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Second Quarter Fixed Income Letter to Clients

The key interest rate benchmark, the U.S. 10-year Treasury Yield, approached fifteen-year highs above 4% after U.S. jobs data showed a still tight labor market at the end of this second quarter/start of the 3rd quarter. The unemployment rate moved lower, labor participation remained low and wage pressure continues even after the Fed's aggressive rate hikes over the past year. So based on this and other economic data, it appears that central banks will be forced to keep policy tight to continue to fight inflationary pressures. And while conventional wisdom would say that market pricing should reflect a hard landing, that's not what prices are doing at this time. So, when markets are "confused," it's a good time for an investor to be reminded to patiently stay the course.

We feel that high quality, investment grade bonds offer a great opportunity in this environment, as the combination of liquidity, quality and attractive yields is a powerful allocation to any portfolio. In general, credit remains strong with historic levels of revenue collections and rainy-day funds. And for investors in a high tax bracket, tax-free municipal bonds are ideal for not only preservation of principal, but also good current income.

The total return of the S&P Municipal Bond Index was +0.89% for the second quarter, and +2.515% for the year-to-date total return.

We feel that investment grade credits on short and intermediate term bonds offer strong value for our clients. Municipal bond yields should be constructive overall during the summer months as the industry is now reinvesting $40 billion from July 1st redemptions, calls and coupon payments. In aggregate, $103 billion is expected to be available to reinvest through August 31 while new issue supply is muted. However, even with this good supply and demand mix, some caution is still warranted given strong valuations and continued interest rate volatility.

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Fixed Income Portfolio Manager