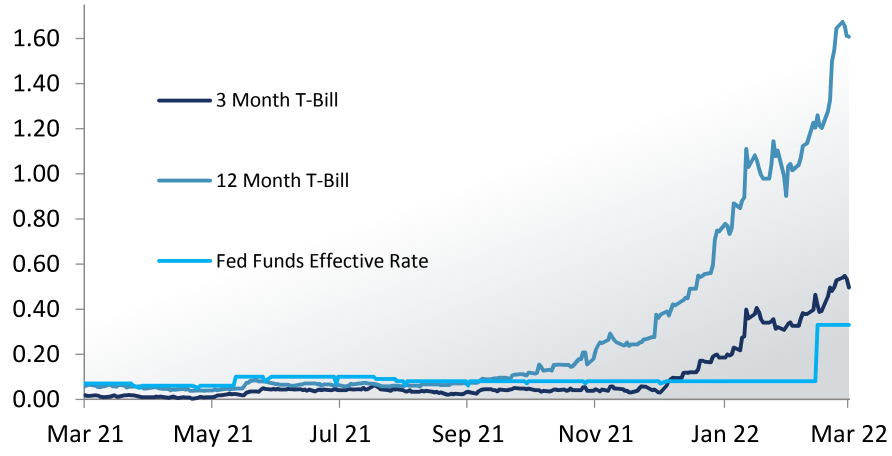
Commentary – First Quarter 2022

Performance Notes

The remarkably swift flattening of the yield curve led to weaker absolute returns over the quarter. However, the strategies' more conservative maturity positions coupled with an emphasis on higher-quality issuers resulted in outperformance versus the benchmark. Looking forward, we now see attractive investment levels across shorter maturity corporates and municipals in excess of 3% and 2%, respectively. Also, the fairly uniform maturity distribution found in both Low Duration Taxable and Short Maturity Muni provides portfolios with consistent cash flow that can now be reinvested back into notably higher yields. This will help portfolios gradually increase income levels while still seeking capital preservation and delivering lower volatility.

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

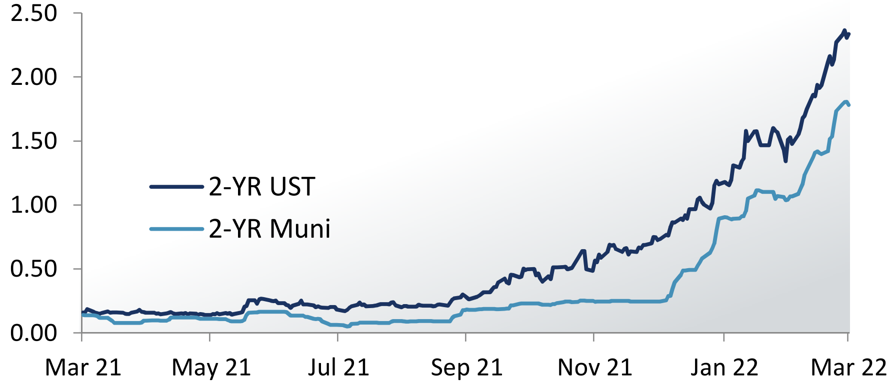
Source: Bloomberg



"Looking forward, we now see attractive investment levels across shorter maturity corporates and municipals in excess of 3% and 2%, respectively."

2 YR UST vs 2 YR Muni Yields (%)

Source: Bloomberg



Contact Us

804.648.3333

WWW.CAPRINBONDS.COM

Media Contact:
aplotkin@caprinbonds.com