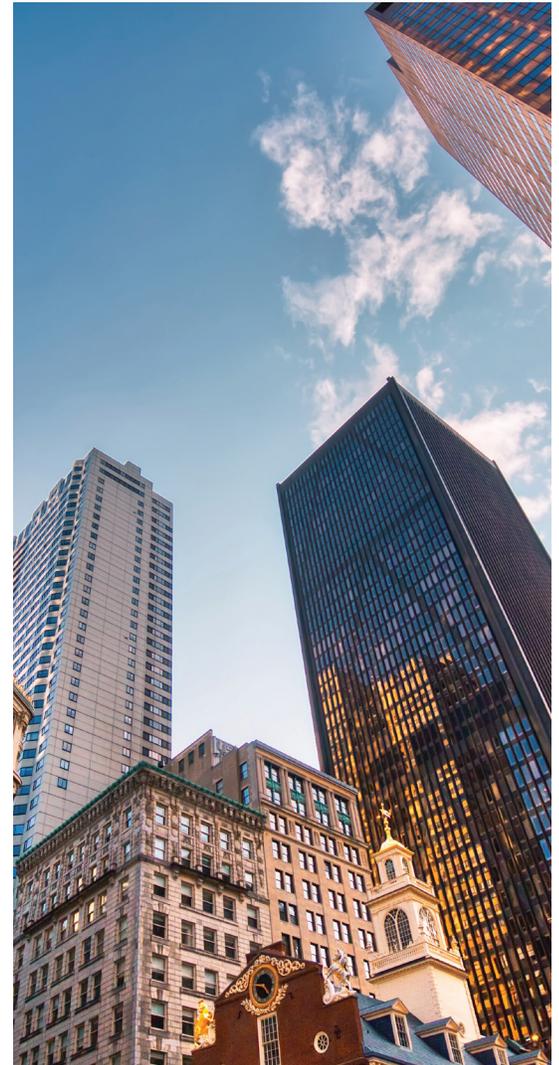


# June 2021 Market Commentary



## Strategy and Outlook

- U.S. Treasury Curve: The Treasury yield curve flattened, as short-term rates increased, and long-term rates decreased.
- Municipal Market Technicals: June's issuance totaled \$43 billion, a 30 percent increase from the prior month but down 19 percent from June 2020, according to *The Bond Buyer*.
- Corporate Market Technicals: Gross investment grade (IG) corporate bond supply for June was about \$142.2 billion, per Bloomberg. IG fund flows strengthened from May levels.
- Securitized Trends: Spreads widened across most mortgage-backed securities (MBS) segments, while they tightened for agency commercial MBS (CMBS), non-agency CMBS, and asset-backed securities (ABS).



### Market Review

A more hawkish tone from the Federal Reserve (Fed) at its June meeting flattened the Treasury curve substantially. Yields at the 10- to 30-year spots fell by 13 to 20 basis points (bps), while 2- to 5-year yields rose by 9bps.<sup>1</sup> The fall in longer yields likely reflects wthe market’s view that growth will peak this quarter and the likelihood of inflation becoming too elevated is lower now that the Fed is discussing tapering asset purchases.

The 10-year Treasury closed the quarter at 1.47 percent, down 30bps from the high at the end of the first quarter. Part of the reason for the fall in yields also may be attributable to the smaller bipartisan infrastructure deal, which at \$550 billion would result in a smaller projected deficit. However, this is subject to change if the Democrats pursue a larger infrastructure proposal through reconciliation, which may re-ignite inflation fears and push yields higher.

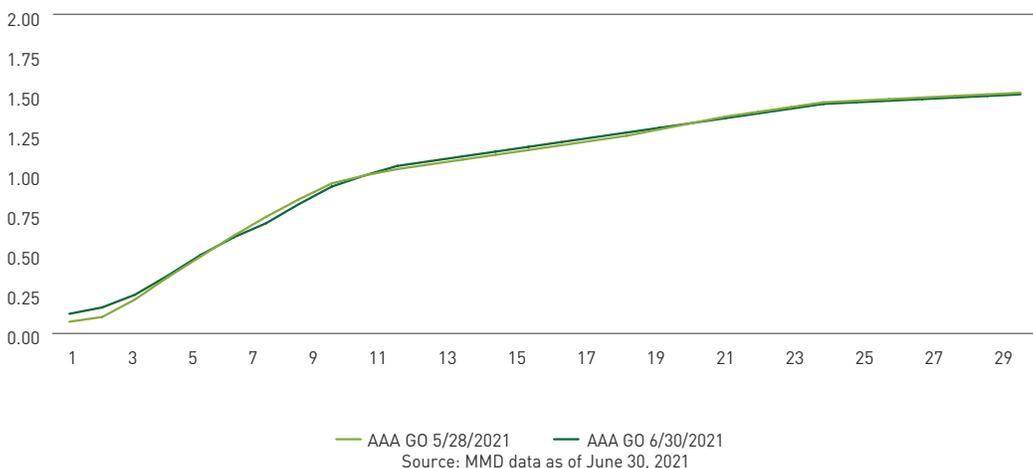
The Fed and the market have moved forward expectations for an interest rate hike, with seven members now forecasting an increase by the end of 2022, up from 4 members earlier this year. The distribution of Fed members is now skewed towards more members favoring a somewhat earlier liftoff and a somewhat faster pace of hikes.

Employment data released for June showed a gain of 850,000 jobs and unemployment rate rising to 5.9% as more people returned to the workforce.<sup>2</sup> Inflation readings remain high, but continue to be driven by transitory categories like cars and travel. May core personal consumption expenditures increased 0.48 percent month over month and 3.5 percent year over year while the core consumer price index rose 0.74 percent month over month and 5.0 percent year over year.<sup>3</sup>

### Municipal Market Review

The municipal yield curve flattened overall during June due to outperformance in longer maturities. The 2s5s curve flattened 5bps, while the 2s10s and 2s30s curves were 6bps and 7bps flatter, respectively (see Figure 1). Municipal/Treasury (M/T) ratios decreased in short- to intermediate-term maturities, while they widened more notably in longer-term maturities. Ratios closed June at 57 percent at the 5-year spot, a decline of 4 ratios, while widening to 68 percent and 72 percent at the 10- and 30-year maturities, respectively, both 6 ratio increases.

FIGURE 1: MUNICIPAL YIELDS CHANGED LITTLE IN JUNE



Supply and demand technicals supported the market. According to *The Bond Buyer*, June’s issuance totaled \$43 billion, a 28 percent increase from the prior month, bringing the year-to-date total to \$223 billion. Despite the higher level of supply, it was easily absorbed by continued mutual fund inflows.



Municipal bond fund flows were positive in June, with inflows averaging about \$2 billion per week, Bloomberg reported. Year-to-date flows through June totaled \$60 billion, according to Lipper.

State revenues continue to impress to the upside, improving the financial position of bond issuers.

For June, the Bloomberg 1-10 Year Blend Index gained 0.07 percent and the Managed Money Short/Intermediate (1-10) Index added a basis point. Per Bloomberg, lower-rated bonds outperformed higher-rated bonds. Bonds with longer maturities outperformed shorter maturities.

Low absolute yields and ratios combined with tight credit spreads made it a challenging time to find attractive relative value in high grade municipals. We found some opportunities to combat the low ratios and add some additional spread and yield in taxable municipal bonds and in the secondary market. As we became more cautious near quarter end, we shortened duration targets by 0.10 years across several intermediate strategies, reducing exposure in the 10-year range in favor of 5-year and shorter ranges. While we do not see a catalyst to drive municipal bonds cheaper in the short-term, upcoming seasonal changes, including street expectations of higher levels of new-issue supply and lower levels of maturing bonds, may present a better entry point later in Q3 and Q4.

### Corporate Market Review

Corporate bond spreads continued to tighten in June. Investment grade corporate bond spreads tightened to 80bps by month-end. The BBG IG Corporate Index IG Index (the "Index") gained 1.63 percent on a total return basis and delivered an excess return of 0.50 percent over duration-matched Treasuries.

Bloomberg's investment grade corporate indices showed that AAA-rated bonds generally outperformed other bonds in the investment grade category on a total return basis, although on an excess return basis, lower-rated bonds held an advantage. Longer-term maturity corporate bonds generally earned higher total and excess returns relative to shorter maturities.

According to Bloomberg, the best-performing sectors in June were Media Entertainment, Wireless, Airlines, Oil Field Services, and Midstream Oil companies. The worst-performing sectors were Sovereigns, Supranationals, Construction Machinery, Integrated Energy, and Banking.

Index-eligible IG fixed-rate corporate bond issuance in June, per Bloomberg, was \$142 billion, down slightly (-3.5 percent) from May. Net issuance, after redemptions, was \$40 billion. Demand for bonds remained strong. According to Wells Fargo, IG fund inflows were \$22.7 billion, leaving year-to-date net flows at a record level for the first half of 2021 of \$207 billion.

We continue to view credit fundamentals as positives for the IG market. Earnings have been growing swiftly and should drive credit metric improvement across most sectors. Agency downgrade activity and fallen angels (e.g., issuers cut to speculative grade from IG) have slowed. Spreads are notably tight by historic standards, although higher-quality IG asset classes offer even less spread and IG corporates benefit from foreign demand as Europe and Japan yield spreads are lower. Technical conditions, balancing supply and demand indicators, are a modest strength in our view.



## Securitized Market Review

After decreasing in May, a faster prepay backdrop for agency MBS during June combined with record-breaking supply and increased taper talk continue to weigh on the sector. MBS, as represented by the Bloomberg MBS index, underperformed Treasuries. Agency CMBS remained one of the bright performers among the sectors we track.

Benchmark ABS spreads were flat, with some tightening within student loans and other smaller sectors. We continue to find value in the small business administration loan market. ABS earned positive returns relative to Treasuries for another month despite record tight spreads. Total issuance is up year to date and demand is strong in non-benchmark sectors. New issue volume remained on pace to match 2019's total issuance of \$229 billion.

Per Bloomberg index data for June, agency CMBS had a negative excess return of 10bps and nonagency CMBS earned a positive excess return of 5bps. MBS delivered a negative excess return of 33bps. Within the ABS segment, excess returns were 7bps for both credit card-backed and auto loan-backed issues.

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### FOOTNOTES:

1. <https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/textview.aspx?data=yield>
2. <https://www.reuters.com/business/us-job-growth-picks-up-june-unemployment-rate-rises-59-2021-07-02/>
3. <https://www.bea.gov/news/2021/personal-income-and-outlays-may-2021>

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