Breckinridge CAPITAL ADVISORS

December 2021 Market Commentary

(The following commentary is a summary of discussions among members of the Breckinridge Capital Advisors Investment Committee as they reviewed monthly activity in the markets and investment returns. The members of the Investment Committee under the leadership of Chief Investment Officer Ognjen Sosa, CAIA, FRM, are Co-Head, Portfolio Management, Matthew Buscone; Senior Portfolio Manager Sara Chanda; Co-Head, Research, Nicholas Elfner; Co-Head, Portfolio Management, Jeffrey Glenn, CFA; Head, Municipal Trading, Benjamin Pease; and Co-Head, Research, Adam Stern, JD.)

Strategy and Outlook

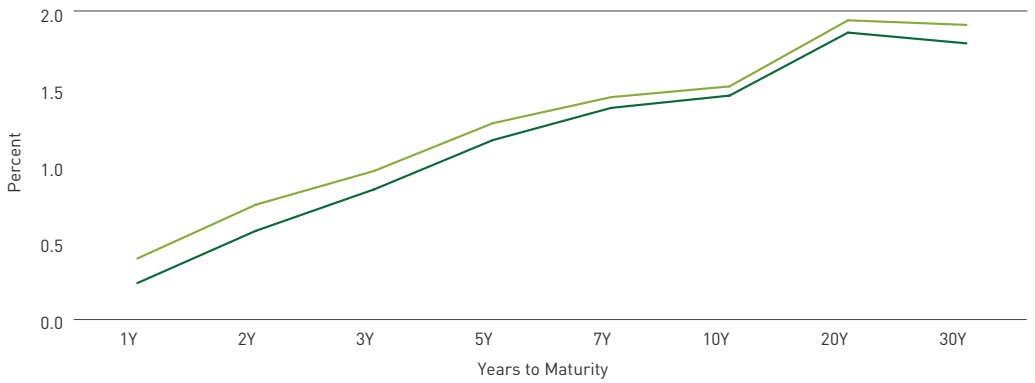
- **U.S. Treasury Curve:** U.S. Treasury rates increased, and the curve flattened. (See Figure 1).
- **Municipal Market Technicals:** December issuance was $38 billion, 13 percent higher than November. Monthly mutual fund inflows were $1.101 billion in December.
- **Corporate Market Technicals:** Investment grade (IG) fixed-rate bond supply for December was $62 billion. IG bond funds reported $7.7 billion of outflows during the month.
- **Securitized Trends:** Excess returns for residential and commercial mortgage-backed securities (MBS and CMBS, respectively) were negative as Treasuries rallied. Excess returns for asset-backed securities (ABS), negative for the month, remained positive year-to-date.

Market Review

The Federal Reserve (Fed) advanced the date by which it expects to complete the taper of bond purchases from June to March 2022. Twelve of 18 Federal Open Market Committee members expect at least three rate raises next year, up from nine members in September who expected at least one hike in 2022. Projections now are for three rate hikes of 25 basis points (bps) each in 2022 and eight such increases by the end of 2024. Meanwhile, growth trends for inflation and COVID-19 Omicron variant infections persisted.

Treasury yields moved higher during December. Yields on the 2-year Treasury rose 17bps while 10-year and 30-year yields increase by 6 and 11bps, respectively. The curve flattened (See Figure 1.) The 2- to 10-year yield curve (2s10s) flattened by 10bps, while the 2s30s flattened by 5bps.

FIGURE 1: TREASURY YIELDS INCREASED AND THE CURVE FLATTENED CURVE DURING DECEMBER



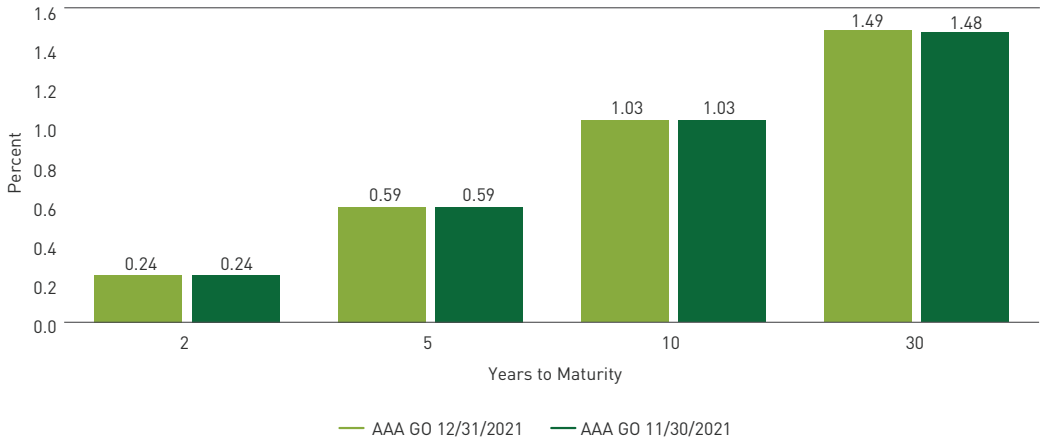
Source: Bloomberg, as of December 31, 2021.

With the Fed's pivot to a more hawkish tone with respect to rates and stimulus, as well as its acknowledgment that inflation is more persistent than previously described, the Breckinridge investment committee is of the view that rates will be rangebound but trend modestly higher. Yields should be capped by long-term demographics, savings, and global yield trends.

Municipal Market Review

While Treasury rates were increasing in December, municipal bond yields remained relatively steady. Yields were unchanged month-over-month at 3, 5 and 10 years and 1bp higher at the 30-year spot, per MMD data (See Figure 2).

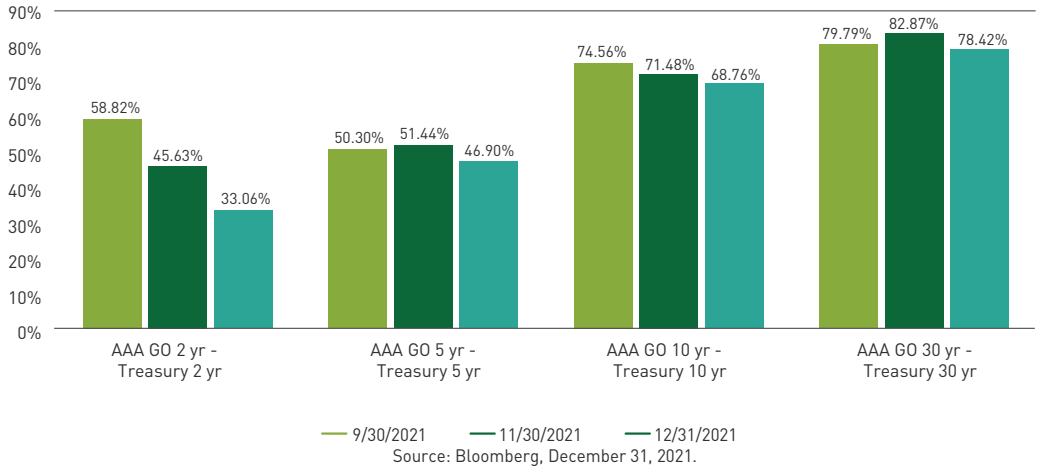
FIGURE 2: MUNICIPAL BOND YIELDS WERE UNCHANGED IN DECEMBER



Source: Municipal Market Data, December 31, 2021.

The Municipal/Treasury (M/T) ratio curve flattened in December also. Municipal bonds outperformed Treasuries over the month with 2- to 3-year ratios trading close to historic lows (See Figure 3). With ratios at those levels, we continued to add taxable municipals and Treasuries when the after-tax yield was more compelling than a tax-exempt municipal.

FIGURE 3: THE M/T RATIO CURVE FLATTENED IN DECEMBER



Source: Bloomberg, December 31, 2021.

December issuance at $38 billion was 13 percent higher than during the prior month, while exceeding December 2020 issuance by almost 9 percent, per *The Bond Buyer*.

Total volume in 2021 of $475 billion fell just shy of last year's record of $485 billion worth of new issue supply, The Bond Buyer reported. Tax-exempt issuance grew 4.2 percent to $342.6 billion from almost $329 billion in 2020. Taxable issuance dropped almost 19 percent to $118.7 billion from $146 billion in 2020. This is a reversal from 2020 when taxables and refundings made up more than 30 percent of the market.

Municipal bond supply was more than offset by continued demand from mutual funds and separately managed account buyers like Breckinridge. According to Lipper, mutual fund inflows surpassed $100 billion for 2021, as reported by JP Morgan.

For December, the Bloomberg Managed Money Short/Intermediate (1-10) Index gained 0.17 percent while the Bloomberg 1-10 Year Blend Index was up 0.13 percent. Intermediate maturity bonds tended to outperform bonds at the shortest and longest ends of the curve. While municipal bonds in the lowest investment grade segment outperformed higher quality, the difference in returns was less than 5bps for AAA- and A-rated bonds, 8 bps for AA-rated bonds.

Corporate Market Review

IG corporate bond spreads narrowed by 7bps in December, per Bloomberg data, to settle at 92bps, ending the year 4bps tighter. The Bloomberg U.S. Corporate Investment Grade (IG) Index lost 0.08 percent for December on a total return basis but had a positive excess return of 0.60 percent compared with duration-matched Treasuries.

Bloomberg data showed that lower-rated IG bonds delivered the highest total returns in December. IG corporate bonds with maturities 5-to-10-year segment of the curve turned in the best performance on a total return basis.

The best-performing sectors were Sovereigns, Metals & Mining, Refining, Wireless, and Independent Exploration and Production. The worst-performing sectors were Foreign Local Government, Supranationals, Electric Utilities, Building Materials, and Packaging.

Index-eligible IG bond issuance in December, per Bloomberg, was nearly $62 billion, a decrease from about $114 billion in November. Net issuance, after redemptions, was a negative total of $13 billion. According to EPFR, IG bond funds reported $7.7 billion of outflows in December. For the full-year total inflows were about $324 billion.

Securitized Market Review

In securitized sectors in December, spreads tightened across mortgage-related, per Bloomberg data. The broad Bloomberg MBS Index delivered 21bps of excess return. Lower coupon MBS tended to earn the best excess return. Commercial Mortgage-Backed Securities (CMBS) and Agency CMBS had excess returns in December of 18 and 13bps, respectively, per Bloomberg data.

In the ABS market segment, spreads narrowed by 1bp across bonds backed by auto loan and credit card debt. For the month, auto loan-backed ABS had an excess return of 7 bps, while bonds backed by credit cards had a negative excess return 2bps. During 2021, excess returns for auto loans and credit cards were positive at 35bps and 20bps, respectively.

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