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# Domestic Investment Grade Fixed Income Market Summary

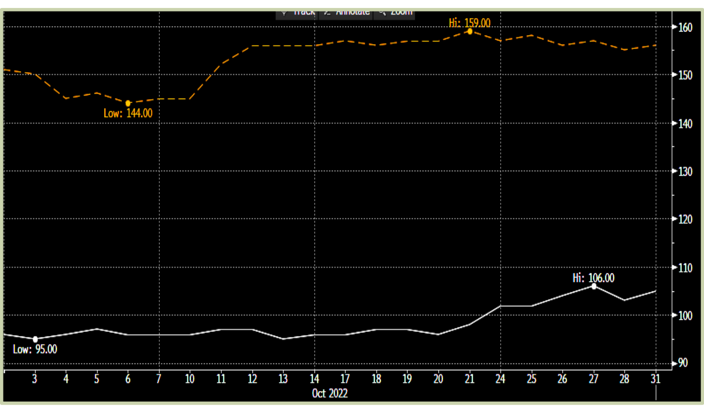
October 2022

## Treasury Rates Continued to Move Higher But Ended October Below Intramonth Highs

- Relatively strong economic data and hawkish sentiment from Fed officials pushed Treasury yields significantly higher for most of the month before the market stabilized over the final week and reversed a portion of the rate rise.
  - 2-10 year Treasury yields rose 14-22 basis points (bps).
  - After reaching an intramonth high of 4.34%, the 10-year Treasury rate ended October at 4.05%, a 22 bp month-over-month increase.
- With labor market and inflation data continuing to show relative strength and Fed officials echoing hawkish comments, market participants increased expectations for cumulative Fed rate hikes into 2023.
  - As of month-end, the futures market projected a 4.98% peak funds rate in mid-2023, nearly 50 bps higher versus September month-end.
  - The projected 2023 year-end funds rate increased 23 bps to 4.56% and still implied rate cuts during the second half of next year.
- The economy added 263,000 jobs in September (expected: 255,000), and the unemployment rate moved lower to 3.5% (expected: 3.7%).
- Given monetary policy tightening lag, the Consumer Price Index (CPI) continued to move higher, increasing 0.4% in September (expected: 0.2%) despite falling energy prices.
  - Core CPI rose 0.6% (expected: 0.4%), largely driven by a 0.7% increase in shelter costs which had a record year-over-year increase of 6.6%.

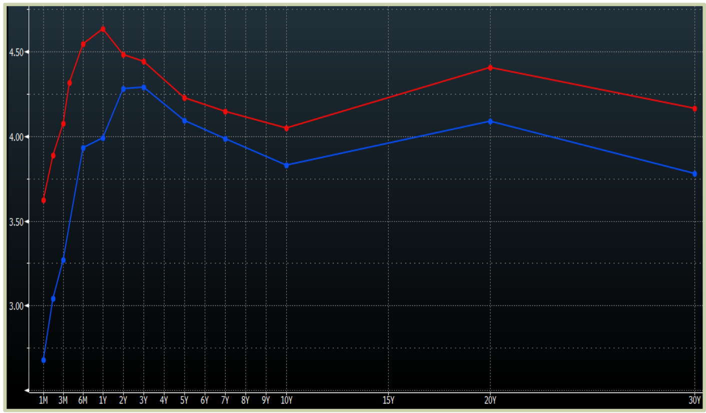
| Segment | October Return | 2022 Return |
|---|---|---|
| Bloomberg Barclays Intermediate Government Credit Index | -0.44% | -10.02% |
| ICE BofA 1-10 Year US Treasury Index | -0.45% | -8.95% |
| ICE BofA 1-10 Year US Inflation-Linked Treasury Index | 1.07% | -7.87% |
| ICE BofA 1-10 Year Corporate Index | -0.52% | -12.47% |
| ICE BofA 1-10 Year Taxable Municipal Index | -0.85% | -11.55% |

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




| Maturity | 9/30/22 Treasury | 10/31/22 Treasury | Change |
|---|---|---|---|
| 2-Year | 4.28% | 4.49% | 0.21% |
| 5-Year | 4.09% | 4.23% | 0.14% |
| 7-Year | 3.99% | 4.15% | 0.16% |
| 10-Year | 3.83% | 4.05% | 0.22% |
| 30-Year | 3.78% | 4.17% | 0.39% |

### Treasury Yield Curve: 9/30/22 (blue) vs. 10/31/22 (red)




## TIPS Rebounded While Credit Mostly Followed Treasuries

- Treasury Inflation Protected Securities (TIPS) outperformed nominal issues and recouped nearly two-thirds of September's relative loss, as global inflation continued to run hot.
  - 1-10 year TIPS provided 175 bps of duration-adjusted excess return in October after lagging nominals by 274 bps in September.
  - After falling to 2.16% in September, the 10-year inflation break-even rate rose 35 bps to 2.51% in October. Meanwhile, the 5-year break-even rate increased 56 bps to 2.66%, once again inverting the inflation expectation curve after normalizing in September.
- Risk aversion stabilized later in the month due to a more fiscally responsible U.K. government leadership transition and signs of less hawkish overtures from global central banks including a smaller than expected rate hike from the Bank of Canada.
- On a duration-adjusted basis, intermediate investment grade corporate bonds narrowly outperformed Treasuries by 9 bps as carry (greater income) offset the slight month-over-month spread widening. For the year, 1-10 year investment grade corporate bonds have underperformed government bonds by 240 bps.
  - After rising 20 bps during September, corporate bond risk premiums increased 5 bps in October.
- Intermediate taxable municipal bonds underperformed largely due to a lag effect from September performance when the sector trailed Treasuries but to a lesser extent versus corporate debt. For October, 1-10 year taxable municipals posted an excess return of -23 bps versus Treasuries, matching September's relative performance and pulling the year-to-date excess return to -99 bps.

*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.

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## Municipal Yields Climbed With Treasuries But Posted Modest Outperformance

- In October, municipal yields initially showed stability after the previous month's selloff before succumbing to the move in Treasuries and resuming their ascent higher for the remainder of the month.
- Tax-exempt rates rose by 9-22 bps, with more pronounced weakness in longer maturities.
- For the second consecutive month, municipal rates across the curve finished October at their highest respective levels in at least a decade.
- Municipal debt mostly outperformed its taxable counterparts thanks to a sharp drop in new issuance volume, pulling relative valuations lower.
- 1-10 year relative valuations remained below their respective historical averages with the 10-year AAA municipal-to-Treasury yield ratio closing the month at 84% (5-year average: 88%).
- For the month and year-to-date, the 10-year AAA municipal yield rose 9 bps and 236 bps, respectively, to 3.39%.
- The yield spread between 2-year and 10-year AAA municipal rates was unchanged at just 21 bps, 41 bps below the 5-year historical average.
- Despite rich curve steepness from a historical perspective, the 2-year and 10-year AAA municipal term premium of 21 bps remained attractive compared to the inverted Treasury counterpart at -44 bps as of October month-end.
- Despite the flat municipal curve, locking in rates with longer maturities reduces reinvestment risk in a potentially declining rate environment over time (e.g., yield curve shifts lower if the Fed pivots).

| Maturity | 9/30/22 Muni | 10/31/22 Muni | Change | % of U.S. Govt 10/31/22 |
|---|---|---|---|---|
| 2-Year | 3.09% | 3.18% | 0.09% | 70.82% |
| 5-Year | 3.12% | 3.24% | 0.12% | 76.60% |
| 7-Year | 3.15% | 3.30% | 0.15% | 79.52% |
| 10-Year | 3.30% | 3.39% | 0.09% | 83.70% |
| 15-Year | 3.54% | 3.69% | 0.15% | 88.07% |
| 20-Year | 3.73% | 3.90% | 0.17% | 88.44% |
| 30-Year | 3.90% | 4.12% | 0.22% | 98.80% |

- Municipal bond fund outflows continued in October at a pace similar to September with Treasury market volatility remaining the dominant factor.
    - According to Refinitiv Lipper, municipal fund outflows totaled $8.8 billion in October, as average weekly losses exceeded $2 billion for the second consecutive month.
    - Through October 26th, municipal bond funds have shed assets for 12 consecutive weeks and 36 of the previous 41 weeks.
    - Year-to-date municipal fund outflows totaled a record $104.8 billion, wiping out the massive $101.7 billion aggregate 2021 inflow.

### 10-Year AAA Municipal Yie ld: 2017-2022


- More attractive nominal rates grabbed the attention of some buyers in October who generally opted for the safety of the front-end of the curve, lured by 1-5 year yields exceeding 3%.
    - The 2-year AAA municipal-to-Treasury yield ratio fell to 71% in October, well below the 5-year average of 88%.
- The 10-12 year maturity range continues to represent the sweet spot of the municipal curve in terms of attractive nominals, roll down price appreciation potential, and ample 'structure' availability.
- Longer-term municipals (15+ years) also offer a compelling value proposition especially for buy-and-hold investors willing to stomach interim price volatility.
- As issuers slowed the pace of issuance in response to the rate volatility, municipal net supply turned negative in October with new issuance ($23.8 billion) unexpectedly falling short of redemptions ($27.9 billion) by $4.1 billion, according to Bloomberg data.
    - The outlook for new issue municipal supply does not look promising, as 30-Day Visible Supply cratered to $4.8 billion as of October month-end, near the lows of 2022 and about half the 2022 average, according to Bloomberg data.
    - Net supply is expected to remain negative over the final two months of the year, producing full-year net negative supply over $40 billion, according to JP Morgan.
- With over half of the year-to-date municipal fund outflows coming from long-term funds, a unique buying opportunity has developed for those willing to become a liquidity provider, as brokers have been less willing to commit capital in this volatile market, especially heading into year-end.
- Due to rising benchmark rates, the ICE BofA 1-12 Year Municipal Securities Index produced a -0.20% loss for the month with a year-to-date total return of -7.91%.

*Source:* Bloomberg; ICE; JP Morgan; MRSB; Refinitiv; SIFMA; Veritable, L.P.
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## 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.

**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.

**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 Index** 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).