Logan Fixed Income

Q4 | 2022

LOGAN FIXED INCOME MARKET COMMENTARY
Q4 | 2022 REVIEW

MARKET ENVIRONMENT

As of this writing, the bond market is still not reflective the Federal Reserve's commitment to lowering inflation back to their 2.0% target and the need for clear evidence of easing price pressures.

At the last Fed meeting on December 14, Chair Powell declined to repeat the statement that it is better to do too much than too little. Still, he was quite clear that the Fed's intention is to maintain restrictive policy for quite some time, and the discussion of core service inflation, labor force dynamics, and missing workers was arguably hawkish. One reason the FOMC wants to slow its tightening pace is to avoid cutting rates too soon, because cutting rates too early is a big mistake when fighting inflation, and raising rates too far is a primary cause of cutting rates too early.

When asked about the rate cuts being priced into the market, Chair Powell said in a response to a question that officials at the Fed were not even pondering yet the idea of easing ahead.

"Our focus right now is really on moving our policy stance to one that is restrictive enough to ensure a return of inflation to our 2.0% goal over time," Powell said. "It's not on rate cuts. I wouldn't see us considering rate cuts until the committee is confident that inflation is moving down to 2.0%."

The biggest question is whether inflation will drop without further help from the Fed? Currently we are observing:

- Favorable seasonal adjustments
- Improved global supply chains
- Discounts at retailers to clear excess inventory
- A downturn in interest rate sensitive sectors (housing)
- Lower energy prices

PORTFOLIO REVIEW

Treasuries

Treasury yields peaked in late October, fell through early December before rebounding to end the period. The biggest source of movement was the October CPI release in November which was less than expected. The bond market started to price a quicker conclusion to the Fed's tightening program and possibly a quicker pivot to easing. We expect the front end of the yield curve to rally in the intermediate term before the Fed officially changes direction.

Corporates

We expect wider spread levels in the New Year, given weaker global growth expectations due to a reduction in corporate profits. After spreads widened significantly the first three quarters of 2022, we observed a reversal throughout the final period of the year which has led to the sector being additive to performance. The slowdown in Fed hiking and general decrease in uncertainty surrounding the economy helped reverse the direction of spreads. New issuance slowed to end the year due to market volatility, but we expect it to pick up considerably in January 2023.

Municipals

State and local government credit remains strong and is strengthened by high levels of reserves and strong tax collections. These strong fundamentals combine with the outflows we have seen in the mutual fund space to keep yields relatively high while the general credit of the sector remains strong. We expect the sector to perform well in the year ahead.

Oil
After been quite volatile in October and November, we have seen prices increase at the end of the period due to both a weaker dollar and declining stockpiles, while China is easing their Covid-19 restrictions. The weakening of the dollar makes most commodities more attractive for overseas buyers. Supply will continue to be constrained due to OPEC+ output cuts as well as Western sanctions against Russia. Investors anticipate a continued increase in the price of oil as Chinese demand increases and less Russian crude makes it to global buyers.

PORTFOLIO OUTLOOK

How sensitive is our economy to the Fed's increases in rates? A higher level of household debt, higher servicing costs, as well as a larger proportion of variable rate mortgages to fixed rate mortgages tends to indicate an economy more sensitive to interest rate hikes. Borrowing costs are expected to remain elevated for an extended period until policymakers are more confident that price pressures are on a sustained downward trend.

Treasuries are expected to rebound in 2023 following the dismal performance in 2022. If a bull steepening occurs (a rally in the front end due to anticipated rate cuts), the curve will move towards an "uninverted" shape, something we have not seen since early July 2022. If the Fed recalibrates its terminal policy rate above 5.0%, the front end will remain at an elevated rate following the Feds "higher for longer" theme. The Fed has repeated its determination to do what it takes to bring inflation down. Investors are watching to see if the Fed has the resolve to maintain its goal in the face of rising unemployment this coming year.

We expect to learn a lot in the first half of 2023.

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Indices are unmanaged and investors cannot invest directly in an index. Unless otherwise noted, performance of indices does not account for any fees, commissions or other expenses that would be incurred. Returns do not include reinvested dividends.

The Consumer Price Index (CPI) is a measure of inflation compiled by the US Bureau of Labor Studies.

Investments in commodities may have greater volatility than investments in traditional securities, particularly if the instruments involve leverage. The value of commodity-linked derivative instruments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity, such as drought, floods, weather, livestock disease, embargoes, tariffs and international economic, political and regulatory developments. Use of leveraged commodity-linked derivatives creates an opportunity for increased return but, at the same time, creates the possibility for greater loss.

U.S. TREASURY YIELDS	12/31/2021	3/31/2022	6/30/2022	9/30/2022	12/31/2022	YTD Change
2 YR	0.726%	2.286%	2.931%	4.200%	4.420%	-3.693%
3 YR	0.955%	2.464%	2.978%	4.210%	4.236%	-3.281%
5 YR	1.265%	2.422%	3.001%	4.040%	4.004%	-2.739%
7 YR	1.436%	2.404%	3.035%	3.940%	3.968%	-2.532%
10 YR	1.512%	2.324%	2.975%	3.800%	3.878%	-2.366%
20 YR	1.935%	2.598%	3.382%	4.070%	4.142%	-2.206%
30 YR	1.905%	2.453%	3.121%	3.770%	3.970%	-2.065%
10S MINUS 2S	78.6bps	3.7bps	4.4bps	-40bps	-54.2bps	

Source: FactSet