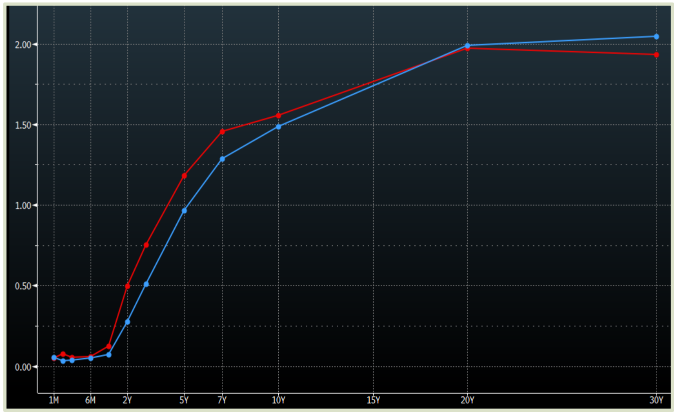
Looming Central Bank Tightening Pushed Treasury Yields Higher

- For the third consecutive month, the Treasury yield curve shifted higher with 2-7-year rates increasing 16-22 basis points, while the 10-year yield rose 7 basis points to 1.56%. However, the 30-year rate (i.e., long bond) fell 12 basis points.
- Global central bank tightening expectations drove rates higher, as economic data remained mostly encouraging but with lingering inflation and labor market uncertainties.
  - Institute for Supply Management surveys showed accelerated growth in both the manufacturing and service sectors for September compared to expectations for slower expansion.
  - Bureau of Labor Statistics (BLS) reported 194,000 jobs added in September, well below consensus for the second consecutive month.
    - Prior month revised upward by 248,000 jobs.
    - Leisure and hospitality segment continued to decelerate with 112,000 total added in August and September after 802,000 additions during the previous two months combined.
    - The unemployment rate fell to 4.8%, closing in on the 3.5% pre-pandemic level, while wages rose a strong 4.6% year-over-year.
  - Retail sales surged 0.7% for the second consecutive month, beating expectations of 0.2%.
  - Consumer Price Index (CPI) rose 0.4% in September (expected: 0.3%), as potential signs of continued pricing pressures remain.
    - Core goods rose 0.2% despite declines in used car and apparel segments, showing volatility in supply chain-related sectors.
    - Shelter components rose a healthy 0.4%.
    - Year-over-year CPI remained elevated at 5.4%.

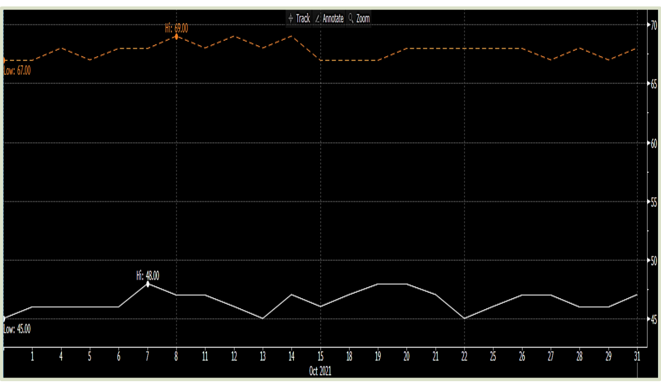
Maturity	9/30/21 Treasury	10/31/21 Treasury	Change
2-year	0.28%	0.50%	+0.22%
5-year	0.97%	1.19%	+0.22%
7-year	1.29%	1.45%	+0.16%
10-year	1.49%	1.56%	+0.07%
30-year	2.05%	1.93%	-0.12%

Treasury Yield Curve: 9/30/21 (blue) vs. 10/31/21 (red)



Segment	October Return	YTD Return
Bloomberg Barclays Intermediate Government Credit Index	-0.56%	-1.43%
ICE BofA 1-10 Year US Treasury Index	-0.50%	-1.63%
ICE BofA 1-10 Year US Inflation-Linked Treasury Index	0.79%	4.90%
ICE BofA 1-10 Year Corporate Index	-0.46%	-0.74%
ICE BofA 1-10 Year Taxable Municipal Index	-0.55%	-0.30%

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



Credit Markets Followed Treasuries; TIPS Continued to Shine

- The Federal Reserve ("Fed") continued to signal a near-term policy shift starting with reducing bond purchases prior to year-end.
  - Minutes from September's Federal Open Market Committee meeting showed that some participants agreed conditions had already been met to reduce purchases, and all participants supported stronger statement wording to signal a reduction.
  - Later in the month, Chairman Powell reiterated that the Fed is "on track to begin a taper of our asset purchases" that would be completed mid-2022 barring unforeseen economic developments.
- Treasury Inflation Protected Securities (TIPS) rode performance tailwinds of current elevated pricing pressures as well as rising inflation expectations to strongly outperform nominal bonds.
  - TIPS pricing indicates expectations for 2.59% annual inflation over the next decade, an increase of 21 basis points in October.
  - In the 5-10-year range, TIPS have outperformed non-inflation-linked Treasuries by 5.34% this year.
- Investment grade credit continued to generally follow benchmark Treasury performance with minimal volatility.
  - With credit spreads compressed, corporate debt provided just 9 basis points of excess return over Treasuries in October, while taxable municipal bonds earned 23 basis points over benchmark government bonds.
  - Performance was virtually identical across the ratings spectrum as risk premiums have potentially reached a credit cycle low with limited room for additional tightening.

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.

Municipal Yields Rose Across the Curve with Treasuries, Posted Mixed Relative Performance

- Tax exempt yields moved higher in October along with Treasury rates with the greatest price weakness expressed in 5-7-year maturities.
- Municipal investors preferred the safety of the front-end of the curve, but short maturities were not immune to the weakness in the Treasury market as investors priced in a more aggressive Fed rate hike path.
  - The 2-year AAA municipal yield rose 8 basis points to 0.25% versus the comparable-maturity Treasury rate up 22 basis points to 0.50%.
    - The 2-year AAA municipal-to-Treasury yield ratio sank to just 50%.
- 1-10-year AAA municipal yields rose 7-14 basis points compared to longer-dated AAA tax-exempt rates increasing just 2-5 basis points.
  - The 10-year AAA municipal yield rose 7 basis points over the month, matching the rise of the 10-year Treasury rate.
    - The 10-year AAA municipal-to-Treasury yield ratio ticked higher to 77.5%.
- In October, the spread between 2-year and 10-year AAA municipal rates narrowed by a single basis point to 96 basis points, hovering near the largest term premium since 2017.

Maturity	9/30/21 Muni	10/31/21 Muni	Change	% of U.S. Govt 10/31/21
2-Year	0.17%	0.25%	+0.08%	50.00%
5-Year	0.50%	0.64%	+0.14%	53.33%
7-Year	0.83%	0.94%	+0.11%	64.83%
10-Year	1.14%	1.21%	+0.07%	77.56%
15-Year	1.30%	1.35%	+0.05%	86.54%
20-Year	1.47%	1.49%	+0.02%	75.63%
30-Year	1.67%	1.69%	+0.02%	87.56%

- According to Refinitiv Lipper, weekly reporting municipal bond funds experienced inflows totaling $1.1 billion in October, recording the 34th consecutive week of positive net flows, although the pace continued to decelerate.
  - After experiencing the first outflow since March in the final week of September, investors redeemed $469 million from high yield municipal bond mutual funds in October.
  - Weekly flows into the municipal bond sector averaged $268 million in October, well below the 2021 year-to-date average of $1.3 billion.

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

- Although short-end relative valuations are quite rich given strong demand, the 10-year AAA municipal-to-Treasury yield ratio remained near equilibrium fair value, closing the month at 77.5%, above the 2021 average of 66.9%.
- For traditional tax-exempt investors preferring the safety of the short-term bonds in terms of duration risk, we continue to identify crossover opportunities in the taxable bond market.
- After producing negative net supply in October, the municipal market is forecasted to be even more supportive to close the year, as JP Morgan projects coupon income and principal payments to exceed new issuance by $16 billion in November to December.
  - The stronger technical environment could support municipals into year-end especially with an improved value proposition, but we are surveilling for idiosyncratic events that may alter supply and/or demand patterns.
- The Build Back Better framework left out several municipal market-specific proposals including tax-exempt advance refunding deals that would lead to a meaningful uptick in new issue volume if reinstated.
  - Much of President Trump's 2017 tax cuts would be left unchanged (e.g., top individual tax rate and corporate tax rate).
  - Some modification of the SALT cap will likely be included in the final version of the plan.
- For the month, the ICE BofA 1-12 Year Municipal Securities Index produced a -0.18% total return but remained in positive territory for the full year.

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

Disclosures

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

Bloomberg Barclays Intermediate Government Credit Index is 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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