OSBORNE PARTNERS
Capital Management, LLC

Credit Markets: The Bond Bear Market Continues

By: Chuck Else

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After years of being underweight to bonds, we now see attractive yields that could become tailwinds for client portfolios.

What was already one of the worst year-to-date performances in bond market history only got worse in the third quarter. During the quarter, the Federal Reserve increased the short-term Federal Funds rate twice – once in July and once in September. Each of those rate hikes were 0.75%, bringing the string of unusually large hikes to three in a row (including the 0.75% increase in June). The Federal Funds rate now stands in a range of 3.00%-3.25% – the highest level since early 2008. The average U.S. bond was down -10.4% for the year at the end of the second quarter and ended the third quarter down -14.6% for the year.

Particularly noteworthy during the quarter was the rhetoric coming from the Fed. In his comments following the Fed's September meeting, Fed Chair Jerome Powell stated, "We have got to get inflation behind us. I wish there were a painless way to do that. There isn't." He went on to say that to halt additional rate hikes, they would need to see continued slowing of economic growth, an increase in unemployment and "clear evidence" that inflation is moving back down toward their 2% target.

Meanwhile, inflation readings during the third quarter continued to spook bond investors. After showing some moderation in July, August saw headline CPI continue to decelerate while core CPI surprisingly reaccelerated. We still believe that inflation likely peaked back in June, although it's taking some time to show up in official figures.

While the average yield on bonds increased by over 1% in the third quarter, option-adjusted interest rate spreads were similar to the end of June, leaving them at multi-year highs. At the same time, with yields moving up as substantially as they have this year, bonds are now offering attractive yields. For example, the average Investment-Grade Corporate bond is now yielding in the mid-5% range. For years, we have been underweight bonds for our average client, but have been net buyers of bonds over the past couple of quarters. As yields become more attractive, we believe the fixed income asset class

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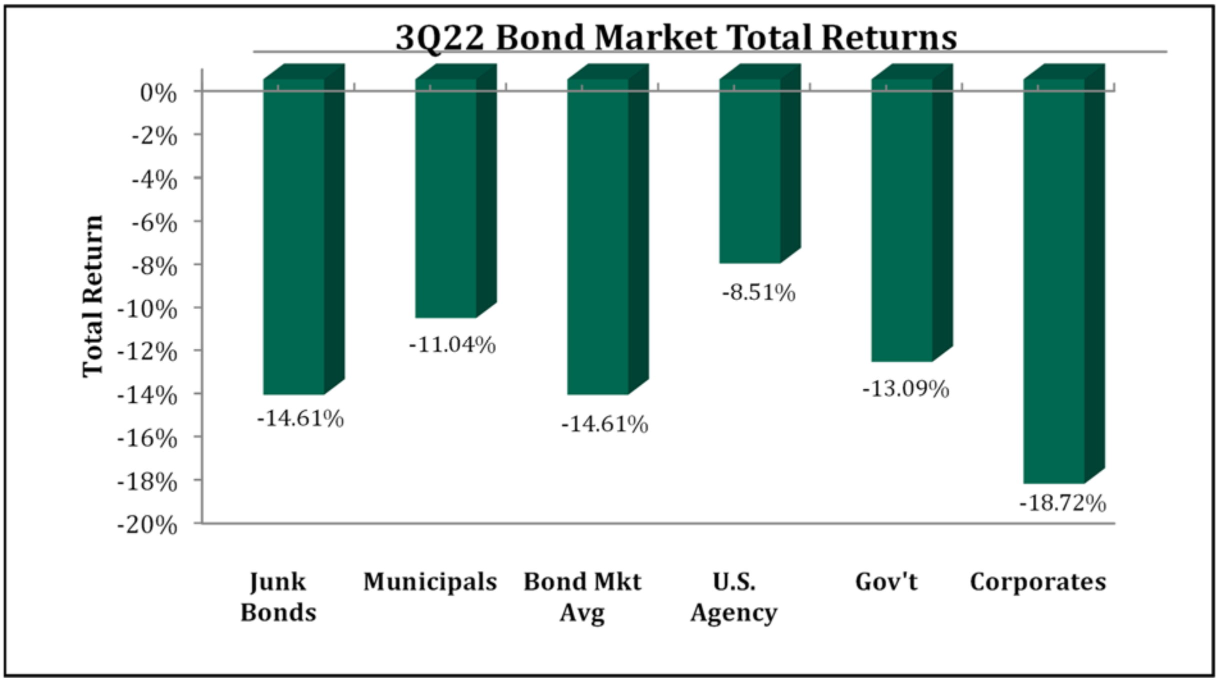
could become a tailwind for client portfolios after many years of being a primary headwind to overall portfolio returns.

Bond Market Yields 9/30/2022			
Average Money Market Fund	0.20%	10 Yr. AAA Muni Bond	3.26%
5 Yr. AAA Muni Bond	3.13%	10 Yr. AA Corporate Bond—Long Term	4.93%
5 Yr. AA Corporate Bond—Intermediate	4.69%	10 Yr. U.S. Treasury	3.83%
		30 Yr. Fixed Rate Mortgage (Conforming)	7.06%

Source: Bankrate.com



Source: Wall Street Journal

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