Second Quarter 2022

Bond Market Commentary

Interest rates rose across the yield curve in the second quarter, resulting in negative returns throughout the domestic investment-grade bond market. No sector, industry, quality or duration was spared. 2022 is starting out as one of the worst periods in bond market history. Much of this damage lays at the steps of the Federal Reserve (Fed) which has held interest rates at historically low levels for nearly 11 of the past 14 years.

Initially, to address a potential financial meltdown at the onset of the great recession of 2008 – 2009, the Fed initiated emergency measures to stabilize and support the entire financial system. While implementing never-before tested policies, their support ultimately helped stabilize financial markets and financial institutions; job well done.

What is difficult to understand is the continuance of these policies for years well beyond their necessity. Certainly, well before the recent move to normalize interest rates, financial conditions were healed enough to operate without the help of the Fed. It is obvious that they had multiple opportunities to begin the process of normalization in the past 14 years. Had they started raising the Federal Funds target rate by 25 basis points every year 10 years ago, I doubt anyone would have hardly noticed. But they didn't.

That leaves us to where we are today. For the first time in 40 years, inflation has risen to near double digit levels. While the Fed has acknowledged the seriousness of the inflation pressures, they deemed the timing as transitory. In March, they could no longer hope that inflation would be a short-term issue or could they remain on the sidelines rather than deal with the problem. They raised the Federal Funds Rate 25 basis points. As the quarter continued, there was no relief in the inflation data and they raised the rate again by 50 basis points. Finally in June, giving in to market pressure and criticism, the Fed raised the Fed Funds rate another 75 basis points to a target range of 1.50% to 1.75%.

Between the bond market adjusting interest rates for the impact of rising inflation and the frustration caused by a lack of action by the Fed, market interest rates rose dramatically. During the second quarter, short-term interest rates rose by 114 to 144 basis points while intermediate and long-term interest rates rose by 50 to 85 points. This follows a similar rise in rates that occurred in the first quarter of 2022.*

Rising interest rates impact the prices of outstanding bonds. As rates rise, the prices of existing bonds fall. The longer maturity bonds are affected much more than shorter maturity bonds. The chart at the top right provides the impact, in terms of performance, of several different bond markets sectors, quality and maturity.

The impact of rates rising has magnified the recent losses in bonds due to the low rates manipulated by the Fed for the past 14 years. There is much work yet to be done.

Source: Bloomberg*

Index Returns As of 6/30/2022	Performance Period		
Index	3 Month	6 Month	1 Year
Bloomberg US Treasury Intermediate	-1.67	-5.80	-6.35
Bloomberg Govt/Credit Intermediate	-2.37	-6.77	-7.28
Bloomberg Intermediate Aggregate	-2.93	-7.48	-7.91
Bloomberg US Treasury	-3.77	-9.14	-8.90
Bloomberg Govt/Credit	-5.03	-11.05	-10.85
Bloomberg Aggregate	-4.69	-10.35	-10.29
Bloomberg US Treasury 20+ Year	-12.67	-22.29	-19.17
Bloomberg Corporate	-7.26	-14.39	-14.19
Bloomberg Corporate Intermediate	-3.92	-8.97	-9.41
Bloomberg Corporate High Yield	-9.83	-14.19	-12.81
Bloomberg Credit AAA	-8.22	-16.44	-15.78
Bloomberg Credit AA	-7.32	-14.60	-14.17
Bloomberg Credit A	-6.56	-13.38	-13.37
Bloomberg Credit BAA	-7.80	-15.12	-14.83
Bloomberg MBS	-4.01	-8.78	-9.03
Bloomberg TIPS	-6.08	-8.92	-5.14
Bloomberg Inter-Short Muni	-0.57	-5.03	-4.91

Source: Bloomberg

Daily Generic Municipal Bond Yields as of 6/30/2022

Term	Maturity	AAA	AA	A	BAA
1 Yr.	2023	1.62	1.84	2.01	2.65
2 Yr.	2024	1.91	2.12	2.32	2.94
3 Yr.	2025	2.07	2.28	2.51	3.11
4 Yr.	2026	2.14	2.37	2.62	3.19
5 Yr.	2027	2.23	2.49	2.73	3.29
7 Yr.	2029	2.54	2.83	3.02	3.58
9 Yr.	2031	2.66	3.03	3.15	3.72
10 Yr.	2032	2.73	3.13	3.23	3.80
12 Yr.	2034	2.82	3.30	3.33	3.89
14 Yr.	2036	2.90	3.47	3.44	4.01
15 Yr.	2037	2.93	3.54	3.48	4.05
17 Yr.	2039	2.99	3.63	3.51	4.96
19 Yr.	2041	3.02	3.71	3.55	4.14
20 Yr.	2042	3.04	3.72	3.56	4.16
25 Yr.	2047	3.14	3.81	3.67	4.27
30 Yr.	2052	3.19	3.93	3.72	4.33

Source: Bloomberg*

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Index Descriptions:

Bloomberg US Intermediate Treasury Index Unmanaged index includes all publicly issued, US Treasury securities that have a remaining maturity of greater than or equal to 1 year and less than 10 years, are rated investment grade, and have $250 million or more of outstanding face value.

Bloomberg Intermediate Government/Credit Index: Is an unmanaged index based on all publicly issued intermediate government and corporate debt securities with maturities of 1-10 years. This index represents asset types which are subject to risk, including loss of principal.

Bloomberg U.S. Treasury Bond Index: Is part of Bloomberg global family of government bonds indices. The index measures the performance of the U.S. Treasury bond market, using market capitalization weighting and a standard rule based inclusion methodology.

Bloomberg Government/Credit Bond Index Unmanaged index that tracks the performance of US Government and corporate bonds rated investment grade or better, with maturities of at least one year.

Bloomberg Intermediate Aggregate Index: Is an unmanaged index that consists of 1-10 year Governments, 1-10 year Corporates, all Mortgages, and all Asset-Backed securities within the Aggregate Index (i.e. the Aggregate Index less the Long Government/Corporate Index).

Bloomberg U.S. Aggregate Bond Index: Is an unmanaged index composed of securities from the Bloomberg Government/Corporate Bond Index, Mortgage-Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization.

Bloomberg U.S. Credit Index: Is composed of all publicly issued, fixed-rate, nonconvertible, investment-grade corporate debt. Issues are rated at least Baa by Moody's Investors Service or BBB by Standard & Poor's, if unrated by Moody's. Collateralized Mortgage Obligations (CMOs) are not included. Total return comprises price appreciation/depreciation and income as a percentage of the original investment.

Bloomberg U.S. Intermediate Credit Index: Measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. The index only includes securities with maturity between one and ten years. It is composed of the Bloomberg U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

Bloomberg U.S. Corporate High Yield Index: Is an unmanaged index that is comprised of issues that meet the following criteria: at least $150 million par value outstanding, maximum credit rating of Ba1 (including defaulted issues) and at least one year to maturity.

Bloomberg U.S. Mortgage-Backed Securities Index: Is an unmanaged index that tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by GNMA, FNMA, and FHLM.

Bloomberg U.S. Treasury Inflation-Protected Securities (TIPS) Index: Represents securities that protect against adverse inflation and provide a minimum level of real return. To be included in this index, bonds must have cash flows linked to an inflation index, be sovereign issues denominated in U.S. currency, and have more than one year to maturity, and, as a portion of the index, total a minimum amount outstanding of 100 million U.S. dollars. An individual cannot invest directly in an index.

Bloomberg Municipal Bond Inter-Short 1-10 Year Index: Is an unmanaged index of municipal bonds traded in the U.S. with maturities ranging from 1-10 years.

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