

## FIXED INCOME MARKET UPDATE

October 2021

### MONTH IN REVIEW

## Inflation and Tapering on Investors' Minds

October was a mixed bag for fixed income investors. With the early November Federal Open Market Committee (FOMC) decision looming, results were varied as investors sifted through market information: inflation was too high based on the Federal Reserve's (Fed) target, but growth in new jobs was too low. The Fed was widely expected to finally begin tapering its asset purchase program, which (spoiler alert) it did announce on November 3. A short-term rate hike is now expected to be a mid-2022 event, although recent history has shown that COVID-19 variants are just one of the many factors that can disrupt the most well-laid plans of central bankers. These macroeconomic and market forces resulted in the Bloomberg U.S. Aggregate Bond Index (the Agg) finishing essentially flat – both in absolute returns and relative to Treasuries. Long duration outperformed short duration in corporate bonds as well as Treasuries. More persistent inflation has led TIPS to outperform most other areas of fixed income. High yield experienced a second consecutive month of negative returns but remains one of the top fixed income categories year-to-date. Read on for more analysis of the world of fixed income for October.

### MARKET SUMMARY

Investment grade corporates posted a gain in October, while high yield corporates posted a second consecutive month of negative returns. HY remains well ahead of Treasuries, IG Corporates and Municipal bonds year-to-date.

#### YIELDS & RETURNS (%)<sup>1</sup>

	Duration (years)	Yield	October Return	YTD Return
Treasuries	7.04	1.14	-0.07	-2.56
Investment Grade Corporates	8.69	2.22	0.25	-1.02
High Yield Corporates	4.04	4.23	-0.17	4.36
Municipal Bonds	4.85	1.21	-0.29	0.50

### U.S. TREASURY MARKET

Treasury yields were volatile in October as short and intermediate yields rose while long yields fell.

#### TREASURY YIELDS (%)<sup>1</sup>

	October Change	Year-to-Date Change	10/31/2021	9/30/2021	8/31/2021	7/31/2021
90-Day T-Bills	0.01	-0.02	0.05	0.04	0.04	0.05
2-year Treasury	0.20	0.37	0.49	0.29	0.21	0.19
5-year Treasury	0.21	0.83	1.19	0.98	0.78	0.70
10-year Treasury	0.04	0.65	1.56	1.52	1.31	1.23
30-year Treasury	-0.14	0.29	1.93	2.08	1.92	1.89

TIPS and long Treasuries performed well for the month while intermediate and short Treasuries were negative. Amid widespread fears of inflation in the U.S., TIPS have emerged as one of the top-performing fixed income asset classes thus far in 2021.

#### TREASURY RETURNS (%)<sup>1</sup>

	Duration (years)	October Return	YTD Return
90-Day T-Bills	0.26	0.00	0.03
2-year Treasury	1.99	-0.30	-0.33
5-year Treasury	4.87	-0.87	-2.77
10-year Treasury	9.21	-0.31	-4.53
30-year Treasury	22.55	3.42	-5.78
U.S. Treasury TIPS	7.70	1.13	4.69

## BROAD INVESTMENT GRADE

The Agg was close to flat in October, as negative returns on Treasuries, Agencies, MBS and ABS were offset by positive returns on long corporates. The Agg was neutral versus duration-matched Treasuries for the month.

#### INVESTMENT GRADE INDEX & SECTOR RETURNS (%)<sup>1</sup>

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
U.S. Aggregate	6.78	1.66	-0.03	0.00	-1.58	0.46
Treasuries	7.04	1.14	-0.07		-2.56	
Agencies	4.33	1.01	-0.42	-0.15	-1.15	0.08
Mortgage-Backed Securities	4.89	1.89	-0.19	-0.01	-0.86	-0.44
Asset-Backed Securities	2.31	0.87	-0.35	-0.07	-0.11	0.35
Intermediate Corporates	4.48	1.67	-0.55	-0.11	-0.99	0.83
Long Corporates	15.21	3.07	1.50	0.18	-1.10	3.65

Spreads widened modestly for IG corporate bonds and mortgage-backed securities. After experiencing volatility earlier in 2021, spread moves have been muted for the past several months.

#### INVESTMENT GRADE SPREADS (basis points)<sup>1</sup>

	October Change	Year-to-Date Change	10/31/2021	9/30/2021	8/31/2021	7/31/2021
Intermediate Corporates	4	-4	64	60	63	62
Long Corporates	1	-17	123	122	124	122
MBS Current Coupon Spread	1	3	46	45	48	45

IG corporates posted positive absolute returns and were mixed versus Treasuries. Year-to-date, corporates have produced negative absolute returns while outperforming Treasuries.

#### INVESTMENT GRADE CORPORATE CREDIT QUALITY RETURNS (%)<sup>1</sup>

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
AAA	12.86	2.03	0.99	-0.15	-2.38	1.12
AA	10.13	1.92	0.62	0.03	-1.44	1.44
A	8.42	2.01	0.18	-0.04	-1.89	1.01
BBB	8.58	2.43	0.23	0.03	-0.22	2.70

Spreads were generally wider in October for IG corporates. The most dramatic widening occurred in Tech and Communications, which were impacted by supply chain disruptions and a global shortage of semiconductors.

#### INVESTMENT GRADE CORPORATE BOND SPREADS BY SECTOR (basis points)<sup>1</sup>

	October Change	YTD Change	10/31/2021	9/30/2021	8/31/2021	7/31/2021
Consumer Non-Cyclical	1	-7	83	82	84	82
Technology	5	2	77	72	73	73
Energy	1	-30	106	105	112	109
Consumer Cyclical	2	-7	75	73	76	75
Transportation	-1	-23	92	93	98	96
Basic Industry	3	-9	112	109	108	105
Communications	5	-6	114	109	111	110
Capital Goods	0	-19	80	80	83	81
Utilities	0	-10	96	96	100	97
Financials	4	-4	79	75	76	76

## HIGH YIELD

High yield returns were negative across ratings categories but outperformed Treasuries. Spread changes were mixed and favored the higher-quality Bs and BBs versus lower-quality CCCs.

#### HIGH YIELD SECTOR RETURNS (%)<sup>1</sup>

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
High Yield Corporates	4.04	4.23	-0.17	0.14	4.36	5.67
BB	4.74	3.33	-0.14	0.15	3.69	5.33
B	3.32	4.67	-0.15	0.19	3.82	4.80
CCC	2.97	6.57	-0.21	0.12	7.78	8.60

#### HIGH YIELD OPTION-ADJUSTED SPREADS (OAS) (basis points)<sup>1</sup>

	October Change	YTD Change	10/31/2021	9/30/2021	8/31/2021	7/31/2021
High Yield OAS	-2	-73	287	289	288	294
BB OAS	-1	-62	202	203	203	214
B OAS	-5	-57	322	327	327	335
CCC OAS	5	-129	529	524	520	502

High yield corporate spreads moved slightly tighter for the majority of HY sectors. The most significant tightening was in Transportation (mainly airlines), while the most significant widening was in Technology and Communications as those sectors grapple with global chip shortages and supply chain disruptions.

#### HIGH YIELD CORPORATE BOND SPREADS (OAS) BY SECTOR (basis points)<sup>1</sup>

	October Change	YTD Change	10/31/2021	9/30/2021	8/31/2021	7/31/2021
Consumer Non-Cyclical	-2	-26	259	261	256	270
Technology	11	-80	245	234	224	242
Energy	-12	-194	331	343	374	389
Consumer Cyclical	-2	-59	280	282	277	294
Transportation	-26	-302	305	331	350	348
Basic Industry	-8	-70	295	303	287	274
Communications	6	-26	305	299	290	287
Capital Goods	-1	-68	281	282	274	292
Utilities	4	-7	271	267	261	265
Financials	-3	-54	267	270	275	279

High yield defaults continue to trend lower; the default rate is now at its lowest level since early 2019.

## HIGH YIELD DEFAULT RATES<sup>2</sup>

	October Change	YTD Change	10/31/21	9/30/21	8/31/21	7/31/21
Number of Issuers in Default	-5	-49	18	23	26	35
Issuer Default Rate	-0.8%	-7.0%	2.5%	3.3%	3.8%	5.1%
Number of Issuers in Default (ex commodities)	-1	-22	9	10	9	13
Issuer Default Rate (ex commodities)	-0.2%	-3.8%	1.5%	1.7%	1.5%	2.2%

## MUNICIPALS & OTHER

Muni bonds posted negative returns in October but remain positive year-to-date while providing additional tax benefits for many purchasers.

### MAJOR MUNICIPAL BOND INDEX RETURNS (%)<sup>1</sup>

	YTW	Duration (years)	October Return	YTD Return
Short Duration (1-5 Years)	0.54	2.72	-0.17	0.21
Intermediate (1-15 Years)	0.93	4.21	-0.29	0.19
Long Duration (22+ Years)	1.94	6.60	-0.29	1.28

### MUNICIPAL YIELDS BY RATING CATEGORY AND DURATION (%)<sup>1</sup>

	AAA	AA	A	BBB
1 Year	0.17	0.27	0.37	0.40
5 Year	0.61	0.76	0.91	1.00
10 Year	1.21	1.38	1.65	1.66
30 Year	1.72	2.02	2.24	2.17

### AA MUNICIPALS – HYPOTHETICAL AFTER-TAX YIELDS BY EFFECTIVE TAX RATE (%)<sup>3</sup>

	<u>20%</u>	<u>25%</u>	<u>30%</u>	<u>35%</u>
1 Year	0.34	0.36	0.38	0.41
5 Year	0.95	1.02	1.09	1.18
10 Year	1.72	1.84	1.97	2.12
30 Year	2.53	2.69	2.89	3.11

Loans and convertible bonds outperformed emerging market bonds and global IG Treasuries. Convertibles were particularly strong for the month and have performed well year-to-date on the back of strong equity market performance.

### OTHER SECTOR RETURNS (%)<sup>1,4</sup>

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
Emerging Markets	5.68	7.09	-1.11	-0.73	-1.95	0.30
Global Investment Grade Treasuries (Unhedged)	8.54	0.94	-0.46	-0.13	-6.10	-1.51
S&P/LSTA Leveraged Loan 100	–	3.79	0.27	–	4.70	–
U.S. Convertibles	1.63	1.12	3.68	–	9.18	–

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<sup>1</sup>Source: Bloomberg.

<sup>2</sup>Source: Bank of America Merrill Lynch.

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

<sup>4</sup>Source: Standard & Poor's.