Intermediate Maturity Taxable

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.

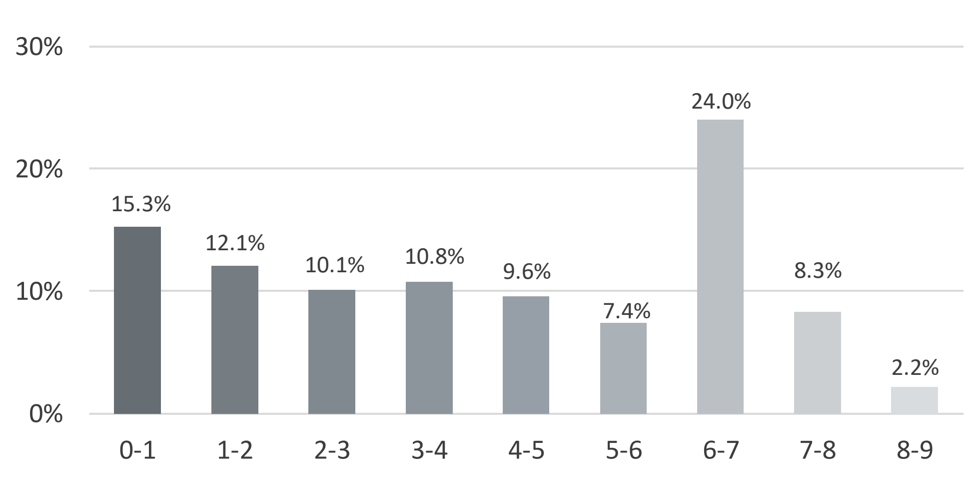
Market Dynamics

UST yield momentum began to give way over the quarter as key technical rate levels were reached and growth concerns began to surface. The first 10 years of the curve, where the strategy primarily invests, finished the period higher by approximately 50bps, versus moves in excess of 150bps over the first three months of the year. Although rate volatility is likely to continue in the near-term, we believe the case for persistently higher interest rates from here is weakening, as the pandemic-fueled rebound is quickly losing steam. Higher current inflation readings will likely see the Federal Reserve continue to raise short-term rates through the remainder of the year, leading to an even more pronounced yield curve inversion, which has historically been a harbinger of both recessions and stronger periods for high quality fixed income.

Composite Characteristics

Duration: 4.14 yrs
Yield-to-Worst: 3.19%
Yield-to-Maturity: 3.20%
Maturity: 5.49 yrs

Duration Profile



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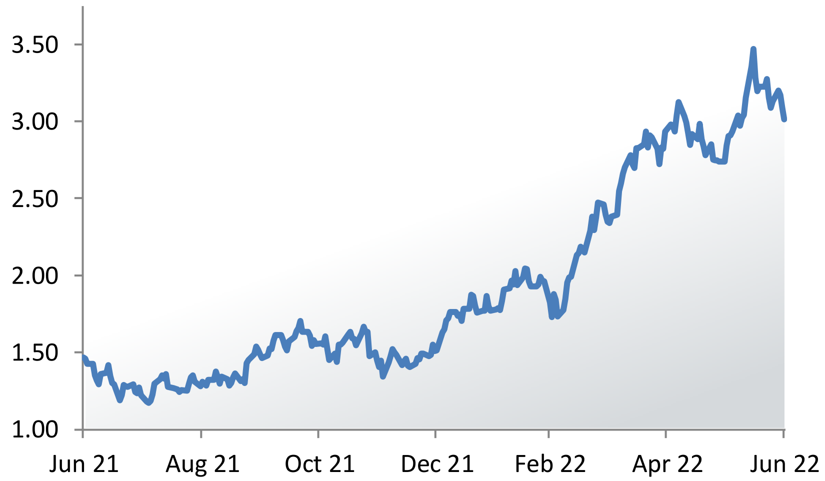
Performance Notes

Corporate credit spreads drifted higher over the period as equity/risk markets declined and growth outlooks softened. While spreads now sit approximately half-way between historically recessionary and non-recessionary period averages, declining issuance and attractive absolute yield levels for investors should benefit the sector in the second half. The strategy's emphasis on higher-quality corporate issuers has helped buffer against the recent spread widening and resulted in outperformance versus the benchmark for the period. We continue to see attractive investment levels across much of the corporate credit curve, now in excess of 4%, but remain patient and deliberate given market volatility. Overall, we see the current fixed income landscape as an excellent opportunity to gradually increase the longer-term income profiles of client portfolios.

10-YR US Treasury Yield (%)

Source: Bloomberg



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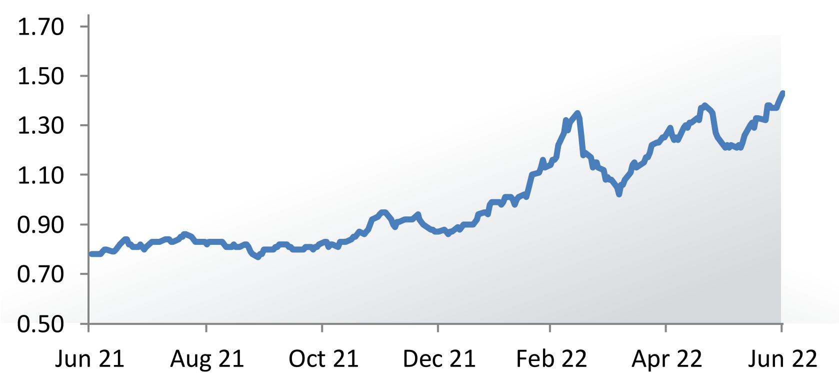
US Credit Index – Spread (%)

Source: Bloomberg



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