Domestic Investment Grade Fixed Income Market Summary

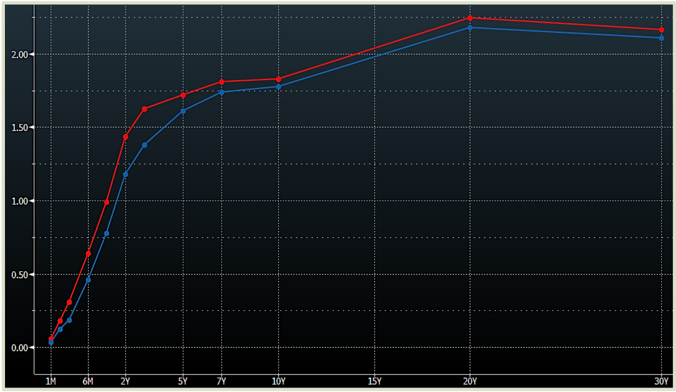
February 2022

Treasury Yield Curve Continued to Bear Flatten on Monetary Policy Expectations Despite War Outbreak

- The Treasury yield curve shifted higher by 25-40 basis points during the first half of the month as expectations for more rapid Federal Reserve (Fed) rate hikes continued to re-price markets.
  - The Fed fund futures market went from pricing in five 25 basis point hikes in 2022 to six hikes by mid-month as speculation of a possible 50 basis point move in March gained steam.
- Volatility increased over the latter part of the month as rising geopolitical tensions culminated with Russia's invasion of Ukraine, pulling intermediate and long-term Treasury rates lower.
- For the full month, the 2-year Treasury rate increased 25 basis points, projecting a faster pace of Fed tightening and a higher terminal rate, while 5+ year yields increased only 5-11 basis points due to a flight to quality rally later in the month.
- Bureau of Labor Statistics reported strong jobs growth of 467,000 compared to 125,000 expected, a sharp improvement from generally disappointing numbers the previous two months.
  - Unemployment rate ticked slightly higher to 4.0% (expected: 3.9%), as labor force participation increased.
  - Average Hourly Earnings YoY: +5.7% (expected: +5.2%).
- Consumer Price Index (CPI) rose 0.6% in January, above 0.4% expectations, as pricing pressures were felt broadly including the largest year-over-year owners' equivalent rent increase since March 2007.
  - CPI YoY: 7.5% (largest since February 1982).
  - Core CPI MoM: 0.6% (expected: 0.5%).

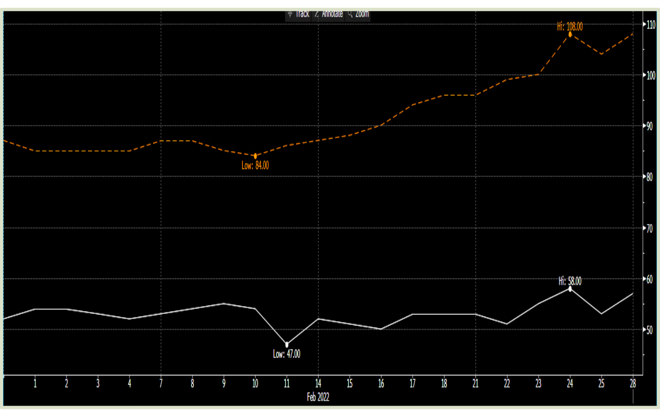
Maturity	1/31/22 Muni	2/28/22 Muni	Change
2-year	1.18%	1.43%	+0.25%
5-year	1.61%	1.72%	+0.11%
7-year	1.74%	1.81%	+0.07%
10-year	1.78%	1.83%	+0.05%
30-year	2.11%	2.16%	+0.05%

Treasury Yield Curve: 1/31/22 (blue) vs. 2/28/22 (red)



Segment	February Return	2022 Return
Bloomberg Barclays Intermediate Government Credit Index	-0.66%	-2.11%
ICE BofA 1-10 Year US Treasury Index	-0.41%	-1.65%
ICE BofA 1-10 Year US Inflation-Linked Treasury Index	1.07%	-0.27%
ICE BofA 1-10 Year Corporate Index	-1.24%	-3.02%
ICE BofA 1-10 Year Taxable Municipal Index	-0.57%	-1.93%

1-10 Year IG Credit Spreads: Corporate (orange) and Taxable Municipal (white) February 2022



Credit Markets Reacted to Fed Policy and Russia Invasion; TIPS Rose on Surging Commodity Prices

- For the second consecutive month, Fed policy expectations pressured financial markets with risky assets further impacted by Russia's invasion of Ukraine.
- Treasury Inflation Protected Securities (TIPS) strongly outperformed nominal Treasuries on continued elevated CPI prints as well as rising inflation expectations due in part to heightened geopolitical tensions.
  - Using TIPS, 10-year inflation expectations rose 13 basis points in February to 2.62%, close to a year-to-date high.
  - Inflation pressures could remain elevated as sanctions against Russia further impact commodity prices and geopolitical uncertainty could cause central banks to decelerate the pace of monetary policy tightening to engineer a soft economic landing.
- The combination of tighter financial conditions and the conflict in Ukraine pushed credit spreads wider for a second consecutive month. Mirroring January, the February price weakness was felt more in corporate debt than taxable municipal bonds.
  - Investment grade corporate bond spreads widened roughly 20 basis points in February, resulting in the worst monthly performance relative to Treasuries since the March 2020 pandemic-induced sell-off.
  - Taxable municipal bond spreads realized only marginal spread widening in February despite broad market weakness. Given this relative outperformance, taxable municipal spreads may widen in the coming months due to typical 'municipal lag' barring a sharp reversal of sentiment.

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 Continued to Rise and Curve Flattened, Posting Modest Outperformance Relative to Treasuries

- While lacking the volatility experienced in late-January, municipal rates continued to steadily march higher during the month as rising inflation and Fed rate hike expectations reduced the attractiveness of municipals before rates fell at month-end, spurred by the flight to quality rally in Treasuries.
  - The late-month flight to quality rally in Treasuries stoked institutional demand, as buyers locked-in higher municipal valuations in anticipation of declining rates.
  - The short-end saw the greatest weakness in terms of absolute rate rise as 2-5-year rates increased by 12-16 basis points on a more hawkish Fed view by market participants.
  - The term premium between 2-year and 10-year AAA municipal rates continued to narrow due to bear flattening, down 13 basis points for the month to 52 basis points, the lowest level since August 2020.
  - The 10-year AAA municipal yield rose to as high as 1.71% mid-month before retracing lower to end February at 1.58%, up 3 basis points for the month.
  - The 10-year AAA municipal slightly outperformed the 5-basis point rise of the 10-year Treasury rate in February, causing the yield ratio to tick lower from 87% to 86%.

Maturity	1/31/22 Muni	2/28/22 Muni	Change	% of U.S. Govt 2/28/22
2-Year	0.90%	1.06%	0.16%	73.61%
5-Year	1.22%	1.34%	0.12%	77.91%
7-Year	1.41%	1.48%	0.07%	81.77%
10-Year	1.55%	1.58%	0.03%	86.34%
15-Year	1.67%	1.72%	0.05%	91.98%
20-Year	1.79%	1.82%	0.03%	80.89%
30-Year	1.95%	1.98%	0.03%	91.24%

- According to Refinitiv Lipper, weekly reporting municipal bond funds experienced outflows totaling $5.2 billion in February, accelerating as benchmark rates rose.
  - High yield and long-term municipal funds were hit particularly hard, losing $2.6 billion and $3.5 billion, respectively.
  - After 45 consecutive weeks of inflows, weekly municipal bond funds have experienced outflows in 5 of the last 6 weeks through February 23, including a $2.9 billion withdrawal at the start of the month, the largest since pre-pandemic.
  - An outflow trend has the potential to create a negative feedback loop as retail investors potentially accelerate redemptions in reaction to negative total return performance.

10-Year AAA Municipal-to-Treasury Yield Ratio: 2017-2022

- The 10-year relative valuation ended the month at 86%, near the 89% historical average over the past five years, offering reasonable shock-absorption if benchmark Treasury rates rise.
- Retail investors have shown a renewed preference for the safety of the front-end of the municipal curve given the current inflation outlook, resulting in outperformance relative to Treasuries, pulling the 2-year municipal-to-Treasury yield ratio down to 74%, well below the five-year average of 88%.
- The supportive technical environment diminished in February as tax-exempt new issuance essentially matched total reinvestment funds (i.e., coupon payments and maturities) at about $26 billion according to Bloomberg data.
  - March and April generally represent a period of reduced technical support for municipal debt as issuance typically outstrips reinvestment demand while also competing with short-end tax season selling.
  - President Biden's domestic agenda has been effectively placed on hold in the wake of Russia's invasion of Ukraine, but portions of the President's Build Back Better plan, likely including some form of SALT relief, are still on the table.
- As longer-dated relative valuations surpassed 90%, demand from banks and insurance companies strengthened, providing a liquidity backstop absent strong retail interest.
- In February, the later-month rally helped recoup some of the losses experienced through mid-month, as the ICE BofA 1-12 Year Municipal Securities Index produced a -0.36% total return, capping the worst two-month start to a year since ICE has tracked the data (1989).

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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