July 2022 | Fixed Income Markets Review

BCT Wealth Advisors | Partnering with: Wilbanks Smith & Thomas

Executive Summary

Fixed income assets experienced a welcomed rally in July amid intermediate and long-term yields declining along the Treasury curve. Although monetary policy tightening has supported higher short-term yields, the consecutive quarterly decline in real GDP has weighed on growth expectations and contributed to falling rates for longer-dated bonds. This dynamic has triggered meaningful curve inversion when viewing the spread on the 10- and 2-year Treasuries, as shown below. Although this spread measure briefly inverted in 2019, investors have not seen the current levels of inversion since the Dot-Com Crash. Following the peak in the 10-year yield to maturity in mid-June, the benchmark rate declined to 2.64% to close July breaking below the 100-day moving average. The downward move in yields provided bond investors some reprieve as fixed income had been suffering the worst start to a calendar year on historical record. Subsequently, risk-on sentiment returned to markets during the month leading to investment grade and high yield credit being among the top performers. The fall in yields and the strengthening of the U.S. dollar conversely resulted in floating rate bonds and emerging markets debt being among the worst performers.

The June CPI release was hotter than expected as the headline figure rose further to 9.1% on an annualized basis – attaining the highest level since 1981. Furthermore, the 1.3% month-over-month rise was the hottest print since 2005. Although goods inflation has somewhat slowed, the continued surge in prices was a function of service costs soaring at the fastest pace in over 30 years. The Atlanta Fed decomposes inflation into "flexible" and "sticky" prices to better illuminate the drivers of rising prices. The below chart highlights the upward trend in "sticky prices" in 2022 and could prove more difficult for the Fed attempting to fight the stubbornly high inflationary pressures. Investor speculation has surrounded the peak inflation narrative as some economists expect inflation to weaken in the months ahead driven by falling energy prices, bloated corporate inventories, retail price cuts and YoY CPI comparisons. However, the next two inflation prints ahead of the September FOMC meeting will provide additional data points for market participants on the path of prices.

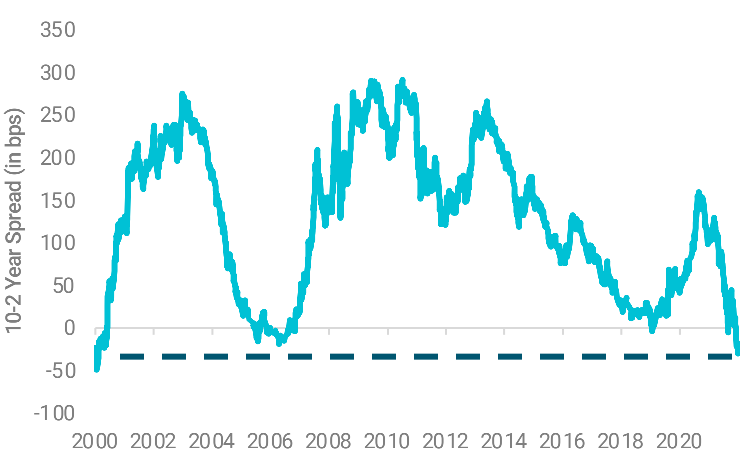
Index Total Returns (%)	1 Mo.	3 Mo.	1 Yr.	3 Yr.
BBg Barc Global Aggregate	2.13	-0.88	-14.58	-2.44
BBg Barc Global Aggregate ex-US	1.92	-2.66	-18.45	-4.23
BBg Barc US Aggregate	2.44	1.49	-9.12	-0.21
BBg Barc US Intermediate Aggregate	2.17	1.73	-6.58	0.08
S&P Global Dev. Sov. ex-US Bond Index	2.73	-0.16	-8.46	-2.42
S&P Eurozone Dev. Sovereign Bond	1.03	-3.16	-22.73	-5.47
S&P Pan-Europe Dev. Sovereign Bond	1.30	-3.43	-22.92	-5.07
ICE BofAML Emerging Markets Sov. Bond	0.71	-2.03	-9.01	-0.19
S&P U.S. Current 2-Year Tsy Bond Index	0.33	0.34	-3.33	0.26
S&P U.S. Current 10-Year Tsy Bond Index	3.16	2.66	-10.31	-0.50
S&P U.S. Current 30-Year Tsy Bond Index	2.70	-1.40	-20.81	-2.65
BBg Barc US Floating Rate Notes (<5 Yr)	0.16	-0.17	-0.30	0.90
S&P US Treasury TIPS	3.98	0.20	-2.95	4.41
BBg Barc Municipal Bond Index	2.64	2.46	-6.93	0.43
BBg Barc Global Aggregate - Corporate	2.79	-0.35	-15.28	-1.41
BBg Barc US Investment Grade Corporate	3.24	1.28	-12.61	-0.11
BBg Barc US Corporate (AA)	3.57	1.97	-12.31	-0.84
BBg Barc US Corporate (BBB)	3.20	1.46	-12.30	-0.16
BBg Barc US Corporate High Yield	5.90	-0.98	-8.02	1.94
S&P/LSTA Leveraged Loan	3.10	-2.26	-1.04	2.07
BBg Barc Global Agg Securitized - US MBS	3.21	2.69	-6.69	-0.53
BBg Barc Global Agg Securitized - US ABS	0.49	0.33	-4.00	0.68

Key Rates (%/ bps)	Current	1 Mo. Change	3 Mo. Change	1 Yr. Change	3 Yr. Change
US 3 Month	2.33	+69	+150	+228	+28
US 2 Year	2.90	-3	+21	+272	+103
US 5 Year	2.70	-30	-21	+200	+86
US 10 Year	2.64	-33	-25	+141	+62
US 30 Year	2.98	-14	+4	+109	+45
1 Month USD LIBOR	2.36	+58	+156	+227	+14
3 Month USD LIBOR	2.79	+50	+145	+267	+52
6 Month USD LIBOR	3.33	+39	+142	+318	+112
12 Month USD LIBOR	3.71	+9	+108	+347	+152

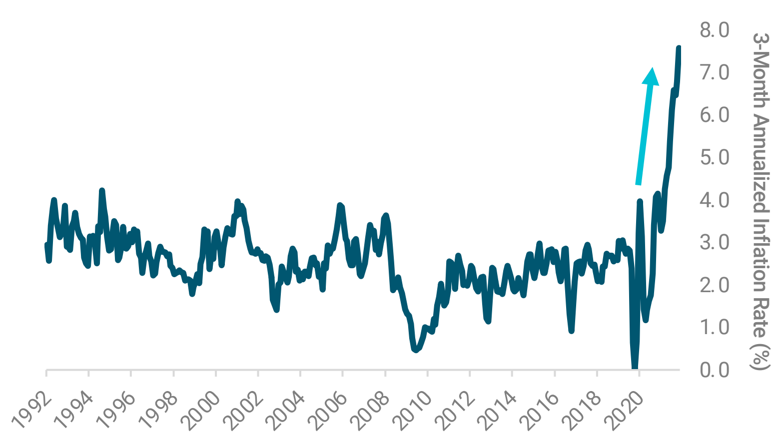
Source: FactSet for all index and market data, shown in USD as of July 31, 2022.

At the July FOMC meeting, Fed officials raised the federal funds rate 75 bps for the second straight month lifting the target policy rate to 2.25% to 2.50%. The cumulative June-July increase of 150 bps is the steepest such move since the Paul Volcker lead-era during the early 1980s. Fed Chairman Powell stressed more rate hikes ahead although the magnitude of the increase will be dependent on economic data released ahead of the next FOMC meeting in September. Currently, the futures market is pricing in a 76% probability of another 75 bps hike while the likelihood of a 50 bps increase stands at 24%. In an effort to limit explicit forward guidance, Powell reiterated the June dot plot for indications on the levels of future policy rates. The FOMC's dot plot highlighted the committee's expectation for increases in rates as the 2022 and 2023 median fed funds rates are projected to be 3.4% and 3.8%, respectively.

10-Year to 2-Year Spread: Yield Curve Inversion



Atlanta Fed CPI: "Sticky" Prices



Source: (Left) FRED. 10-year Treasury yield to maturity minus 2-year Treasury yield to maturity, for the period 2000 to 2022. (Right) Bloomberg. Monthly Atlanta Fed Sticky CPI 3 Month Annualized Rate, for the period 1992 to 2022.

Notes & Disclosures

Index Returns – all shown in US dollars
All returns shown trailing 7/31/2022 for the period indicated. "YTD" refers to the total return as of prior-year end, while the other returns are annualized. 3-month and annualized returns are shown for:

- The Barclay's US Aggregate Index, a broad-based unmanaged bond index that is generally considered to be representative of the performance of the investment grade, US dollar-denominated, fixed-rate taxable bond market.
- The ICE BofAML Emerging Markets Sovereign Bond Index is a subset of The BofA Merrill Lynch World Sovereign Bond Index excluding all securities with a country of risk that is a member of the FX G10, all Western European countries, and territories of the U.S. and Western European countries. The FX G10 includes all Euro members, the U.S., Japan, the U.K., Canada, Australia, New Zealand, Switzerland, Norway, and Sweden.
- The Bloomberg Barclays Global Aggregate Index, which measures global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.
- The S&P Global Developed Sovereign Bond index includes local-currency denominated debt publicly issued by governments in their domestic markets.
- S&P Eurozone Developed Sovereign Bond - seeks to measure the performance of Eurozone government bonds.
- The S&P Pan-Europe Developed Sovereign Bond Index is a comprehensive, market-value-weighted index designed to track the performance of local currency-denominated securities publicly issued by Denmark, Norway, Sweden, Switzerland, the U.K. and developed countries in the Eurozone for their domestic markets.
- ICE BofAML Emerging Markets Sovereign Bond - tracks the performance of US dollar (USD) and Euro denominated emerging markets non-sovereign debt publicly issued within the major domestic and Eurobond markets.
- The Bloomberg Barclay's US Corporate Bond Index (AA), which measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
- The Bloomberg Barclay's US Corporate High Yield Index, which covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market.
- Bloomberg Barclay's Global Aggregate Securitized- US Mortgage-Backed Securities, which is a component of the Bloomberg Barclay's US Aggregate Index and measures investment grade mortgage backed pass-through securities of GNMA, FNMA, and FHLMC.
- Bloomberg Barclay's Global Aggregate Securitized- US Asset-Backed Securities, which is a component of the Bloomberg Barclay's US Aggregate Index and includes the pass-throughs, bullets, and controlled amortization structures of only the senior class of ABS issues.
- The Blomberg Barclay's US Floating Rate Notes (<5 Yr) Index, measures the performance of U.S dollar-dominated, investment grade floating rate notes with maturities less than 5 years.
- The Bloomberg Barclay's Municipal Bond Index, which measures investment grade, tax-exempt bonds with a maturity of at least one year.
- The S&P/ LSTA Leveraged Loan Index is designed to reflect the performance of the largest facilities in the leveraged loan market.

An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance to certain asset classes. Index performance used throughout is intended to illustrate historical market trends and performance. Indexes are managed and do not incur investment management fees. An investor is unable to invest in an index. Their performance does not reflect the expenses associated with the management of an actual portfolio. No strategy assures success or protects against loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. All investing involves risk including loss of principal. Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market. Past performance is no guarantee of future results.

Key Rates
Key Rates are shown for US Treasuries and London Interbank Offered Rate (LIBOR), the interest rate at which banks offer to lend funds (wholesale money) to one another in the international interbank market. LIBOR is a key benchmark rate that reflects how much it costs banks to borrow from each other. "Current" refers to the percentage rate as of 6/30/2018, while the rates of change are stated in basis points.

Credit Spreads
Credit Spreads shown comprise the Option-Adjusted Spread of the indices indicated, versus the US 10-Year Treasury Yield. "Current" refers to the spread as of 6/30/2018, while the rates of change are stated in basis points.

Key Indicators
Key Indicators correspond to various macro-economic and rate-related data points that we consider impactful to fixed income markets.

- 2s10s (bps)/ 10 Yr vs 2 Yr Treasury Spread, which measures the difference between yields on 10-Year Treasury Constant Maturity Securities and 2-Year Treasury Constant Maturity Securities.
- West Texas Intermediate, which is an oil benchmark and the underlying asset in the New York Mercantile Exchange's oil futures contract.
- Core Consumer Price Index, which measures the consumer price index excluding food and energy prices. Shown as of the prior month-end.
- Breakeven Inflation: 5 Yr %/ bps, which uses a moving 30-day average of the 5-Year Treasury Constant Maturity Securities and 5-Year Treasury Inflation–Indexed Constant Maturity Securities to derive expected inflation.
- Breakeven Inflation: 10 Yr %/ bps, which uses a moving 30-day average of the 10-Year Treasury Constant Maturity Securities and 10-Year Treasury Inflation–Indexed Constant Maturity Securities to derive expected inflation.

General Disclosure
Wilbanks, Smith & Thomas Asset Management (WST) is an investment adviser registered under the Investment Advisers Act of 1940. Registration as an investment adviser does not imply any level of skill or training. The information presented in the material is general in nature and is not designed to address your investment objectives, financial situation or particular needs. Prior to making any investment decision, you should assess, or seek advice from a professional regarding whether any particular transaction is relevant or appropriate to your individual circumstances. This material is not intended to replace the advice of a qualified tax advisor, attorney, or accountant. Consultation with the appropriate professional should be done before any financial commitments regarding the issues related to the situation are made.

This document is intended for informational purposes only and should not be otherwise disseminated to other third parties. Past performance or results should not be taken as an indication or guarantee of future performance or results, and no representation or warranty, express or implied is made regarding future performance or results. This document does not constitute an offer to sell, or a solicitation of an offer to purchase, any security, future or other financial instrument or product. This material is proprietary and being provided on a confidential basis, and may not be reproduced, transferred or distributed in any form without prior written permission from WST. WST reserves the right at any time and without notice to change, amend, or cease publication of the information. The information contained herein includes information that has been obtained from third party sources and has not been independently verified. It is made available on an "as is" basis without warranty and does not represent the performance of any specific investment strategy.

Some of the information enclosed may represent opinions of WST and are subject to change from time to time and do not constitute a recommendation to purchase and sale any security nor to engage in any particular investment strategy. The information contained herein has been obtained from sources believed to be reliable but cannot be guaranteed for accuracy.

INVESTMENTS ARE:

Not Insured by FDIC or Any Other Government Agency	Not Bank Guaranteed
Not Bank Deposits or Obligations	May Lose Value