

FIXED INCOME MARKET UPDATE

February 2022

MONTH IN REVIEW

2022: Coming in Like a Wrecking Ball

January's pain in fixed income carried over into February as the market focused on two key themes: continued inflation in the U.S. and the geopolitical upheaval in Ukraine. For the second consecutive month, every component of the Bloomberg U.S. Aggregate Bond Index (the Agg) produced negative returns. High yield (HY) corporates and municipal bonds were also negative. There were two key drivers of the negative returns. Early in the month, inflation – and the Federal Reserve's (Fed) expected reaction to it – was the primary driver, which drove Treasury yields higher. Then Russia's invasion of Ukraine led to a flight to quality, driving spreads wider in both high yield (HY) and investment grade (IG) corporates. On a fundamental level, however, corporate earnings have been generally positive, and balance sheets remain in fairly good shape. This would normally create a decent buying opportunity for fundamental-driven investors, but market liquidity has been quite strained, and primary market issuance has also been slower than at any point since the early days of the COVID-19 pandemic. The Fed appears poised to hike short-term interest rates in March, and the situation in Ukraine appears far from a resolution, so volatility is likely to continue in the near term. We have always placed a premium on selecting securities we consider to be high quality, which makes us optimistic that our portfolios will hold up comparatively well during periods like the one we are currently experiencing. Read on for further analysis of the ups (very few) and downs (widespread) in fixed income markets in February.

MARKET SUMMARY

February's returns continued the slide experienced in January. All major sectors were negative for the second month in a row. Year-to-date losses have been most pronounced in investment grade corporates.

YIELDS & RETURNS (%)¹

	Duration (years)	Yield	February Return	YTD Return
Treasuries	6.97	1.76	-0.66	-2.54
Investment Grade Corporates	8.32	3.08	-2.00	-5.30
High Yield Corporates	4.58	5.62	-1.03	-3.73
Municipal Bonds	4.90	1.86	-0.36	-3.09

U.S. TREASURY MARKET

Treasury yield volatility was elevated during the month, with an overall move higher across the curve. Yields moved off their February highs toward the end of the month as the situation in Ukraine took center stage.

TREASURY YIELDS (%)¹

	February Change	Year-to-Date Change	2/28/2022	1/31/2022	12/31/2021	11/30/2021
90-Day T-Bills	0.12	0.29	0.34	0.22	0.05	0.05
2-year Treasury	0.27	0.72	1.45	1.18	0.73	0.55
5-year Treasury	0.12	0.47	1.73	1.61	1.26	1.15
10-year Treasury	0.05	0.33	1.83	1.78	1.50	1.44
30-year Treasury	0.05	0.28	2.16	2.11	1.89	1.79

TIPS were the top-performing Treasury-related category in February. Returns were negative across all but the shortest T-Bills as rates moved higher.

TREASURY RETURNS (%)¹

	Duration (years)	February Return	YTD Return
90-Day T-Bills	0.25	0.01	0.01
2-year Treasury	1.98	-0.40	-1.14
5-year Treasury	4.79	-0.51	-2.04
10-year Treasury	9.13	-0.36	-2.79
30-year Treasury	22.02	-1.39	-6.06
U.S. Treasury TIPS	7.72	0.85	-1.19

BROAD INVESTMENT GRADE

No component of the Agg came out ahead in February, and Treasuries outperformed every category on a duration-matched basis. Long corporates got hit, while agency mortgage-backed securities (MBS) hung in better than most other categories.

INVESTMENT GRADE INDEX & SECTOR RETURNS (%)¹

	Duration (years)	Yield	February Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
U.S. Aggregate	6.76	2.33	-1.12	-0.49	-3.25	-0.82
Treasuries	6.97	1.76	-0.66		-2.54	
Agencies	4.02	1.76	-0.67	-0.18	-1.90	-0.25
Mortgage-Backed Securities	5.37	2.48	-0.97	-0.48	-2.44	-0.59
Asset-Backed Securities	2.28	1.88	-0.63	-0.25	-1.19	-0.05
Intermediate Corporates	4.45	2.66	-1.09	-0.57	-2.96	-1.06
Long Corporates	14.66	3.78	-3.46	-2.33	-8.88	-4.31

Spreads in IG corporates made a significant move wider for a second straight month.

INVESTMENT GRADE SPREADS (basis points)¹

	February Change	Year-to-Date Change	2/28/2022	1/31/2022	12/31/2021	11/30/2021
Intermediate Corporates	15	28	96	81	68	76
Long Corporates	18	34	164	146	130	135
MBS Current Coupon Spread	20	40	97	77	57	56

All IG ratings categories produced negative returns, with a slight outperformance from the higher quality categories.

INVESTMENT GRADE CORPORATE CREDIT QUALITY RETURNS (%)¹

	Duration (years)	Yield	February Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
AAA	12.23	2.67	-1.77	-0.79	-6.49	-2.59
AA	9.90	2.67	-1.83	-0.98	-5.38	-2.08
A	8.07	2.86	-1.92	-1.17	-5.02	-2.15
BBB	8.19	3.33	-2.10	-1.35	-5.48	-2.54

February, like January, saw spreads move wider for every IG sector, with the largest moves coming in Utilities and Financials.

INVESTMENT GRADE CORPORATE BOND SPREADS BY SECTOR (basis points)¹

	February Change	YTD Change	2/28/2022	1/31/2022	12/31/2021	11/30/2021
Consumer Non-Cyclical	15	29	116	101	88	95
Technology	11	28	108	97	81	88
Energy	15	27	143	128	116	126
Consumer Cyclical	16	29	107	92	78	86
Transportation	15	26	124	109	98	104
Basic Industry	18	33	148	129	115	124
Communications	16	32	151	135	118	127
Capital Goods	15	27	112	97	86	92
Utilities	19	29	136	117	107	108
Financials	19	32	115	97	83	90

HIGH YIELD

High yield (HY) corporate returns were negative across all quality categories in February, though they performed better overall than IG corporates.

HIGH YIELD SECTOR RETURNS (%)¹

	Duration (years)	Yield	February Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
High Yield Corporates	4.58	5.62	-1.03	-0.56	-3.73	-2.12
BB	5.17	4.64	-1.21	-0.70	-4.47	-2.60
B	4.07	5.94	-0.80	-0.38	-2.93	-1.56
CCC	3.57	8.21	-0.83	-0.45	-2.87	-1.63

HIGH YIELD OPTION-ADJUSTED SPREADS (OAS) (basis points)¹

	February Change	YTD Change	2/28/2022	1/31/2022	12/31/2021	11/30/2021
High Yield OAS	17	76	359	342	283	337
BB OAS	17	73	267	250	194	241
B OAS	11	70	383	372	313	374
CCC OAS	31	73	622	591	549	612

HY corporate sector spreads moved wider across the board. The Energy sector was the least impacted, while the Communications sector (cable, media, telcos) experienced the most significant move wider.

HIGH YIELD CORPORATE BOND SPREADS (OAS) BY SECTOR (basis points)¹

	February Change	YTD Change	2/28/2022	1/31/2022	12/31/2021	11/30/2021
Consumer Non-Cyclical	4	83	333	329	250	307
Technology	19	81	326	307	244	301
Energy	3	43	370	367	327	402
Consumer Cyclical	13	74	342	329	269	323
Transportation	9	42	351	342	309	370
Basic Industry	11	72	360	349	288	338
Communications	45	110	428	383	317	361
Capital Goods	11	63	338	327	276	323
Utilities	6	79	328	322	249	303
Financials	19	74	340	321	265	310

HY default rates held steady in February, still at all-time lows.

HIGH YIELD DEFAULT RATES²

	February Change	YTD Change	2/28/22	1/31/22	12/31/21	11/30/21
Number of Issuers in Default	0	-4	7	7	11	12
Issuer Default Rate	0.0%	-0.5%	1.0%	1.0%	1.5%	1.7%
Number of Issuers in Default (ex commodities)	0	-2	5	5	7	7
Issuer Default Rate (ex commodities)	0.0%	-0.3%	0.8%	0.8%	1.1%	1.1%

MUNICIPALS & OTHER

Municipal bonds produced negative returns for the month, although less pronounced than most fixed income sectors.

MAJOR MUNICIPAL BOND INDEX RETURNS (%)¹

	YTW	Duration (years)	February Return	YTD Return
Short Duration (1-5 Years)	1.37	2.71	-0.29	-1.97
Intermediate (1-15 Years)	1.64	4.14	-0.31	-2.75
Long Duration (22+ Years)	2.46	7.07	-0.52	-4.04

MUNICIPAL YIELDS BY RATING CATEGORY AND DURATION (%)¹

	AAA	AA	A	BBB
1 Year	0.82	0.94	1.17	1.72
5 Year	1.36	1.53	1.79	2.31
10 Year	1.59	1.80	2.11	2.58
30 Year	1.97	2.25	2.63	3.03

AA MUNICIPALS – HYPOTHETICAL AFTER-TAX YIELDS BY EFFECTIVE TAX RATE (%)³

	20%	25%	30%	35%
1 Year	1.17	1.25	1.34	1.44
5 Year	1.91	2.04	2.18	2.35
10 Year	2.25	2.40	2.58	2.77
30 Year	2.81	3.00	3.21	3.46

U.S. Convertibles were one of the few sectors to produce a positive result in February. Preferred stocks and Emerging Market bonds continued their rough start to 2022.

OTHER SECTOR RETURNS (%)^{1,4}

	Duration (years)	Yield	February Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
Emerging Markets	5.62	8.52	-4.27	-3.82	-6.14	-4.07
Global Investment Grade Treasuries (Unhedged)	8.33	1.27	-0.91	-0.18	-2.78	-0.16
S&P/LSTA Leveraged Loan 100	–	4.25	-0.51	–	-0.15	–
S&P Preferred Stock Index	–	5.46	-4.46	–	-8.60	–
U.S. Convertibles	1.93	0.91	0.09	–	-6.87	–

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¹Source: Bloomberg.

²Source: Bank of America Merrill Lynch.

³Hypothetical yields are calculated as the AA municipal yield divided by (1-tax rate). Actual tax-adjusted yields will depend on individual tax circumstances.

⁴Source: Standard & Poor's.