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Credit Markets: A Historically Bad Year So Far

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During the first half of 2022, U.S. Bonds performed worse than any full year since 1842.

According to a May 6, 2022 article* in The Wall Street Journal, the performance of the broad U.S. bond market has performed worse so far this year than in any full year since 1842. The culprits: 1) persistent inflation; 2) concerns about how aggressively the Federal Reserve will continue to raise interest rates; and 3) fears the Fed tightening will send the economy into a recession.

For the quarter, the yield on the benchmark 10-year U.S. Treasury bond continued it's climb from 2.32% on March 31st to end the quarter at 2.98%. However, during the quarter the 10-year Treasury hit a high of 3.49% on June 14th amidst continuing inflation fears and a day before the Federal Reserve hiked the Federal Funds rate by 0.75% after raising it 0.50% in May. The 0.75% increase in June was the largest single meeting increase since 1994.

On the inflation front, we continued to see stubbornly high inflation numbers in the second quarter, most notably an 8.6% reading for headline Consumer Price Index in May. The War in Ukraine and continued supply chain disruptions have added to what was already a challenging inflation environment coming out of the pandemic. However, as we enter the third quarter, we are optimistic we will begin to see inflation readings begin to moderate, particularly year-over-year comparisons as inflation really began to spike in the third quarter of 2021. Increasing supply and moderating demand for several commodities has already started weighing on prices, which should help the inflation picture as well.

The Federal Reserve is currently expected to raise interest rates in July by another 0.50%-0.75% as price stability has become their primary focus and the labor market remains in good shape. Fed Chair Powell has stated he believes a "softish" economic landing is still possible, although markets appear very skeptical at this point. In fact, according to the Atlanta Federal Reserve Bank's *GDPNow* economic forecasting model (which has had a strong historical track record), U.S. Gross Domestic Product (GDP) likely contracted -2.1% in the second quarter, after a revised reading of a -1.6% contraction in the first quarter (primarily due to a large inventory buildup in the fourth quarter of 2021).

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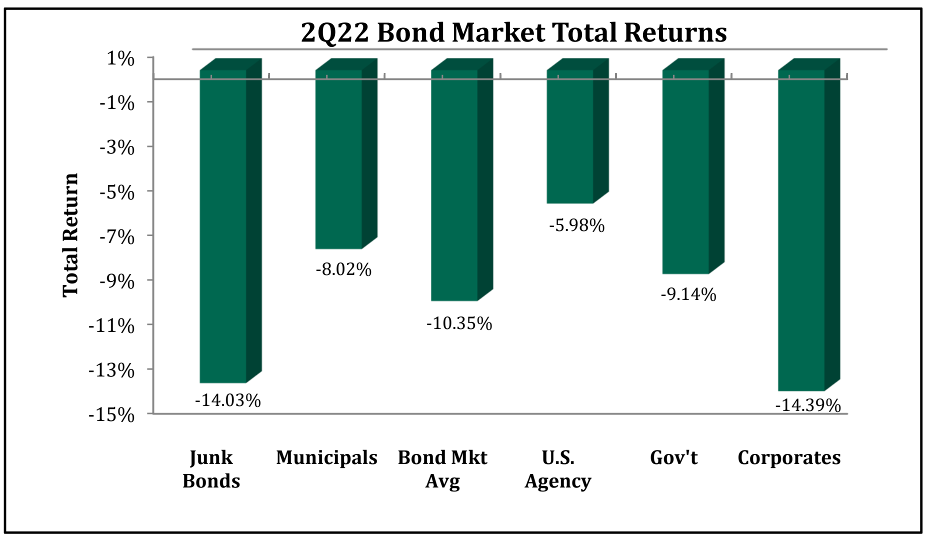
During the quarter, we made several changes to client portfolios given the ongoing volatility in markets. For our clients with fixed income allocations, we removed our interest rate hedge and added a tactical position in long-term Treasury bonds. 30-Year U.S. Treasury bonds had fallen over 20% for the year by mid-June, which is extremely rare in bond market history. We also reduced our inflation hedges during the quarter, indicating we believe long-term interest rates and inflation readings have likely peaked and are set to improve in the coming quarters. As always, we will continue to stick to our investment discipline to take advantage of opportunities as they develop amidst ongoing market volatility.

**"It's the Worst Bond Market Since 1842. That's the Good News.", The Wall Street Journal, May 6, 2022*



Source: Wall Street Journal

Bond Market Yields 6/30/2022

Average Money Market Fund	0.01%	10 Yr. AAA Muni Bond	2.71%
5 Yr. AAA Muni Bond	2.22%	10 Yr. AA Corporate Bond—Long Term	2.48%
5 Yr. AA Corporate Bond—Intermediate	2.00%	10 Yr. U.S. Treasury	2.98%
		30 Yr. Fixed Rate Mortgage (Conforming)	5.89%

Source: Bankrate.com