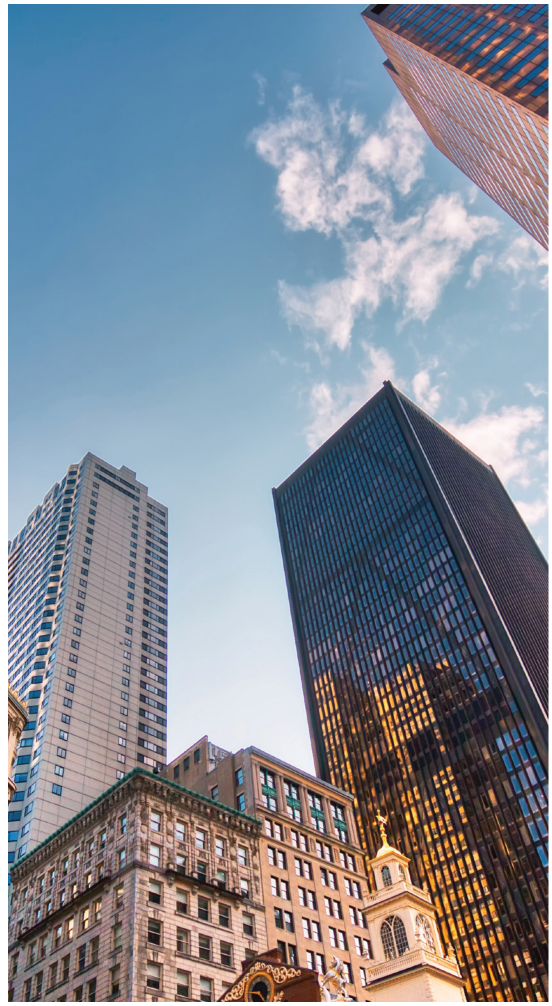


September 2021 Market Commentary

(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:** Treasury yields increased as the month drew to a close and the curve steepened (See Figure 1).
- **Municipal Market Technicals:** September issuance was $36 billion, 14 percent lower than August. Fund flows surpassed $6 billion in September.
- **Corporate Market Technicals:** Investment grade (IG) fixed-rate bond supply for September was more than $184 billion. IG fund flows were about $21 billion.
- **Securitized Trends:** Mortgage-backed securities (MBS) and bonds backed by credit card and auto loan assets delivered positive excess returns.

Market Review

After a summer of declining yields and Municipal/Treasury (M/T) ratios, Treasury yields increased during the last ten days of September, as investors grew more concerned about potential inflation, Federal Reserve (Fed) policy, and the debates in Washington, D.C. about infrastructure spending and the debt limit.

The discussion about transitory versus structural inflation continued, despite a lower-than-expected August Consumer Price Index report. Wage increases and higher shelter and commodity costs indicated price increases may stick around for longer than initially expected.

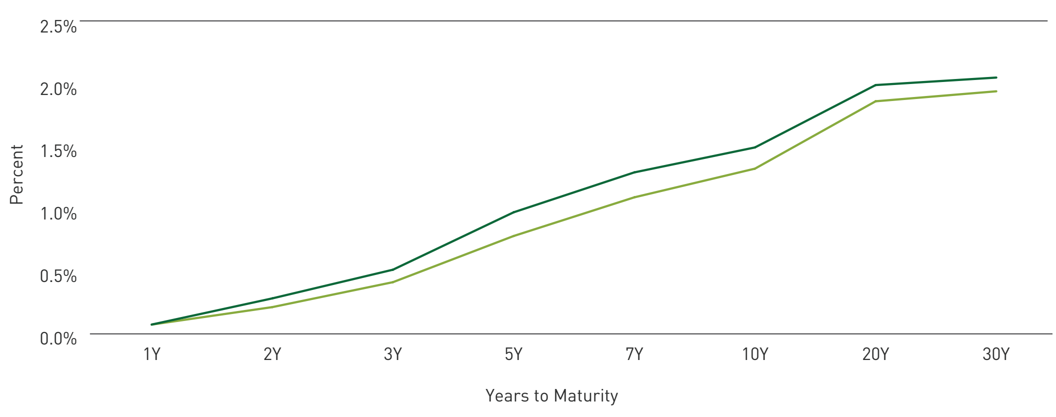
After its September meeting, the Fed indicated it could raise interest rates next year and its dot plot, indicating Fed Governors' views of rate increases, shifted, with 9 of 18 members seeing a 2022 hike, up from 7 in June. The Fed also signaled it will announce at its November meeting more information on tapering of the $120 billion monthly purchases of Treasuries and MBS debt if the economy doesn't suffer a significant setback.[1]

Daily new COVID-19 cases increased during the summer, reducing airport and restaurant traffic, flattening office traffic, and dampening U.S. consumer confidence, according to the Conference Board.[2]

Congress and the White House debated infrastructure spending and an increase in the federal debt limit, with a potential default on the government's debt looming. On the last day of the quarter, Congressional approval of government funding through December 3 did little to assuage the markets and left the debt ceiling limit unaddressed. In the days that followed risk asset values fell, and bond yields increased.

Treasury yields remained in a tight trading range until growing more volatile during the last ten days of the month. Month-end yield changes were higher by 7 to 19bps in the 2- to 5-year range, 18bps in 10 years, and 11bps in the 30-year spot. The 2- to 5-year yield curve (2s5s) steepened by 12bps while the 2s10s curve was 11bps steeper, per Bloomberg data.

FIGURE 1: TREASURY YIELDS INCREASED AND THE CURVE STEEPENED DURING SEPTEMBER 2021

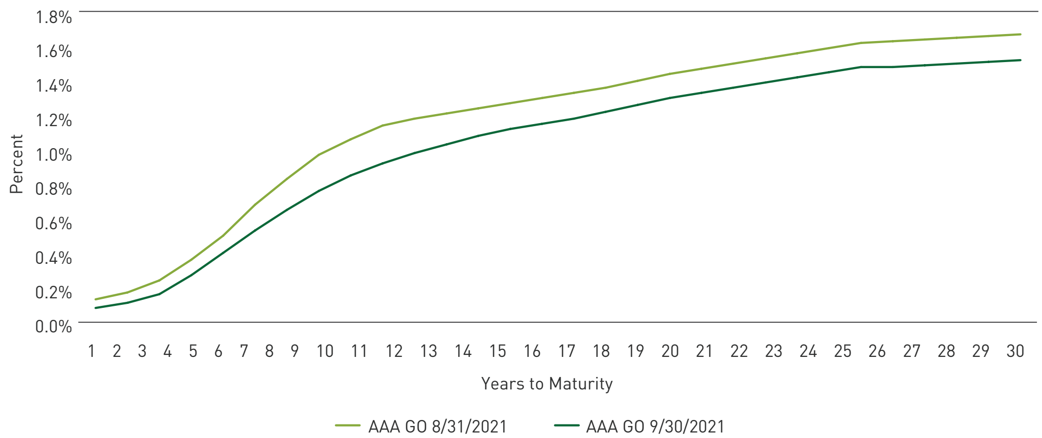


Source: Bloomberg, September 30, 2021.

Municipal Market Review

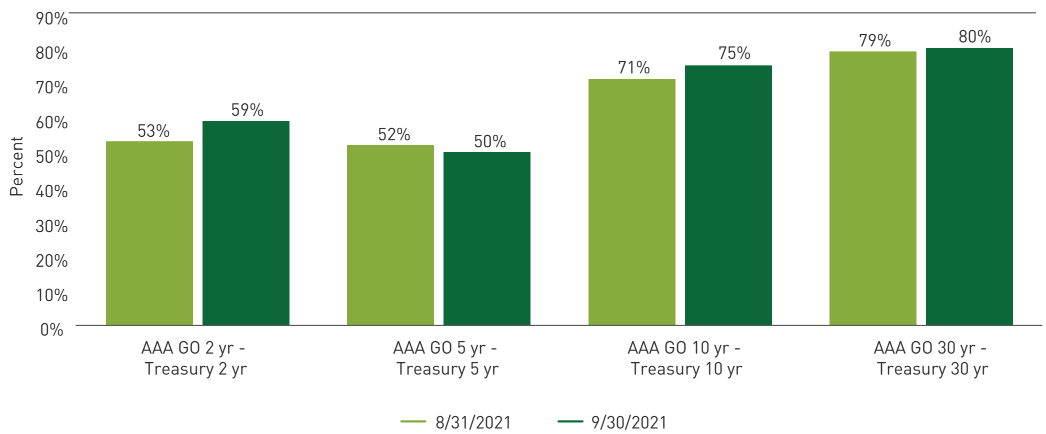
Similar to Treasuries, municipal bond yield changes were muted until yields jumped higher near month end. By month end, yields jumped higher by 6bps for the 2-year maturity and 10, 22 and 15bps at 5-, 10-, 30-years, respectively, per Municipal Market Data. Underperformance in longer-dated maturities compared with shorter maturities steepened the 2s10s curve by 10bps. The 2s30s curve was 7bps steeper. (See Figure 2).

FIGURE 2: MUNICIPAL BOND YIELDS INCREASED AND THE CURVE STEEPEND DURING SEPTEMBER



Source: Bloomberg, September 30, 2021.

FIGURE 3: M /T RATIOS MOSTLY IMPROVED IN SEPTEMBER



Source: Bloomberg, September 30, 2021.

Municipal/Treasury (M/T) ratios mostly improved during September (See Figure 3). Ratios improved in the 2-, 10-, and 30-year spots and fell slightly at 5 years. The steeper curve and higher ratios represented a better entry point than at any point during 3Q. September issuance at $36 billion was 14 percent lower than during the prior month and 33 percent lower than September 2020.

Year-to-date total issuance in 2021 was $346.5 billion through September 30, just 2.5 percent less than the same period in 2020. During 2020, summer new supply benefited from a spate of issuance following reduced activity due to COVID-19 restrictions in the spring. At $6.5 billion, September taxable municipal bond issuance was more than 60 percent lower than in September 2020.

Municipal bond funds reached 30 consecutive weeks of positive flows during September, *The Bond Buyer* reported. Lipper reported year-to-date inflows of $88.5 billion for the period ending September 29.

The Bloomberg Managed Money Short/Intermediate (1-10) Index declined 0.67 percent while the Bloomberg 1-10 Year Blend Index was 0.51 percent lower. In August, investors saw the performance advantage of lower-rated municipal bonds narrow compared with higher-rated bonds. In September, as investors confronted higher levels of uncertainty the performance scale tipped to higher-rated bonds. Municipal bonds rated AA and A outperformed BBB-rated bonds by 8 and 9bps, respectively. AAA-rated bonds trailed BBB-rated bonds by 2bps for the month. Shorter maturity bonds outperformed longer maturity bonds.

With sustained high demand for bonds in an environment of lower new supply, yields, and M/T ratios, we remained patient entering September. We sought to add value by leveraging our experience and acumen in the secondary and taxable municipal bond markets, where relative values were somewhat better, in our view. Based on historical experience, we continued to anticipate that new issue supply would rebound entering the fall months. Those expectations were realized as September ended and, with the increased volatility in yields, we identified more opportunities to capture better relative values.

IG corporate bond spreads tightened by 2bps in September, per Bloomberg data, to settle at 84bps, and were 12bps tighter year-to-date. The Bloomberg IG Corporate Index declined 1.05 percent for September on a total return basis and generated an excess return of 26bps compared with duration-matched Treasuries. Bloomberg corporate bond data showed that lower-rated IG bonds outperformed higher-rated bonds. Shorter-maturity bonds generally earned higher total returns than did longer-maturity bonds.

The best-performing sectors were Oil Field Services, Refining, Airlines, Independent Energy, and Railroads. The worst-performing were Sovereigns, Gaming, Metals and Mining, Transportation Services and Cable Satellite, according to Bloomberg.

Index-eligible IG bond issuance in September, per Bloomberg, was $184 billion, an increase of nearly 110 percent from August's low level. Net issuance, after redemptions, was a $79 billion, up from $17 billion during the prior month. Demand for bonds remained strong. According to EPFR, monthly IG fund inflows were about $21 billion in September, bringing the year-to-date total to nearly $304 billion.

Real gross domestic product (GDP) increased at an annual rate of 6.7 percent in the second quarter of 2021, according to the third estimate released by the Bureau of Economic Analysis on September 30, 2021. With a number of issues across political, policy, economic, health, and social strata serving to cloud the outlook, some observers are moderating their estimates for future GDP growth. For example, as of October 1, 2021, the Federal Reserve Bank of Atlanta's GDPNow forecasting model estimated third quarter gross domestic product growth at 2.3 percent on an annualized basis.

After peaking in 2020, IG corporate leverage has declined due to growth in cash flows and low rates, helping to reduce interest burdens through the refinancing of higher-cost debt. Labor shortages and supply chain disruptions are a risk looking ahead. But profit margins are high relative to longer-term averages and price increases in some sectors may offset rising costs. Current spreads are low relative to historic medians, although there have been periods of prolonged tight spreads. Relative to competing IG asset classes and in a global context, US IG appears to still offer some relative value.

Securitized Market Review

MBS spreads tightened during September, resulting in positive excess returns at almost every conventional and Government National Mortgage Association (GNMA) coupon cohort, particularly among the higher rates. Commercial mortgage-backed securities (CMBS) and Agency CMBS also delivered positive excess returns.

Breckinridge and other participants in the MBS sector now wait for additional clarity from the Fed on its plans to taper MBS purchases. Further demand weakness in the market if and when the Fed withdraws could offer attractive buying opportunities.
The ABS sector outperformed Treasuries on an excess return basis in September, based on Bloomberg data, as spreads widened just a basis point or two. Auto loan ABS narrowly outperformed credit card ABS.

#271315 (10/13/2021)

FOOTNOTES:

1. *https://www.wsj.com/articles/fed-tees-up-taper-and-signals-rate-rises-possible-next-year-11632333617*
2. *https://apnews.com/article/business-health-coronavirus-pandemic-consumer-confidence-4e12e60b27fe5acaa2d7f963e6506e31*