VERITABLE

# Domestic Investment Grade Fixed Income Market Summary

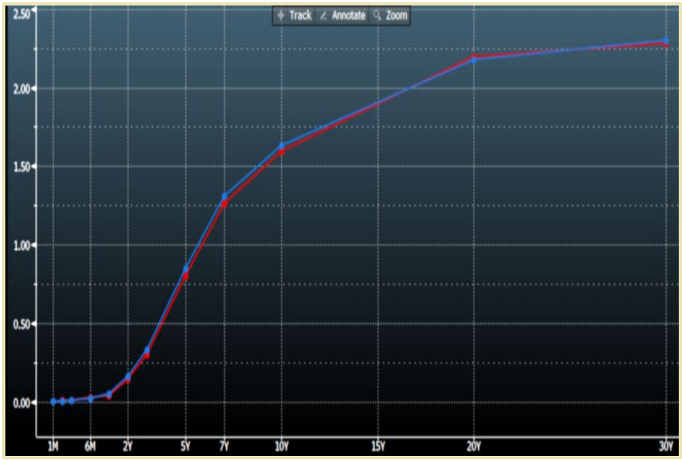
May 2021

## Treasury Yields Fall Slightly on Mixed Economic Data Despite Inflation Uptick

- The Treasury yield curve generally shifted lower by 2-5 basis points on uneven economic data as April price strength continued into May following the first quarter optimism-driven selloff in bonds.
    - Institute for Supply Management surveys unexpectedly showed slower growth in both the manufacturing and service sectors.
    - Bureau of Labor Statistics reported just 266,000 jobs were added in April, well below expectations for 1 million new jobs.
        - Continued hiring in the Leisure and Hospitality segment was partially offset by jobs lost within other sectors such as Transportation and Warehousing.
        - Unemployment rate rose to 6.1% (pre-pandemic: 3.5%).
        - Average hourly earnings rose 0.3% after an unexpected -0.4% decline in March.
    - Retail sales were flat in April (expected: +1.0%).
    - Consumer Price Index (CPI) rose the most since June 2009, surging 0.8% (expected: 0.2%) in April, heavily influenced by airline fares (+10.2%), used cars/trucks (+10.0%), and lodging away from home (+7.7%) prices.
        - Year-over-Year CPI jumped 4.2% due to comparison to weak month during height of pandemic/shutdown (i.e., base effect).
        - Core CPI rose 0.9% in April, the largest monthly increase since September 1981.
- Inflation expectations reached as high as 2.57% following the CPI release before retracing lower and ending May at 2.45%, four basis points higher for the month based on 10-year Treasury Inflation Protected Securities (TIPS) pricing.

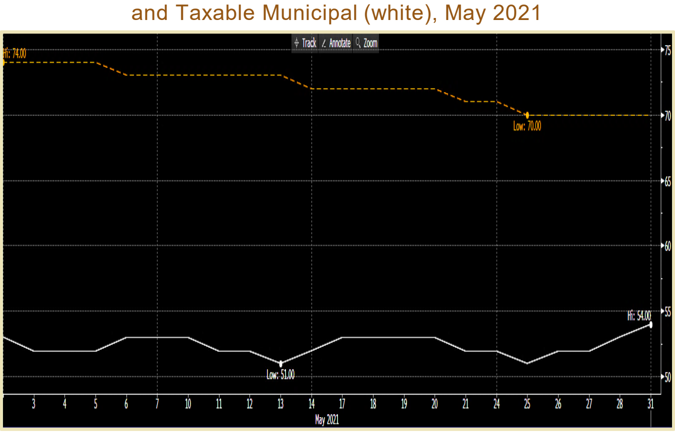
| Maturity | 4/30/21 Treasury | 5/31/21 Treasury | Change |
|---|---|---|---|
| 2-year | 0.16% | 0.14% | -0.02% |
| 5-year | 0.85% | 0.80% | -0.05% |
| 7-year | 1.31% | 1.26% | -0.05% |
| 10-year | 1.63% | 1.60% | -0.03% |
| 30-year | 2.30% | 2.28% | -0.02% |

Treasury Yield Curve: 4/30/21 (blue) vs. 5/31/21 (red)




| Segment | May Return | YTD Return |
|---|---|---|
| Bloomberg Barclays Intermediate Government Credit Index | 0.40% | -0.98% |
| ICE BofA 1-10 Year US Treasury Index | 0.28% | -1.08% |
| ICE BofA 1-10 Year US Inflation-Linked Treasury Index | 0.95% | 2.24% |
| ICE BofA 1-10 Year Corporate Index | 0.55% | -0.79% |
| ICE BofA 1-10 Year Taxable Municipal Index | 0.45% | -0.23% |

1-10 Year IG Credit Spreads: Corporate (orange) and Taxable Municipal (white), May 2021




## The Federal Reserve (Fed) Stares Down Inflation; TIPS and Credit Outperform Treasuries

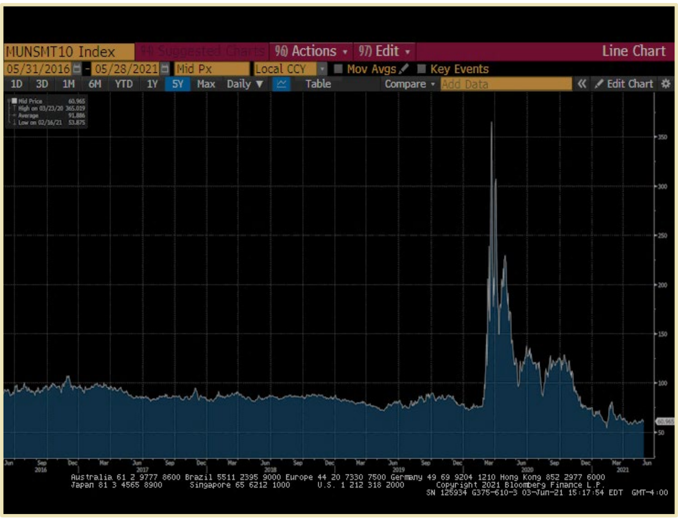
- While the Fed did not convene in May, minutes from the late April meeting indicated that multiple officials suggested that it might be appropriate in upcoming meetings to begin discussing tapering of asset purchases.
    - Chairman Powell has continuously classified pricing pressures as transitory; however, Fed Vice Chairs Randal Quarles and Richard Clarida publicly acknowledged potential near-term taper talk with the latter calling April's CPI an "unpleasant surprise."
        - However, April's lower-than-expected jobs report may be a sign of a weaker labor market, a potential counterpoint against tapering.
    - The initial Fed taper scuttlebutt likely puts actual policy change at least two meetings away, as the central bank next convenes in mid-June and then late-July.
- Corporate bonds, taxable municipals, and TIPS all outperformed Treasuries in May.
    - Even with record high cash holdings and a year-to-date uptick in rates, corporate bond issuance remains robust and on pace to be the second largest year ever according to Refinitiv data.
    - A Build America Bonds-like government-subsidized program incentivizing taxable municipal bond issuance has gained bi-partisan support to fund infrastructure spending plans and could increase future supply.

Source: Bloomberg; Bureau of Economic Analysis; Federal Reserve; ICE BofA; Veritable, L.P.
All numbers are estimates. See Disclosures for index descriptions and additional information.

## Municipals Post Underperformance in Shorter-Maturities and Outperformance in Longer-Maturities Versus Treasuries

- Tax-exempt yields were mixed in May, as short-end rates were unchanged to higher, while longer-dated rates were unchanged to lower.
- Investors continued to add to duration and credit risk during the month.
    - Performance was strongest in longer-dated maturities as 15+ year rates were lower by 5-8 basis points, as investors extended duration to maximize yield.
    - The yield spread between 2-year and 10-year municipal debt remained unchanged at 89 basis points, but the curve flattened further relative to longer-dated maturities, as the yield spread between 2-year and 20-year municipal debt fell 8 basis points to 122 basis points, the smallest term premium since mid-February.
    - According to Refinitiv Lipper weekly fund reporting data, investors added more than $3.5 billion to municipal funds, which included over $2 billion to high-yield municipal funds.
- While relative valuations improved modestly in the front-end due to modest tax-related selling pressure in the municipal sector, municipal-to-Treasury yield ratios continued to hover near historic lows.
    - Relative valuations remained below 70% for all maturities greater than 2 years, as the 10-year municipal-to-Treasury yield ratio ended the quarter at just 61.9% compared to a 91.7% average over the past five years.

10-Year AAA Municipal-to-Treasury Yield Ratio: 2016-2021




| Maturity | 4/30/21 Muni | 5/31/21 Muni | Change | % of U.S. Govt 5/31/21 |
|---|---|---|---|---|
| 2-Year | 0.10% | 0.10% | 0.00% | 71.43% |
| 5-Year | 0.43% | 0.48% | 0.05% | 60.00% |
| 7-Year | 0.69% | 0.73% | 0.04% | 57.94% |
| 10-Year | 0.99% | 0.99% | 0.00% | 61.88% |
| 15-Year | 1.20% | 1.15% | -0.05% | 63.19% |
| 20-Year | 1.40% | 1.32% | -0.08% | 60.00% |
| 30-Year | 1.59% | 1.51% | -0.08% | 66.23% |

- Despite the low absolute rate environment and historically expensive municipal-to-Treasury yield ratios, demand for state and local government debt remained healthy due to improving credit fundamentals as well as tax reform risk that could increase the value of the tax exemption on municipal income.
- According to Refinitiv Lipper, year-to-date municipal fund net inflows totaled around $48 billion, already surpassing the 2020 yearly total and the fastest pace on record.
- Price strength in longer-dated municipal debt outweighed front-end weakness, resulting in the ICE BofA 1-12 Year Municipal Index producing a +0.14% total return in May.
- Municipal debt now moves into a period of technical strength that typically results in outperformance versus taxable bonds, as issuance generally reaches its nadir during the summer doldrums while reinvestment demand via principal and interest payments peaks.
    - From June through August, JP Morgan projects $122 billion in reinvestment proceeds potentially recycling back into the municipal market with net supply expected to fall into negative territory to -$32 billion.
- Multiple factors that could lead to municipal price weakness despite the strong seasonal technical environment include, but are not limited to:
    - Municipal supply surge if state and local governments issue debt to help finance the rebuilding of the country's infrastructure under The American Jobs Plan and/or if advance refunding deals are reinstated;
    - Rising benchmark Treasury yields as inflation expectations rise, particularly with the Fed's tolerance for an overshoot, and/or the U.S. central bank begins to taper bond purchases;
    - A scaled down version of President Biden's stimulus package and accompanying tax hikes could dampen demand for tax havens including municipal bonds.

Source: Bloomberg; JP Morgan; Refinitiv; Veritable, L.P.
All numbers are estimates. See Disclosures for index descriptions and additional information.

## Disclosures

*This Summary reflects the views of Veritable's Fixed Income Desk and is for your general information. It is not intended to provide personal investment advice and does not take into account the unique investment objectives and financial situation of the reader. Investors should only seek investment advice from their individual financial adviser. Investments in fixed income securities involve the risk of loss that investors should be prepared to bear. Forecasts may not be realized due to a variety of factors, including changes in economic growth, corporate profitability, geopolitical conditions, and inflation.*

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**Index Descriptions** *(Investors cannot invest directly in an index)*

**Bloomberg Barclays Intermediate Government Credit Index**: A total returns index of U.S. dollar denominated U.S. Treasuries, government-related securities, and investment grade U.S. corporate securities that have a remaining maturity of greater than or equal to 1 year and less than 10 years. Securities must have $250 million or more of outstanding face value and must be fixed rate and non-convertible.

**ICE BofA 1-10 Year US Treasury Index** is a subset of ICE BofA Treasury Index including all securities with a remaining term to final maturity greater than or equal to 1 year and less than 10 years.

**ICE BofA 1-10 Year US Inflation-Linked Treasury Index** is a subset of ICE BofA US Inflation-Linked Treasury Index including all securities with a remaining term to final maturity greater than or equal to 1 year and less than 10 years.

**ICE BofA 1-10 Year Corporate Index** measures the performance of investment grade corporate bonds of both U.S. and non-U.S. issuers that are U.S. dollar-denominated and publicly issued in the U.S. domestic market with a remaining term to final maturity greater than or equal to 1 year and less than 10 years.

**ICE BofA 1-10 Year Taxable Municipal Index** is designed to track the performance of U.S. dollar-denominated taxable municipal debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. market with a remaining term to final maturity greater than or equal to 1 year and less than 10 years.

**ICE BofA 1-12 Year Municipal Securities Ind*ex*** is a subset of ICE BofA Municipal Securities Index including all securities with a remaining term to final maturity less than 12 years. The ICE BofA Municipal Securities Index is market capitalization weighted and tracks the performance of U.S. dollar denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. Qualifying securities must have at least one-year remaining term to final maturity, at least 18 months to final maturity at the time of issuance, a fixed coupon schedule and an investment grade rating (based on an average of Moody's, S&P and Fitch).

**Consumer Price Index (CPI)** is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate. The CPI is published by the US Bureau of Labor Statistics on a monthly basis.

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