BH | Beech Hill Advisors

March 31, 2022

First Quarter Fixed Income Letter to Clients

The US bond market has undergone significant selling pressure during the first quarter. Strong economic data and the expectation that the US Federal Reserve Board would end their long-term policy of stimulus and support drove up interest rates. In addition, geopolitical uncertainty of escalating conflict in Ukraine, great tension between China and the US, as well as inflation running wild with no end in sight for global supply chain shortages. Inflation has reached levels not seen in several decades, and increases in energy, fuel and food prices have been particularly sticky.

The quarter ended with the March employment report showing a robust pace of hiring. Job gains have consistently averaged over 500,000 per month since the start of 2021, an unprecedented pace of sustained employment gains. The Fed is left facing a conundrum in managing monetary policy. While normal wage growth has accelerated, real wages have fallen as a result of strong inflation. This complicated the interpretation of labor market data as it suggests that workers still do not have enough power to bargain wage gains large enough to improve their standard of living. Thus, the US labor market is tightening at an unsustainable pace and the Fed will need to implement interest rate increases and balance sheet runoff aggressively to reduce the risk of inflation settling too far above its 2% target.

The total return of the S&P Municipal Bond Index was –5.46% for the quarter. The best performers were shorter-duration tax free bonds, which are less sensitive to interest rates adjustments, and strategies targeting both ends of the credit spectrum

The US Treasury 10-year bond began the quarter with a yield of 1.63% and ended at 2.32%; while the 30-year bond i.e., the long-end of the yield curve, began the quarter at around 2.01% and ended at 2.44%.

We have changed our view from neutral to cautious on the yield curve. As always, we search for good opportunities to find attractive situations during those extremely volatile times.

Evan Slater
Fixed Income Portfolio Manager