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Third Quarter Fixed Income Letter to Clients

The intermediate-term and long-term US Treasury yields have bounced around in a relatively contained range throughout the third quarter. Inflation is typically cause for concern in the bond market, however, even with inflation threatening the economy, rates are not aggressively rising. Yields remain near their historical lower bounds. The US Treasury 10-year bond began the quarter at a yield of 1.45% and ended at 1.54%, while the long end of the yield curve began the quarter at around 2.00% and ended the quarter at 2.10%. Rising debt levels might pose risks to this low-rate environment at some point but all the traditional rules have been thrown out the window over the past year with the Fed's Quantitative Easing program in full force as the Fed continues to finance the US Treasury to the tune of $120 billion dollars per month, while inflation picks up.

Tax-free municipal bond prices were slightly weak in the second quarter but still firm. The S&P Municipal Bond Index has returned about 1.67% year-to-date. Tax-exempt supply exceeded expectations this quarter and firm demand continues in this sector of the fixed income market. We believe that it's a time to maintain a defensive posture over the near term considering strong bond valuations. There is elevated risk of greater volatility due to political, monetary, and fiscal policy uncertainties, and of course COVID is still affecting the economy. Municipal market investors continue to track Congressional negotiations on infrastructure and budget reconciliation bills. The Senate's $1 trillion bipartisan infrastructure bill passed in August. Now the question is whether the House passes the bill.

We maintain a neutral position on the yield curve. Specifically, we continue to add to high quality positions using a 10-year laddered approach while shifting to a slightly short stance on duration within the laddered portfolio.

Evan Slater
Fixed Income Portfolio Manager