Short Maturity Muni and Low Duration 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

Despite growing uncertainty surrounding future growth, the Federal Reserve reiterated its intent to curb inflation when it met late in the quarter. Not only did the committee raise its short-term borrowing rate by 75bps, but their own median forecasts for Fed Funds climbed to nearly 3.5% by the end of '22, and 3.8% by the end of '23. This represented a nearly 150bps increase from their last forecast in March and, if realized, would mark the highest level on Fed Funds since 2008. Subsequently, shorter-term maturity yields also rose through the quarter, with the 2YR UST reaching nearly 3.5% by mid-June. Looking forward, we believe it will be difficult for the Fed to reach its forecasted levels as recession threats continue to mount and ultimately undermine the very strong labor market that has propelled the post pandemic rebound.

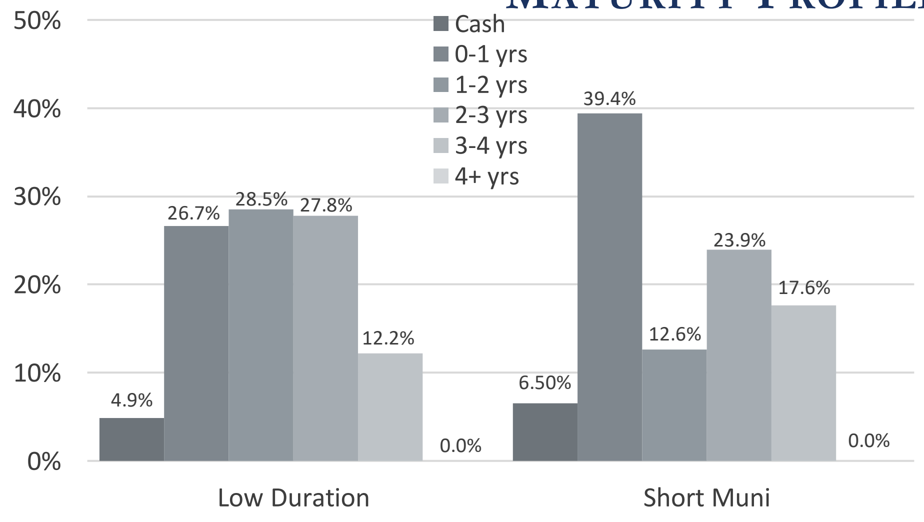
Low Duration

Duration: 1.58 yrs
Yield-to-Worst: 3.00%
Yield-to-Maturity: 3.01%
Maturity: 1.66 yrs

Short Muni

Duration: 1.51 yrs
Yield-to-Worst: 1.91%
Yield-to-Maturity: 1.91%
Maturity: 1.61 yrs

Maturity Profile



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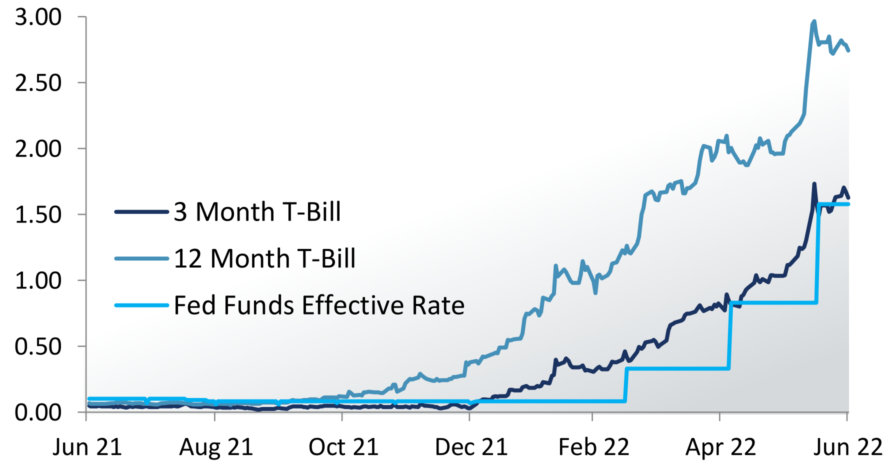
Performance Notes

Although the UST yield curve continued to flatten over the quarter, led by higher short maturity yields, the velocity and degree of the move was far less pronounced than in Q1. Short municipal and taxable benchmarks saw flat to modestly negative total returns, with portfolio returns displaying similar results. Looking forward, we continue to see attractive investment levels, particularly across shorter maturity corporates in excess of 4%. Also, the more uniform maturity distribution found in both Low Duration Taxable and Short Maturity Muni provides portfolios with consistent cash flow that continues to 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 (%)

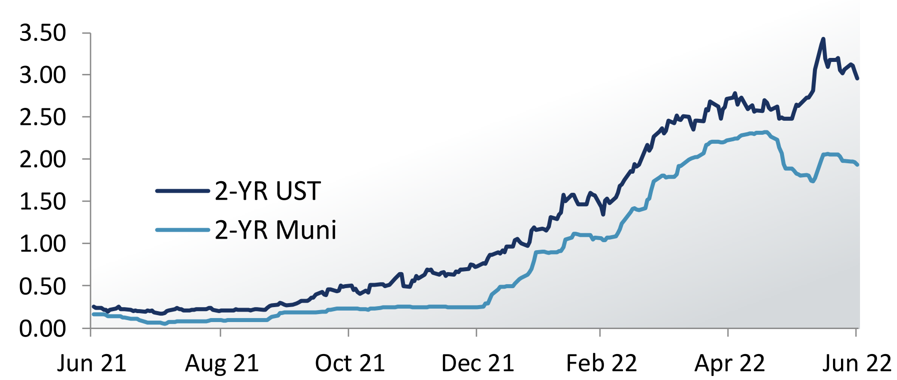
Source: Bloomberg



"The more uniform maturity distribution found in both Low Duration Taxable and Short Maturity Muni **provides portfolios with consistent cash flow** that continues to be reinvested back into notably higher yields."

2 YR UST vs 2 YR Muni Yields (%)

Source: Bloomberg



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