Intermediate Maturity Muni

Commentary – Second Quarter 2022

Macro Overview

The Fed's fight against persistently high inflation continued throughout Q2. However, their attempt at a "soft landing" has become even more challenging as the economy begins to show signs of significant deceleration. Retail sales, consumer confidence, mortgage applications and construction employment all continued to weaken throughout the quarter after a 1.6% decline in Q1 GDP, which was dragged down by a surge in imports and a drawdown of inventories. An upside surprise in May CPI along with a rise in consumer inflation expectations forced the Fed to hike 75bps in June vs. an expected 50bps, pushing UST yields higher across the curve. US equities dipped into bear market territory, with the S&P 500 down 16% over the quarter and down 20% for the year, marking the worst first half of the year for US equities in over 50 years.

- FOMC now indicates a strong desire to front-load rate hikes and a willingness to see some job destruction. Chair Powell alluded to future policy action now being near-term data dependent.
- GDP estimates for full year 2022 continue to soften: Q1 came in well below expectations (-1.6%) while current Q2 estimates are now in the range of -1% to -2%. Should that hold, it would mark two consecutive quarters of negative growth, indicating the US is already in a technical recession.
- Recent release of Univ. of Michigan consumer confidence moved to the lowest level (50.2) ever recorded. Over last 40+ years, sharp declines in consumer confidence coupled with readings below 70 have almost always been seen in conjunction with a recession.
- US corporate earnings releases and forward guidance, particularly from consumer facing firms, have been weak and have noted material margin declines, rising inventories, and shifting buyer behavior towards essentials.

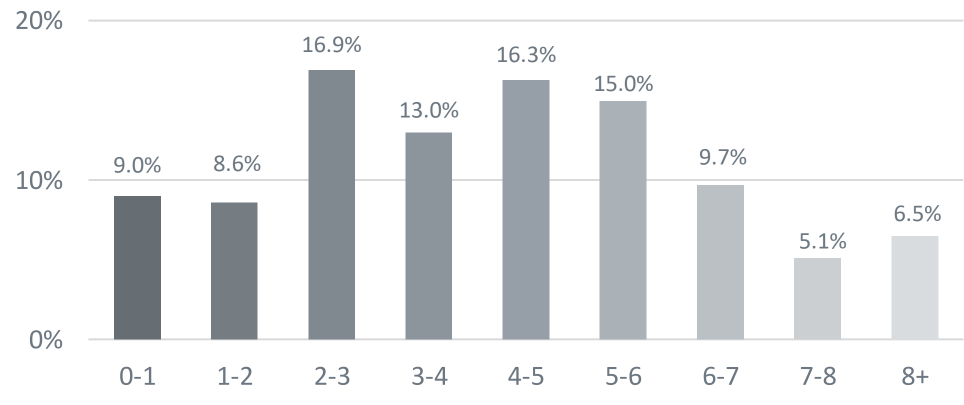
Market Dynamics

Municipal yields continued to rise throughout the quarter, however the moves weren't nearly as dramatic as the shift higher during Q1. Higher yields year-to-date can largely be attributed to the correlation between muni and UST rates and is not credit related, as underlying credit fundamentals remain sound. Total primary market issuance is down ~12% year-over-year led by an obvious reduction in refundings – not surprising due to the move higher in yields. Year-to-date, we have seen unprecedented outflows from muni funds, totaling -$88.5 billion. However, we expect this trend to moderate, if not reverse, as the summer months historically provide a strong technical backdrop. The slope of the muni curve in the first 10 years is steep relative to USTs, and we see 7 to 10 year bonds now as offering the most attractive relative value.

Composite Characteristics

Duration: 4.25 yrs
Yield-to-Worst: 2.37%
Yield-to-Maturity: 2.62%
Maturity: 6.62 yrs

Duration Profile



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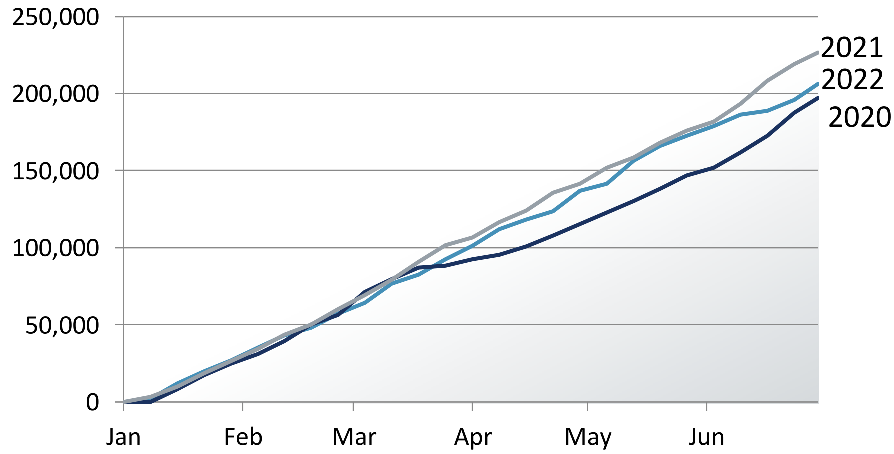
Performance Notes

The Bloomberg Barclays 1-15 Year Municipal Index posted positive performance in May, but that was not enough to offset negative total returns in April and June, which brought total return for the quarter to -1.55%. The Intermediate Maturity Municipal strategy moderately outperformed the benchmark over the course of the quarter. Our more defensive duration position and overweight to higher-rated credits drove outperformance; our exposure to shorter, high-quality General Obligation credits proved additive as they outperformed revenue bonds and provided a buffer against the impact of higher yields. Given our outlook for weaker growth and a likely recession, coupled with the eventual cooling of price pressures, we believe current yield levels present an attractive entry point for new investors or clients looking to add to their portfolios.

Total Municipal Issuance YoY ($Bln)

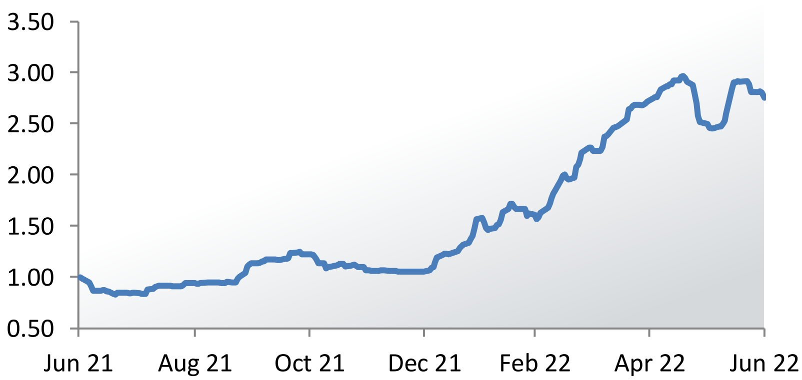
Source: Bloomberg



"We believe fund outflows should **slow and perhaps reverse** as investors look to capture current elevated yields, which should facilitate a more positive tone to the market."

10 YR AAA Municipal Yield (%)

Source: Bloomberg



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