Fixed Income Quarterly Commentary

Growth Through Stability

Q3 ▪ 2023

Market Update

The Federal Reserve rate hike in July, persistent inflation, and commentary around "higher for longer" weighed on Fixed income markets in Q3. Longer dated bonds have higher interest rate sensitivity and were thus down more than shorter term bonds. The bond market has been anticipating a recession for over a year now, as evidenced by the inverted yield curve predicting rate cuts in 2024. The bond market is also wrestling with a supply and demand mismatch in treasuries driven by Federal Government issuance to fund deficit spending and weaker demand due to the Fed tapering asset purchases. This pushed 5–30-year treasury bond yields up dramatically during the 3rd quarter and while these imbalances should find an equilibrium over time, they can create a large amount of volatility in the short run.

Core Taxable Fixed Income

Core accounts generally finished with negative returns in third quarter and slightly underperformed the index that returned -0.74% [1]. The underperformance was primarily driven by taxable municipal bonds, which underperformed other government bonds during the quarter. This was partially offset by outperformance in corporate bonds, which benefited from strong economic data in the second quarter.

Municipal Bonds

Municipal accounts were down in the 3rd quarter, underperforming the index that was down -2.05% [2]. The rapid rise in treasury yields hurt virtually all municipal bonds, with the longer maturity bonds underperforming shorter bonds, a reversal of last quarter. This was compounded by large outflows from mutual funds at the end of the quarter. Callable bonds with longer maturities drove the underperformance relative to the index. In munis, we continue to focus on essential services (water, sewer, and electric) and Mello-Roos bonds (backed by property taxes) with clear cash flows and low pension liabilities.

High Yield Fixed Income

High Yield accounts posted positive returns during the third quarter and outperformed the index that was up 0.27% [3]. The primary driver of the outperformance was due to being overweight floating rate and Financials. The Financial sector outperformed as banks have posted stronger than expected results after the crisis in the first quarter. We remain cautious on the economy and are positioned for an economic slowdown with a focus on higher quality bonds.

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1. Figures presented on page one are from the ICE BofAML 1-10 Year US Corp and Government Index as of 9/30/23

2. Figures presented on page one are from the ICE BofAML 3-7 Year US Municipal Securities Index as of 9/30/23

3. Figures presented on page one are from the ICE BofAML 1-10 Year US High Yield BB-B Index as of 9/30/23