

Bond Market Review

January 10, 2022

Summary

- Treasury rates sold off last week with the 10-year nearly touching 1.80% following the mixed-bag of economic releases on Friday. Unemployment rate for December fell to 3.9%, while December headline payrolls reflected its lowest point since December 2020.
- Tax-exempt municipal yields increased significantly last week despite a lackluster new issue calendar and another week of positive mutual fund inflows. Comments from the Federal Reserve preparing investors for additional rate hikes and balance sheet reduction plans pushed yields higher across the bond market.
- The heavy new issue supply in the investment grade market was well received with balanced two way flows. Investment grade credit spreads remained flat at 92 option-adjusted spread despite the new issue volume, yet high yield spreads widened 10 basis points for the week to 293 as the HY market suddenly started to price in the higher rates. The 5Y Treasury yield, which most impacts the asset class, spiked by 23 bps (bps) from year-end to reach 1.5%, the highest level seen since January 2020.

Treasury Yields

| Term | Treasury Yield | Δ MTD | Δ YTD |
|---------|----------------|-------|-------|
| 1 Year | 0.41 | 0.03 | 0.03 |
| 2 Year | 0.86 | 0.13 | 0.13 |
| 5 Year | 1.50 | 0.24 | 0.24 |
| 10 Year | 1.76 | 0.25 | 0.25 |
| 30 Year | 2.12 | 0.21 | 0.21 |

Tax-Free

New Issue Supply

- 2021 issuance officially closed at \$475.3 billion, down just 1.9% from the 2020 record of \$484.6 billion in spite of record December issuance of \$38.2 billion. The lower year-over-year total supply figures came as taxable municipal issuance fell nearly 19% on the year to \$118.75 billion. Supply expectations for 2022 range from \$550 billion on the high end from Bank of America to a low of \$390 billion from Morgan Stanley. According to Municipal Market Analytics, \$260 billion is the minimum amount needed for current municipal investors to remain fully invested in order to offset the scheduled \$300 billion of maturing and called bond principal during the year.

School Going Remote

- We are beginning to see school closures across the U.S. once again, although much of the closure decisions this time are largely due to staffing shortages tied to the Omicron variant. Atlanta, Detroit, and Prince George County, MD recently adopted remote instruction protocols just days into the new year. Chicago School District teachers voted to strike earlier this week which so far has led to three days of cancelled classes after the school board resisted calls for reinstating remote classes.

States Not Allowed to Use Pandemic Aid for Debt Reduction

- Yesterday the Treasury Department stuck to its original rule preventing states and cities from using the \$350 billion in federal pandemic aid for debt reduction purposes. Several states, including Illinois, had been lobbying the Treasury Department for the extra flexibility. The final rule also prevents governments from using the aid to replenish reserve balances or to pay off legal settlements.

Municipal Yields

| Term | Municipal Yield | Δ MTD | Δ YTD | Tax-Equivalent Yield | Municipal/Treasury Ratio (%) | Δ MTD | Δ YTD |
|---------|-----------------|-------|-------|----------------------|------------------------------|-------|-------|
| 1 Year | 0.30 | 0.16 | 0.16 | 0.46 | 73.30 | 36.08 | 36.08 |
| 2 Year | 0.40 | 0.16 | 0.16 | 0.62 | 46.40 | 13.62 | 13.62 |
| 5 Year | 0.73 | 0.14 | 0.14 | 1.12 | 48.71 | 1.99 | 1.99 |
| 10 Year | 1.17 | 0.14 | 0.14 | 1.80 | 66.40 | -1.81 | -1.81 |
| 30 Year | 1.63 | 0.14 | 0.14 | 2.51 | 77.04 | -1.25 | -1.25 |

Taxable

Corporate Supply Comes Out Swinging

- Issuers came out of the gates with guns blazing this year as supply massively surprised to the upside. Per Barclays, this was the second largest first week ever, only behind 2020 (\$68.9 billion). Financials dominated, making up 79% of total supply, including 14 Yankee bank deals and 11 life insurance/funding-agreement-backed deals. As is normally the case with financial issuance, shorter maturities dominated. 64% came inside 5 years and only 6% was longer than 10 years. The pace is expected to slow some next week with the average dealer projecting \$35 billion of issuance.

Heavy Volume Well Digested

- Volume picked up substantially from the past few weeks, but at only about \$23-25 billion per day. Judging by the net buy/sell numbers, investors and dealers alike were fairly well set up for the massive calendar with the balanced flows. Domestic investors net sold about \$1.5 billion worth of bonds while overseas investors net bought about \$1.4 billion. Strong net buying in the long end where there was almost no supply and better selling in the front end.

As of 01.07.2022. Sources: Bloomberg, Bank of America Merrill Lynch. Please see page 3 and 4 for important disclosures and definitions.



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| Sectors ¹ | | | | | | |
|---|----------|--------|-------|-------|---------------|-------------|
| | Duration | Spread | Δ MTD | Δ YTD | 52- Week High | 52-Week Low |
| Investment Grade Corporate | 8.58 | 92 | 0 | 0 | 101 | 80 |
| - Financial | 6.47 | 84 | 1 | 1 | 91 | 71 |
| - Industrial | 9.39 | 95 | 0 | 0 | 105 | 83 |
| - Utility | 10.44 | 105 | -2 | -2 | 112 | 93 |
| High Yield | 3.96 | 298 | 15 | 15 | 362 | 262 |
| Securitized | 5.28 | 34 | 0 | 0 | 40 | 11 |
| - Commercial Mortgage-Backed Securities | 5.06 | 67 | -1 | -1 | 78 | 54 |
| - Asset-Backed Securities | 2.31 | 36 | -2 | -2 | 41 | 22 |
| - Mortgage-Backed Securities | 5.32 | 31 | 0 | 0 | 38 | 7 |

| International Yields | | | | | | | |
|----------------------|---------|-------|------|--------|-------|-------|--------|
| | Germany | Japan | U.K. | France | Italy | Spain | Greece |
| 2 Year | -0.59 | -0.05 | 0.83 | -0.64 | -0.06 | -0.56 | -- |
| 5 Year | -0.38 | -0.04 | 1.00 | -0.18 | 0.50 | -0.10 | 0.75 |
| 10 Year | -0.04 | 0.14 | 1.18 | 0.29 | 1.31 | 0.65 | 1.54 |
| 30 Year | 0.28 | 0.72 | 1.29 | 0.97 | 2.16 | 1.46 | -- |

| Equity | | | |
|-----------|-----------|---------|---------|
| | Current | Δ MTD | Δ YTD |
| Dow Jones | 36,231.66 | -106.64 | -106.64 |
| S&P 500 | 4,677.03 | -89.15 | -89.15 |
| Nasdaq | 14,935.90 | -709.07 | -709.07 |

| Volatility | | | |
|------------|---------|-------|-------|
| | Current | Δ MTD | Δ YTD |
| VIX | 18.76 | 1.54 | 1.54 |
| MOVE | 74.69 | -2.41 | -2.41 |

| Commodities | | | |
|-------------|----------|--------|--------|
| | Current | Δ MTD | Δ YTD |
| CRB | 237.90 | 5.53 | 5.53 |
| Gold | 1,797.40 | -31.20 | -31.20 |
| Oil | 78.90 | 3.69 | 3.69 |
| Gas | 229.89 | 7.43 | 7.43 |

| Currency | | | |
|-----------------|---------|--------|--------|
| | Current | Δ MTD | Δ YTD |
| U.S. Dollar | 96.565 | 0.571 | 6.628 |
| Euro | 1.124 | -0.010 | -0.097 |
| Pound | 1.325 | -0.005 | -0.043 |
| Yen | 113.630 | 0.460 | 10.430 |
| Canadian Dollar | 1.289 | 0.011 | 0.016 |
| Franc | 0.923 | 0.004 | 0.037 |

| Central Bank Rates | | | |
|--------------------|---------|-------|-------|
| | Current | Δ MTD | Δ YTD |
| United States | 0.25 | 0.00 | 0.00 |
| Europe | 0.00 | 0.00 | 0.00 |
| United Kingdom | 0.25 | 0.00 | 0.00 |
| Japan | 0.10 | 0.00 | 0.00 |
| Canada | 0.25 | 0.00 | 0.00 |
| TED Spread | 14.5 | -3.39 | -3.39 |

As of 01.07.2022. Source: Bloomberg. Please see page 3 and 4 for important disclosures and definitions.

¹Sectors are represented by the following indices: Investment Grade Corporate – Bloomberg U.S. Corporate Bond; Financial – Bloomberg U.S. Aggregate Investment Grade Finance; Industrial – Bloomberg U.S. Aggregate Investment Grade Industrial; Utility – Bloomberg U.S. Investment Grade Utility; High Yield – Bloomberg U.S. Corporate High Yield; Securitized – Bloomberg U.S. Securitized; Commercial Mortgage-Backed Securities – Bloomberg U.S. Aggregate CMBS; Asset-Backed Securities – Bloomberg U.S. Aggregate ABS; Mortgage-Backed Securities – Bloomberg U.S. Aggregate MBS.



Important Information

Technical Terms & Indices

Technical Terms

Duration: a tool used in assessing the price volatility of a fixed-income security

Green Bond: a type of fixed-income instrument that is specifically earmarked to raise money for climate and environmental projects

Municipal/Treasury Ratio: a comparison of the current yield of municipal bonds to U.S. Treasuries

Tax-Equivalent Yield: the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment

TED Spread: the difference between the three-month Treasury bill and the three-month LIBOR based in U.S. dollars

Tranche: a security that can be split up into smaller pieces and subsequently sold to investors

West Texas Intermediate (WTI): WTI crude oil is a specific grade of crude oil and one of the main three benchmarks in oil pricing, along with Brent and Dubai Crude.

Yield: income-only return on investment expressed as an annual percentage

Yield Spread: the difference between the quoted rates of return between two different investment vehicles; also called the credit spread

Indices

The volatility of an index varies greatly; all indices are unmanaged and investments cannot be made directly in an index.

Bloomberg U.S. Aggregate ABS Index: A component of the Bloomberg U.S. Aggregate Index, the Bloomberg U.S. Aggregate ABS Index includes pass-through, bullet and controlled amortization structures. The Index includes only the senior class of each ABS issue and the ERISA-eligible B and C tranche.

Bloomberg U.S. Aggregate CMBS Index: A component of the Bloomberg U.S. Aggregate Index, the Bloomberg U.S. Aggregate CMBS Index includes investment grade securities that are ERISA-eligible under the underwriter's exemption.

Bloomberg U.S. Aggregate MBS Index: A component of the Bloomberg U.S. Aggregate Index, the Bloomberg U.S. Aggregate MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). The Index is formed by grouping the universe of over 600,000 individual fixed rate MBS pools into approximately 3,500 generic aggregates.

Bloomberg U.S. Aggregate Investment Grade Finance Index: A component of the Bloomberg U.S. Corporate Bond Index, the Bloomberg U.S. Aggregate Investment Grade Finance Index measures publicly issued investment grade U.S. corporate bonds in the Finance sector.

Bloomberg U.S. Aggregate Investment Grade Industrial Index: A component of the Bloomberg U.S. Corporate Bond Index, the Bloomberg U.S. Aggregate Investment Grade Finance Index measures publicly issued investment grade U.S. corporate bonds in the Industrial sector.

Bloomberg U.S. Aggregate Investment Grade Utility Index: A component of the Bloomberg U.S. Corporate Bond Index, the Bloomberg U.S. Aggregate Investment Grade Finance Index measures publicly issued investment grade U.S. corporate bonds in the Utility sector.

Bloomberg U.S. Corporate Bond Index: The Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Bond Index: The Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Bloomberg U.S. Securitized Index: Bloomberg U.S. Securitized Index is comprised of predominantly MBS Agency securities, but also includes ABS, CMBS and covered securities. Bloomberg U.S. Treasury Strips 20+ Year Index tracks the performance of zero coupon U.S. Treasuries with a duration of 20 years or more.

CRB: The Commodity Research Bureau (CRB) Index acts as a representative indicator of today's global commodity markets. It measures the aggregated price direction of various commodity sectors.

Dow Jones: The Dow Jones Industrial Average (DJIA) is an index that tracks 30 large, publicly-owned blue chip companies trading on the New York Stock Exchange (NYSE) and the NASDAQ.

ICE BofAML 1-10 Year Municipal Securities Index: The ICE BofAML 1-10 Year Municipal Securities Index is a subset of the ICE BofAML U.S. Municipal Securities Index including all securities with a remaining term to final maturity less than 10 years.

MOVE: The MOVE Index is a well-recognized measure of U.S. interest rate volatility that tracks the movement in U.S. Treasury yield volatility implied by current prices of one-month over-the-counter options on 2-year, 5-year, 10-year and 30-year Treasuries.

Nasdaq: The Nasdaq Composite Index is the market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq-listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debenture securities.

S&P 500: The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The S&P 500 Index focuses on the large-cap segment of the market; however, since it includes a significant portion

of the total value of the market, it also represents the market.

VIX: The CBOE Volatility Index, or VIX, is a real-time market index representing the market's expectations for volatility over the coming 30 days.

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