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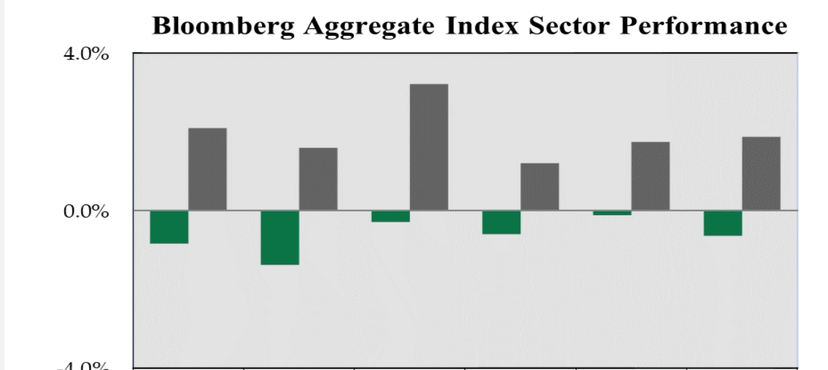
SECOND QUARTER 2023 *INVESTMENT REVIEW*

FIXED INCOME OVERVIEW

Bonds took a breather during the second quarter, as market participants reassessed their interest rate outlook on mixed economic data and a difficult-to-read Federal Reserve (the Fed). Mixed signals were the key to the equation as inflationary readings slowed, while remaining elevated as the services componentry proved sticky. Market expectations for Fed action started the quarter, with just one more hike priced followed by a cut in mid-September. Current market expectations call for another hike this summer with a cut expected at the December meeting. The short-end of the curve suffered with the yield on the 2-year Treasury moving from 4.03% to 4.90%, but rates were more muted out the curve with the 10-year about 35bps higher. For the quarter, the Bloomberg Aggregate Index finished lower by 0.84%, with Treasury securities showing the most weakness. ABS and corporates did better as buyers seemed encouraged by the strength in the labor market along with consistently high business margins.

ARTICLE HIGHLIGHTS

- Possible rate cut expected in December?
- Inflation remains quite sticky despite the energy price tailwind
- Disconnect between Manufacturing & Services ISM readings
- Housing and auto markets seems to be normalizing
- All banks have recently passed the Federal Reserve stress test
- Keeping a close eye on bank earnings



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q2 '23	-0.84%	-1.38%	-0.29%	-0.60%	-0.12%	-0.64%
YTD	2.09%	1.59%	3.21%	1.20%	1.74%	1.87%

Source: Bloomberg

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SCAN IT & GO

777 E Wisconsin Ave
Suite 2350
Milwaukee, WI
53202

Phone:
414.765.1980

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CREDIT SPREADS

Investment grade corporate credit spreads managed a small rally of 15bps during the quarter, but the main action was in high yield corporate bonds. This market finished 1.75% for the quarter, handily outpacing their investment grade counterparts. The 65bps spread move was impressive, but we note that it was partially driven by the more speculative part of this market.

We remain underweight in high yield within our DFI and Core Plus accounts, as we do not think this market has fully factored in the possibility of a demand-driven slowdown in some of the cyclical sectors. Within our investment-grade portfolios, we continue to pare back our municipal exposure, while carefully trading within the corporate area. We have taken advantage of relatively flat credit curves in the money center banks, moving from 10-year to 5-year paper giving 15bps or less in spread, while losing only single digits in yield. This spread differential was 25-35bps.

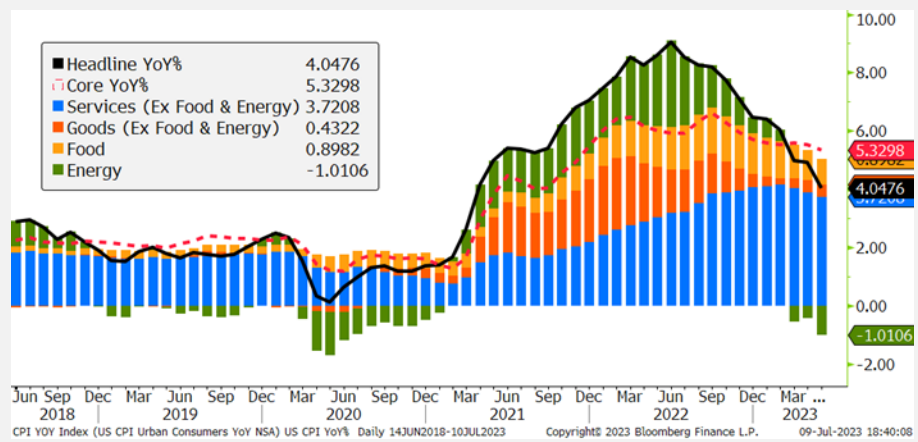
Credit Spreads

Source: Bloomberg

FISCAL AND MONETRARY POLICY

Even with 500bps of policy tightening over the last five quarters and a rolling over of the M2 money supply, inflation remains quite sticky despite the energy price tailwind. The energy component of inflation (green bars in CPI chart) now signals negative inflation which tends to flow into other segments of the economy as it is embedding into much of what we all consume, so there seems to be light at the end of the tunnel.

CPI



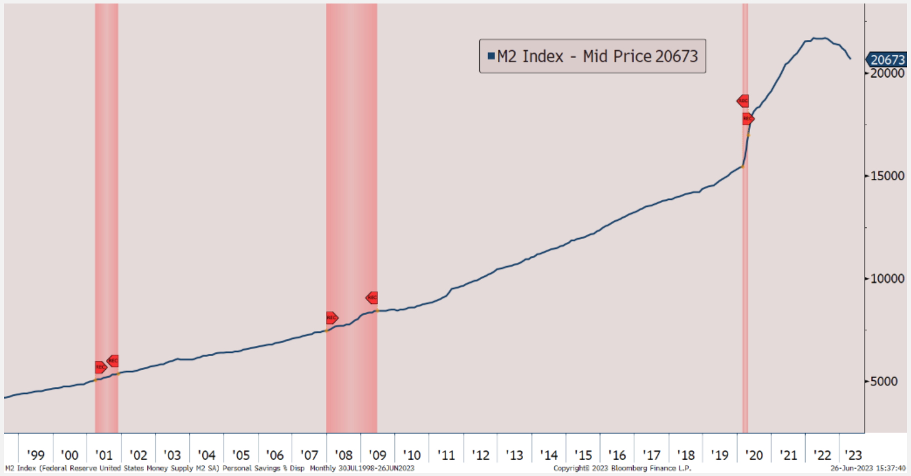
Source: Bloomberg, Bureau of Labor Statistics

Fed chair, Powell, has commented that the Fed will likely raise interest rates at least one more time this year because of persistently high inflation in the economy's service sector and the surprisingly tight job market. We would have to agree with everything in that statement, except for the "surprising" part. No matter how you look at it, there is still a lot of money looking for a home (both literally and figuratively), as evidenced by the sheer size of M2 money supply which is still north of $20 trillion. It is certainly tough to slow this train of consumer spending, and it will be interesting to see if the normal correlation of year-over-year M2 growth and GDP holds, (Cont.)

FISCAL AND MONETRARY POLICY

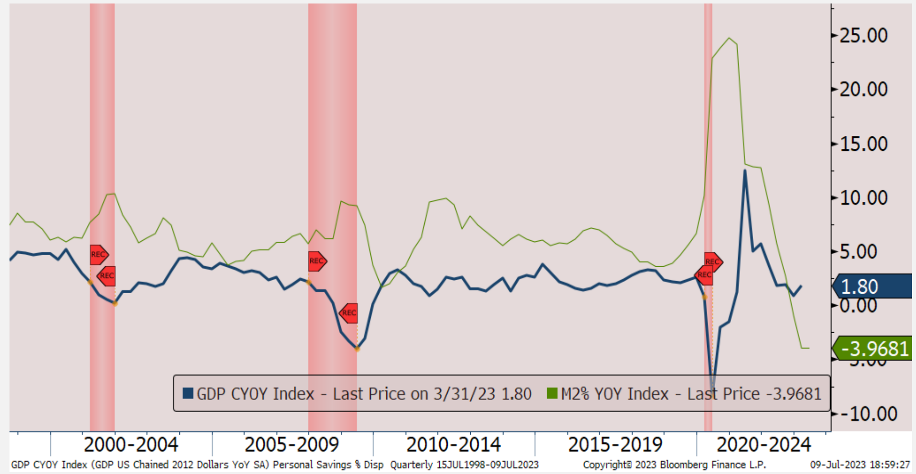
(Cont.) or whether the much-feared recession keeps getting pushed out.

Money Supply



Source: Bloomberg, Federal Reserve

M2% Change vs. GDP



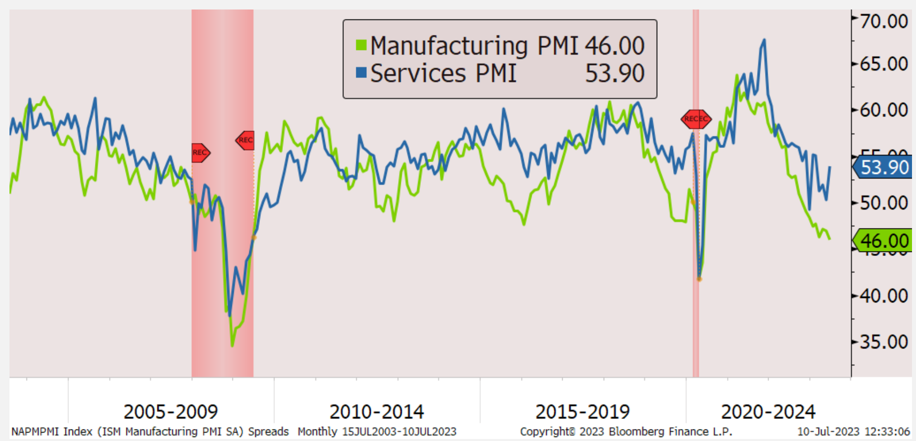
Source: Bloomberg, Bureau of Economic Analysis, Federal Reserve

THE ECONOMY

While the inverted yield curve often foreshadows a recession, it is somewhat difficult to envision things heading south quickly, especially given the robust labor market. Recent ADP and Non-farm payroll data suggests a still-tight labor market, especially on the services side, and one that just witnessed an upside surprise in Average Hourly Earnings. We are keeping a watchful eye on the disconnect between Manufacturing and Services ISM readings for a turn in either of the readings.

Meanwhile, the single-family housing market remains robust as inventory is still relatively scarce and housing starts are back at levels seen in the late 1990's. Home prices have been edging lower, however, as year-over-year Case-Shiller readings now show negative, something we have not witnessed since 2012. Overall, the housing market seems to be normalizing and that is good news, especially those looking for their first homes. Autos are also (Cont.)

ISM Levels



Source: Bloomberg, Institute for Supply Management

THE ECONOMY

(Cont.) getting closer to equilibrium, as the Manheim Used Vehicle Index is down about 15% year-over-year, which should help upcoming inflation readings but remains handsomely above pre-pandemic levels.

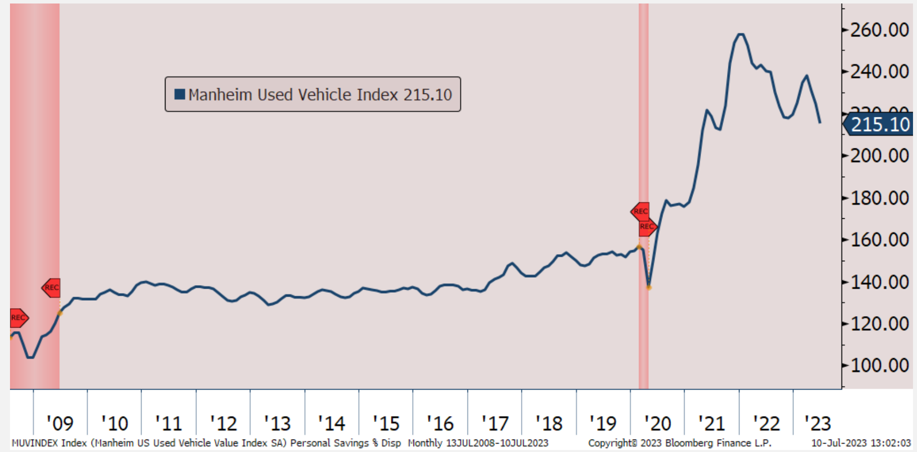
THIRD QUARTER STRATEGY

The second half of the year begins with our market again trying to time a Fed pivot, which has seemed a difficult task to say the least. We have recently noticed there is more of an institutional demand for duration, and we fall into this camp. We have been opportunistically adding duration across most mandates, but are still a touch underweight relative to our benchmarks. Our intention is to further close this gap in our traditionally managed portfolios in the back-half of the year.

The yield on the Bloomberg Aggregate index currently sits near its highest level (4.99%) since the end of 2008. With corporate spreads near their historical averages, the market appears to offer some long-term opportunity for us and investors to explore.

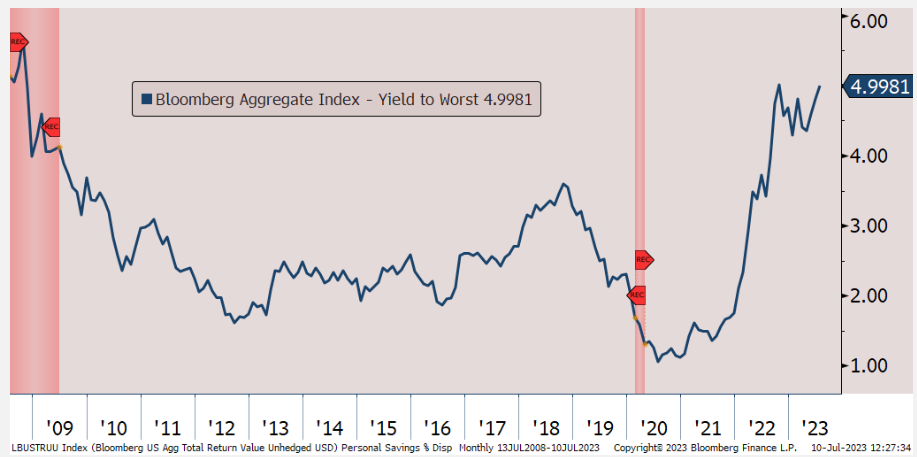
Our managers have been selling within our taxable muni area with the proceeds going to U.S. Treasuries/Cash, Agency MBS and certain sectors of the Corporate Bond market. Within Corporates, we still prefer the large banks to regionals, but we are currently finding decent value in super-regional names, like PNC. All banks have recently passed the Fed stress tests, although we will be keeping a close eye on bank earnings. We remain cautious around commercial real estate and have trimmed here. Our structured finance managers also like equipment (truck and trailer, computer equipment, software license and services) based ABS deals vs. bank credit card and prime auto loans as the latter have mostly retraced from their March-April wides. The yield pick-up here can often be in the 40bps range for highly rated instruments.

Used Vehicle Price Index



Source: Bloomberg, Manheim Auctions

Bond Market Yield



Source: Bloomberg

Mark R. Anderson, CFA
Chief Strategy Officer

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