Fixed Income Quarterly Commentary

Growth Through Stability

Q2 ▪ 2023

Market Update

Fixed income markets were mixed in the second quarter. Bonds with high interest rate sensitivity were mostly down as inflation pressures continued and interest rates increased. Less interest rate sensitive bonds that are more correlated with economic strength had positive returns. The Federal Reserve continued to increase interest rates, hiking 25 basis points in May, but they elected not to hike in June. This pause appears to be more due to timing around the debt ceiling increase than progress on inflation. The Fed maintained that it would continue to raise rates until inflation falls towards its 2% target and the market is now pricing in an additional hike in July as inflation remains in flux and not easily predictable. The bond market is currently anticipating a recession, as evidenced by the inverted yield curve, which forecasts rate cuts in 2024.

Core Taxable Fixed Income

Core accounts generally finished with modest positive returns in the second quarter and outperformed the index that returned -0.77% [1]. The outperformance was driven by our selection of corporate bonds and our skew towards shorter Treasury bonds. Our best performing sector was corporate bonds, which benefited from strong economic data in the second quarter. Our Taxable Municipal bonds and Treasuries posted small negative returns due to their higher exposure to interest rates.

Municipal Bonds

Municipal accounts were relatively flat during the second quarter, outperforming the index that was down -0.73% [2]. The inverted treasury yield curve and higher short treasury yields (an alternative to municipal bonds) hurt short maturity municipal bonds. Our preference for callable bonds with longer maturities drove the outperformance. We continue to focus on essential services (water, sewer, and electric) and Mello-Roos (backed by property taxes) bonds with clear cash flows and low pension liabilities.

High Yield Fixed Income

High Yield accounts posted positive returns during the second quarter, but underperformed the index that was up 1.28% [3]. The primary driver of the underperformance was due to being overweight higher quality corporate bonds. The index has more exposure to lower rated bonds which did better during the quarter. We believe staying positioned for an economic slowdown is prudent and are not increasing our exposure to lower rated bonds at this time.

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Disclosures

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1. Figures presented on page one are from the ICE BofAML 1-10 Year US Corp and Government Index as of 6/30/23

2. Figures presented on page one are from the ICE BofAML 3-7 Year US Municipal Securities Index as of 6/30/23

3. Figures presented on page one are from the ICE BofAML 1-10 Year US High Yield BB-B Index as of 6/30/23

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