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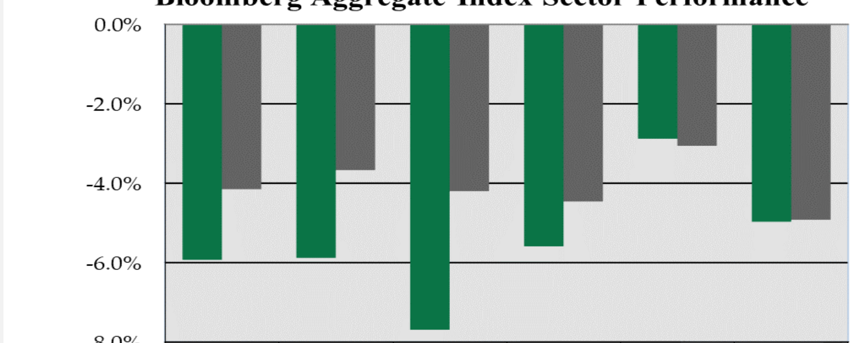
FIRST QUARTER 2022 INVESTMENT REVIEW

FIXED INCOME OVERVIEW

Bloomberg Aggregate Index Sector Performance



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q1 '22	-5.93%	-5.88%	-7.69%	-5.59%	-2.88%	-4.97%
12-Month	-4.15%	-3.67%	-4.20%	-4.46%	-3.06%	-4.92%

Source: Bloomberg

It seems a bit trite discussing and reflecting on one of the worst quarters in the history of the bond market while an entire country and their people face the horror of war, but we must. Our hearts and thoughts are with those in Ukraine as well as their family and friends. Just as folks were getting ready to move past the Omicron variant, inflationary data reminded everyone that higher prices are everywhere and the Fed will need to be more aggressive as they try to cool things. If that weren't enough to digest, Russia's unprovoked but telegraphed invasion of Ukraine sent energy prices higher and most risk markets lower as already tight supply chains got called into question once more. The Bloomberg Aggregate Index was down about 6% this quarter, which effectively eliminates about two years of coupon interest. The table above shows that there was really no place to hide, even short duration U.S. Treasuries finished lower with the 2-Yr. bellwether down over 2.5%, as the curve started to reflect the reality of an hawkish Federal Reserve.

CREDIT SPREADS

Investment grade corporate credit spreads (green line on the following chart) widened in linear fashion as the two-headed monster of war and inflation pushed people to the sidelines. The market experienced steady outflows despite offering some of the most attractive yields in quite a while. IG spreads finished the quarter at 115bps after peaking at 144bps and starting at 92bps. (Cont.)

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CREDIT SPREADS

(Cont.) Things became a bit more volatile in the high yield sector (blue line on the chart to the right) as spreads widened about 130 bps by the middle of March, only to rally and finish approximately 40bps wider for the quarter. The chart to the right highlights the action and just how sanguine the market was during most of 2021. We recently trimmed some high yield exposures in certain accounts and continue to look at opportunities within the space as things remain fluid. Within our investment grade portfolio's we pared back some of our municipal exposure and deployed some capital into the corporate bond arena as better than expected supply offered what we felt were attractive entry points to select credits.

Bond Market Spreads

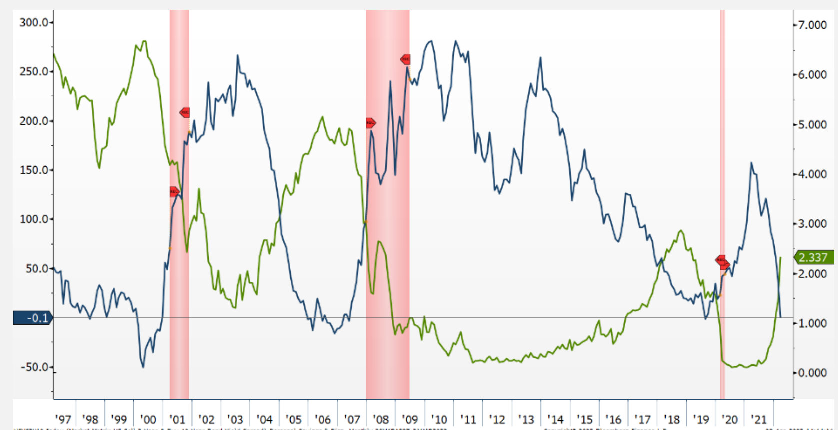
Source: Bloomberg

THE ECONOMY

Russia, rates and recession fears are having a large impact on the outlook for the economy these days. On the chart to the right, recent movement on the 2-yr Treasury yield (green line) and an oft quoted reciprocal, the 2/10 Treasury curve, has many participants taking notice as it teeters near zero. The upswing in 2-yr. yields is certainly a reaction to Fed action, while an inversion (blue line) hints at slowdown fears in our future on the chart to the right.

While it is certainly difficult to envision a recession given what has thus far been a very strong housing and job markets coupled with the general reopening theme; nevertheless we have some concerns. One being the difference between job openings and the amount of people still seeking work as potentially meaning sticky inflation. It currently sits at about two job openings for every one person seeking work, and the armchair economist would say that wages will likely remain high for the near future, as average hourly earnings registered a 5.6% year-over-year gain while the business leader's survey of future wages remains near cycle highs. (Cont.)

2-yr Treasury, 2/10 Curve



Source: Bloomberg

THE ECONOMY

(Con.t) Unfortunately, the war in Ukraine has only added pressure to the outlooks for energy and food prices as higher input costs across many facets of the chain affect those that can least afford it. We doubt we have seen the worst of inflation.

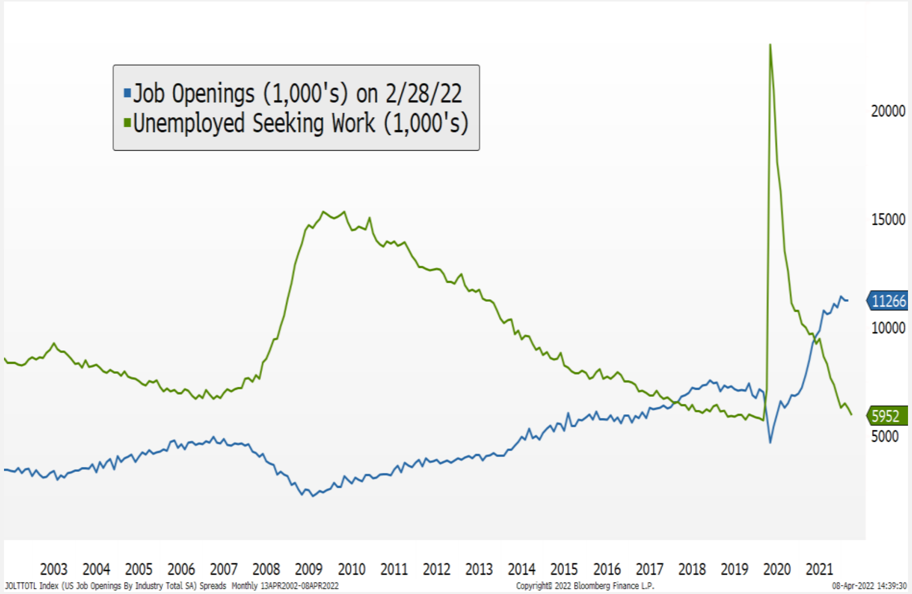
FISCAL AND MONETARY POLICY

Just a few short months ago, "transitory inflation" seemed an easy way to write-off ever-increasing prices. Unfortunately, nothing seems easy these days and markets must now adjust for higher interest rates, less accommodation as recent CPI inflation came in at a whopping 7.9% in February, putting everyone on notice, including the Fed, and no doubt, it encouraged them to begin raising rates.

The March 25bp move in the FED funds rate was the first move higher since the Pandemic began over two years ago. Fed expectations for further hikes have also moved northward (up 100bps already this year) with a median year-end projection of 1.875% and another 100bps of movement in 2023, with a 2.75% target. 50bps is certainly on the table and expected at the May meeting. If that was not enough to spook the markets, the Fed finally put some detail behind their plans to tighten monetary policy and normalize their balance sheet. The Treasury market was certainly a beneficiary of prior easing, but that is no longer the case, and we are noting a somewhat concerning uptick in volatility.

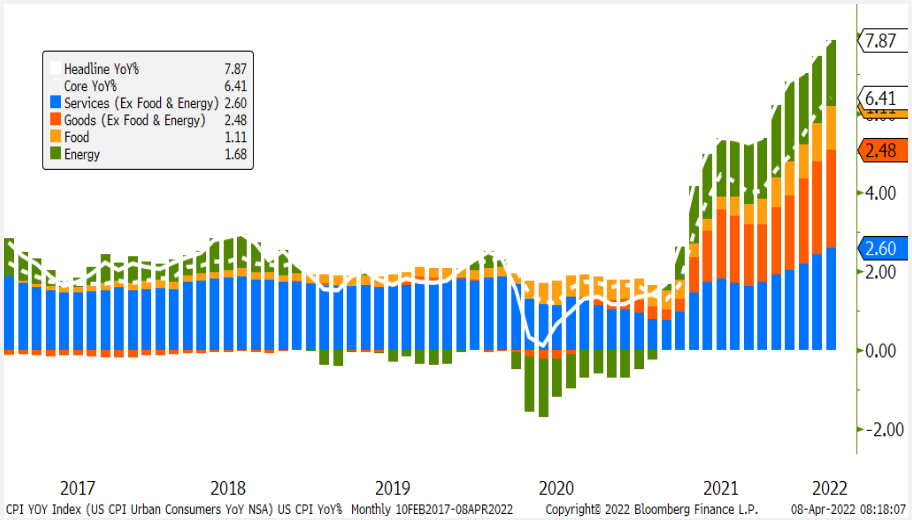
(Cont.)

U.S. Employment



Source: Bureau of Labor Statistics, Bloomberg

Headline Inflation

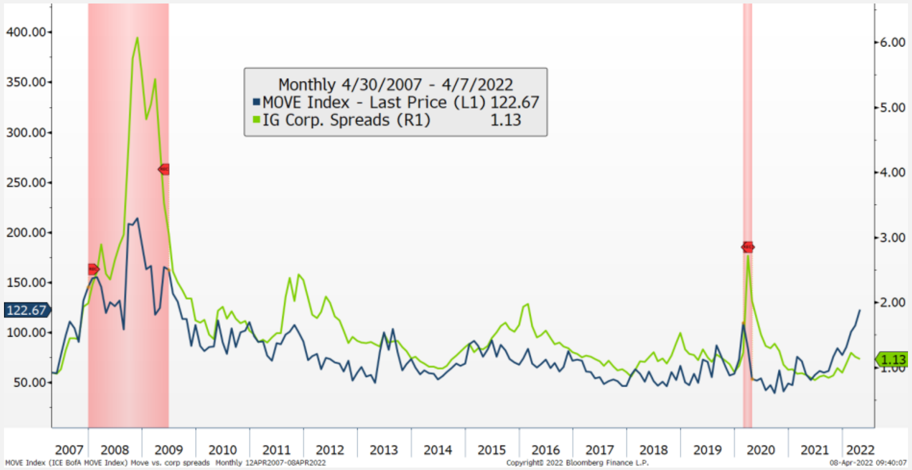


Source: Bureau of Labor Statistics, Bloomberg

FISCAL AND MONETARY POLICY

We like to monitor the MOVE index in the chart on the right (blue line) that tracks 1-month forward options across the curve, and it seems to be signaling uncertainty on rates, which does not appear fully discounted in corporate spreads (green line). We are expecting more volatility in the near-term as markets adjust to the new reality.

MOVE Index and IG Spreads



Source: BofA, Bloomberg

SECOND QUARTER 2022 STRATEGY

It also seems weird that we have not yet mentioned Covid caseloads until the final segment of the outlook, but after an early spring reprieve, cases are on the rise on the East Coast. If history is any gauge, it usually spreads west and builds, so add one more brick to the wall of worry. Fortunately, our assessment of the overall bond market is a bit more constructive as "all-in yields" available in corporate bonds are almost 4% from investment grade credits and over 6% in the high yield market. We have not seen those levels since early 2019, and we have been opportunistically adding to our corporate bonds. We think money centers look attractive to regional banks and continue to have an overweight here. Additionally, financials continue to look cheap to industrials and are overweight the sector. Additionally, our CMBS team is finding value from AAA Single Asset, Single Borrower floaters in the low-low/mid 100s while selling some seasoned, more subordination structures. Lastly, we feel that interest rates may still drift higher, so we remain underweight duration in portfolios.

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