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# Domestic Investment Grade Fixed Income Market Summary

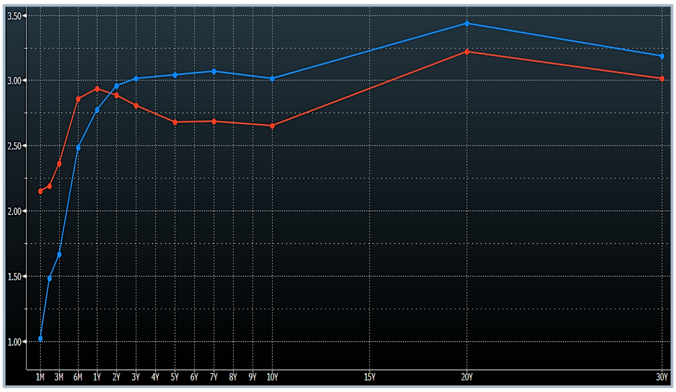
July 2022

## Treasury Rates Mostly Fell, and the Yield Curve Inverted

- Treasury yields in the 5-10 year maturity range declined 36-39 basis points (bps) despite rates on 1-year and shorter maturities moving higher.
- While the Fed maintained its current hawkish stance, market participants priced-in potential rate cuts starting next year, helping pull intermediate-term rates lower in July.
  - Expectations for further aggressive tightening this year to combat inflation combined with potential rate cuts next year with rising recession headwinds resulted in a more pronounced inversion of the Treasury curve; the 2-year and 10-year Treasury yield spread fell to -24 bps.
- The Fed followed up its largest rate hike in 28 years in June with another 75 bp increase during the late July meeting to a range of 2.25% - 2.50% as the Committee reiterated its commitment to bringing inflation back down to its 2% target.
  - In his post-meeting press conference, Fed Chair Powell stated his belief that the economy is not currently in a recession but also implied the Committee would hike rates further to fight inflation even in the midst of a slowdown.
- Despite aggressive Fed tightening, the Bureau of Labor Statistics continued to report strength in the labor market as 372,000 jobs were added in June, easily exceeding expectations of 265,000.
- The Consumer Price Index (CPI) increased 1.3% in June (year-over-year: 9.1%), which again exceeded projections of 1.1% (year-over-year: 8.8%), as pricing pressures continue to be broadly felt across most categories.

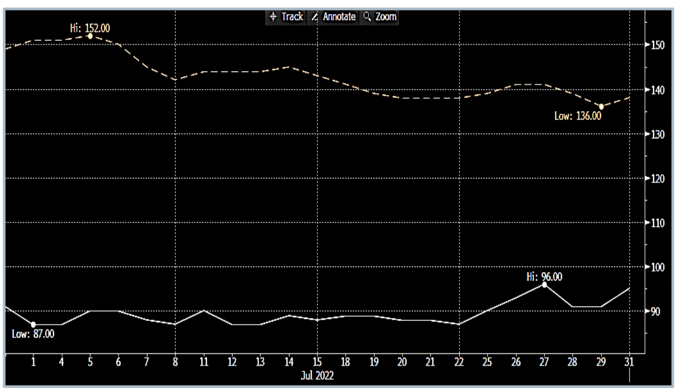
| Maturity | 6/30/22 Treasury | 7/31/22 Treasury | Change |
|---|---|---|---|
| 2-year | 2.96% | 2.89% | -0.07% |
| 5-year | 3.04% | 2.68% | -0.36% |
| 7-year | 3.07% | 2.68% | -0.39% |
| 10-year | 3.02% | 2.65% | -0.37% |
| 30-year | 3.19% | 3.01% | -0.18% |

Treasury Yield Curve: 6/30/22 (blue) vs. 7/31/22 (red)



| Segment | July Return | 2022 Return |
|---|---|---|
| Bloomberg Barclays Intermediate Government Credit Index | 1.63% | -5.25% |
| ICE BofA 1-10 Year US Treasury Index | 1.22% | -4.39% |
| ICE BofA 1-10 Year US Inflation-Linked Treasury Index | 3.27% | -1.84% |
| ICE BofA 1-10 Year Corporate Index | 2.08% | -7.19% |
| ICE BofA 1-10 Year Taxable Municipal Index | 1.56% | -6.00% |

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




## TIPS and Credit Markets Rebounded, Outperformed Nominal Treasuries

- Treasury Inflation Protected Securities (TIPS) broke a two-month losing streak by outperforming nominal Treasuries by more than 200 bps in the 1-10 year area of the curve.
  - The combination of another elevated CPI print and speculation that the Fed may need to pivot from its aggressive tightening perhaps as early as next year fueled the strong performance with the latter helping push inflation expectations higher.
  - After falling from 3.04% (multi-decade high) in April to 2.34% at quarter-end, the 10-year TIPS inflation break-even rate increased 21 bps to 2.55% in July.
- Underperformance for investment grade corporate bonds continued to start the month but better earnings than dismal expectations helped the market stabilize and rebound slightly with 1-10 year issues providing 67 bps of excess return over duration-adjusted Treasuries in July.
  - Generally, credit spreads tightened around 10 bps in July with outperformance across the ratings spectrum.
- After outpacing Treasuries in June despite the broad risk-off market sentiment, 1-10 year taxable municipals provided just 8 bps of excess return over duration-neutral government bonds in July.
- With yields lagging the upward movement in the Treasury market, FDIC-insured certificates of deposit (CDs) have been largely unattractive this year. After the decline in Treasury rates since mid-June, CDs have become relatively more attractive, albeit in limited supply, and may provide an attractive alternative to credit given the uncertain economic outlook.

*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.

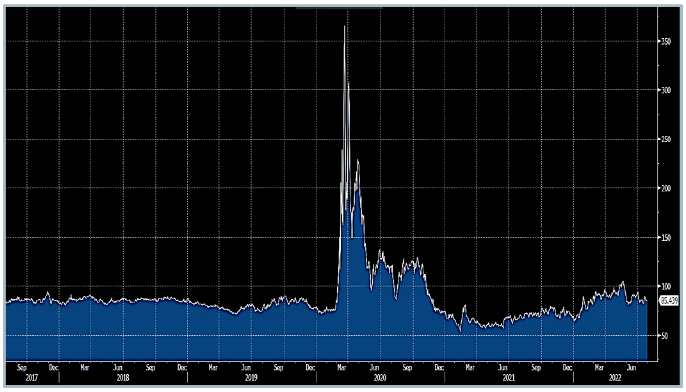
## Treasury Market Rally and Supportive Technical Environment Resulted in Strong Municipal Performance

- The rally that started in late June continued in July as municipal yields fell steadily throughout the month, barely responding to intermittent periods of weakness in the Treasury market as tax-exempt rates fell to their lowest levels since at least April.
    - Tax-exempt rates fell by 29-51 bps, and the municipal curve bull flattened.
    - Indicative of the steady move lower, municipal yields moved higher in just 2 trading days in July.
- Municipal debt outperformed the rally in Treasuries across all maturities with the greatest strength expressed in intermediate-term maturities as 5-10 year tax-exempt rates declined 42-51 bps versus a 22-35 bp decline in the front-end and a 29-38 bp drop in the back-end of the curve.
    - Municipal-to-Treasury yield ratios out to 5 years were pulled below 70% by month-end with each maturity's relative valuation below its respective historical average over the past five years.
- The most supportive seasonal reinvestment period of the year as well as a slowdown in mutual fund outflows were strong tailwinds for municipal outperformance in July.
- For the month, the 10-year AAA municipal rate fell 51 bps to 2.21% and the yield ratio declined to around 83%, below the five-year average of 88%.
- The term premium between 2-year and 10-year AAA municipal rates declined 16 bps to 61 bps, roughly in-line with the 5-year historical average.

| Maturity | 6/30/22 Muni | 7/31/22 Muni | Change | % of U.S. Govt 7/31/22 |
|---|---|---|---|---|
| 2-Year | 1.95% | 1.60% | -0.35% | 55.36% |
| 5-Year | 2.22% | 1.80% | -0.42% | 67.16% |
| 7-Year | 2.48% | 2.03% | -0.45% | 75.75% |
| 10-Year | 2.72% | 2.21% | -0.51% | 83.40% |
| 15-Year | 2.91% | 2.53% | -0.38% | 93.36% |
| 20-Year | 3.04% | 2.75% | -0.29% | 85.40% |
| 30-Year | 3.18% | 2.89% | -0.29% | 96.01% |

- According to Refinitiv Lipper, weekly-reporting municipal bond fund outflows moderated significantly in July as stability in the Treasury market helped slow redemption activity.
    - In July, outflows totaled just $570 million, down sharply from the $10.6 billion in withdrawals out of municipal funds in June.
    - Weekly-reporting municipal funds experienced inflows in 2 of the 4 weeks during the month of July, but still have lost assets in 24 of the last 28 weeks.
    - Investors should remain vigilant as a resurgence in Treasury volatility could reignite the longer-term outflow trend that has already surpassed the previous record set in 2013.

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




- Defensive demand remained a strong theme, as front-end municipal debt continued to outperform Treasuries.
    - The 2-year AAA municipal-to-Treasury yield ratio dropped to just 55% (5-year historical average: 88%).
    - Given the expensive valuations in short-term maturities, we continue to explore crossover opportunities (e.g., Treasuries) for the best available after-tax yield. Otherwise, premium callable are a source of incremental yield.
- Municipal net supply remained negative in July with redemptions ($42.7 billion) exceeding new issuance ($34.5 billion) by $8.2 billion, according to Bloomberg data.
- The technical environment is expected to remain supportive in August, as JP Morgan estimates monthly net supply of -$13 billion.
- Exiting the summer reinvestment season, JP Morgan estimates that net supply will turn positive in September and October by about +$13 billion.
- With rate stability in Treasuries and a strong technical environment in the municipal market, the ICE BofA 1-12 Year Municipal Securities Index produced a 1.89% total return for July, the best monthly return since May 2020.
- Municipal yields will continue to be tethered to the Treasury market with factors such as inflation expectations and Fed policy impacting directional movement throughout the remainder of the year. Multiple idiosyncratic events could specifically impact tax-exempts, but investors are hyper-focused on Treasury volatility that could negatively impact demand, pushing tax-exempt rates higher.
- Despite the recent rally, we continue to identify pockets of opportunities across the curve but are holding dry powder to strategically extend if risk factors reemerge, sending municipal rates higher.

*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** 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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