SEGALL BRYANT & HAMILL
ASSET MANAGEMENT

Fixed Income Market Update

First Quarter 2023

First Quarter Recap: Booms, Busts, and Banks

Strong Returns and Volatility Return to the Bond Market

The Bloomberg U.S. Aggregate Bond Index (the Agg) produced a 2.96% return in the quarter, the strongest since the first quarter of 2020. Every sub-component of the Agg posted positive absolute returns, with the weakest areas being anything tied to the banking sector. The banking sector was put into great stress near the end of the quarter by the failure of Silicon Valley Bank (SIVB). While the story continues to unfold, the bank's failure (and Signature Bank's concomitant failure) changed the dialogue considerably. Debate about whether there would be two or three more rate increases by the Federal Reserve (Fed) shifted to whether the rapid pace of tightening over the last 12 months was creating collateral damage. Volatility in the Treasury markets returned to levels last seen in 2008. Following the collapse of SIVB, the market's nerves were calmed by promises from banking executives, politicians, and Fed officials to take extraordinary measures to support the banking system. While the banking panic appears largely contained for now, the market's expectations around short-term rates has adjusted sharply downward. Futures markets are now pricing in several Fed Funds rate cuts throughout the remainder of 2023, despite historically low unemployment rates and reported inflation well above the targeted 2% level. Investment grade (IG) bond spreads bounced around but ultimately finished relatively flat to where they began. In the high yield (HY) corporate space, spreads moved tighter in most sectors, and HY returns were among the strongest of any fixed income category. The Treasury yield curve remained inverted, prompting many economists to continue calling for a recession sometime in 2023. Corporate earnings season is set to begin in mid-April, and investors will be watching closely for any such recessionary signs. Read on for more analysis and commentary on the fixed income market in the first quarter.

MARKET SUMMARY

First quarter returns were strong across the major fixed income market segments.

YIELDS & RETURNS (%) [1]

	Duration (years)	Yield	Q1 Return	YTD Return
Treasuries	6.38	3.83	3.01	3.01
Investment Grade Corporates	7.48	5.17	3.50	3.50
High Yield Corporates	4.24	8.52	3.57	3.57
Municipal Bonds	5.83	3.25	2.78	2.78

U.S. TREASURY MARKET

Yields were volatile in the quarter across most of the Treasury curve, ultimately finishing lower. T-Bill yields rose following two quarter-point rate hikes from the Fed during the quarter.

TREASURY YIELDS (%)[1]

	Q1 Change	Year-to-Date Change	3/31/2023	2/28/2023	1/31/2023	12/31/2022
90-Day T-Bills	0.36	0.36	4.74	4.82	4.66	4.38
2-year Treasury	-0.37	-0.37	4.03	4.79	4.18	4.40
5-year Treasury	-0.38	-0.38	3.59	4.16	3.60	3.96
10-year Treasury	-0.35	-0.35	3.48	3.90	3.49	3.83
30-year Treasury	-0.28	-0.28	3.66	3.89	3.62	3.94

Treasury returns were strong across the curve, with long bonds leading the way.

TREASURY RETURNS (%)[1]

	Duration (years)	Q1 Return	YTD Return
90-Day T-Bills	0.24	1.12	1.12
2-year Treasury	1.94	1.46	1.46
5-year Treasury	4.62	2.39	2.39
10-year Treasury	8.40	3.76	3.76
30-year Treasury	18.36	5.99	5.99
U.S. Treasury TIPS	6.99	3.34	3.34

BROAD INVESTMENT GRADE

Every component of the Agg generated positive absolute returns. Corporates had the strongest excess returns, as they outperformed similar-duration Treasuries.

INVESTMENT GRADE INDEX & SECTOR RETURNS (%)[1]

	Duration (years)	Yield	Q1 Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
U.S. Aggregate	6.50	4.40	2.96	-0.09	2.96	-0.09
Treasuries	6.38	3.83	3.01		3.01	
Agencies	3.44	4.33	2.09	0.00	2.09	0.00
Mortgage-Backed Securities	6.15	4.51	2.53	-0.50	2.53	-0.50
Asset-Backed Securities	2.89	4.94	1.86	-0.05	1.86	-0.05
Intermediate Corporates	4.29	5.10	2.50	0.12	2.50	0.12
Long Corporates	13.57	5.29	5.45	0.34	5.45	0.34

Spreads on corporate bonds moved tighter early in the quarter but ultimately finished wide of where they began. MBS spreads did essentially the same, finishing the quarter one basis point wider.

INVESTMENT GRADE SPREADS (basis points)[1]

	Q1 Change	Year-to-Date Change	3/31/2023	2/28/2023	1/31/2023	12/31/2022
Intermediate Corporates	11	11	127	107	103	116
Long Corporates	2	2	160	158	145	158
MBS Current Coupon Spread	1	1	157	162	135	156

All investment grade corporate ratings categories posted positive returns on an absolute basis and relative to Treasuries.

INVESTMENT GRADE CORPORATE CREDIT QUALITY RETURNS (%)[1]

	Duration (years)	Yield	Q1 Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
AAA	11.54	4.26	5.03	0.56	5.03	0.56
AA	8.83	4.48	3.95	0.22	3.95	0.22
A	7.26	4.98	3.31	0.09	3.31	0.09
BBB	7.39	5.45	3.57	0.29	3.57	0.29

This update provides an overview of certain broad-based Fixed Income benchmarks and does not include performance of the Segall Bryant & Hamill Fixed Income styles.
Past performance cannot guarantee future results. All investments involve risk, including the possible loss of capital.

Investment grade corporate bond sector spreads were mixed. Communications (media, telecommunications, etc.) tightened the most, while Financials (mainly banks) widened dramatically in the final month of the quarter.

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

	Q1 Change	YTD Change	3/31/2023	2/28/2023	1/31/2023	12/31/2022
Consumer Non-Cyclical	-2	-2	112	113	105	114
Technology	1	1	112	113	103	111
Energy	3	3	147	139	129	144
Consumer Cyclical	2	2	106	101	97	104
Transportation	2	2	127	121	115	125
Basic Industry	1	1	154	145	139	153
Communications	-7	-7	153	155	145	160
Capital Goods	-1	-1	109	109	102	110
Utilities	7	7	136	130	120	129
Financials	24	24	164	126	122	140

HIGH YIELD

High yield corporates performed well in the quarter in both absolute terms and relative to Treasuries. CCCs were the strongest-performing category in both respects. HY spreads widened in March but ended the quarter tighter than where they began.

HIGH YIELD SECTOR RETURNS (%)[1]

	Duration (years)	Yield	Q1 Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
High Yield Corporates	4.24	8.52	3.57	1.23	3.57	1.23
BB	4.63	6.80	3.44	0.97	3.44	0.97
B	3.94	8.68	3.47	1.22	3.47	1.22
CCC	3.66	13.44	4.96	2.81	4.96	2.81

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

	Q1 Change	YTD Change	3/31/2023	2/28/2023	1/31/2023	12/31/2022
High Yield OAS	-14	-14	455	412	420	469
BB OAS	-12	-12	283	267	267	295
B OAS	-24	-24	465	421	434	489
CCC OAS	-34	-34	974	891	893	1008

High yield corporate spreads moved tighter across all but two sectors; only the Financials and Communications sectors realized wider spreads.

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

	Q1 Change	YTD Change	3/31/2023	2/28/2023	1/31/2023	12/31/2022
Consumer Non-Cyclical	-23	-23	495	465	483	518
Technology	-8	-8	490	446	435	498
Energy	-12	-12	347	330	325	359
Consumer Cyclical	-52	-52	425	393	407	477
Transportation	-56	-56	366	323	340	422
Basic Industry	-28	-28	398	381	396	426
Communications	56	56	626	532	535	570
Capital Goods	-34	-34	359	336	346	393
Utilities	-9	-9	261	260	264	270
Financials	17	17	528	435	443	511

The high yield default rate increased slightly for the full quarter while remaining low versus historical levels.

HIGH YIELD DEFAULT RATES[2]

	Q1 Change	YTD Change	3/31/22	2/28/22	1/31/22	12/31/22
Number of Issuers in Default	4	4	17	17	16	13
Issuer Default Rate	0.5%	0.5%	2.1%	2.0%	1.9%	1.6%
Number of Issuers in Default (ex commodities)	4	4	16	16	15	12
Issuer Default Rate (ex commodities)	0.5%	0.5%	2.2%	2.2%	2.1%	1.7%

MUNICIPALS & OTHER

Municipal bonds performed well in March to finish the quarter with positive returns across all maturities. Yields fell across all ratings categories.

MAJOR MUNICIPAL BOND INDEX RETURNS (%)[1]

	YTW	Duration (years)	Q1 Return	YTD Return
Short Duration (1-5 Years)	2.68	2.63	1.48	1.48
Intermediate (1-15 Years)	2.87	4.23	2.27	2.27
Long Duration (22+ Years)	4.18	10.46	4.27	4.27

MUNICIPAL YIELDS BY RATING CATEGORY AND MATURITY (%)[1]

	AAA		AA		A		BBB	
	3/31	12/31	3/31	12/31	3/31	12/31	3/31	12/31
1 Year	2.45	2.80	2.67	2.89	2.79	3.17	3.37	4.07
5 Year	2.20	2.53	2.50	2.70	2.61	3.07	3.17	3.81
10 Year	2.26	2.62	2.57	2.91	2.83	3.26	3.22	3.89
30 Year	3.31	3.57	3.77	4.13	4.32	4.74	4.30	4.86

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

	35%	30%	25%	20%
1 Year	4.11	3.82	3.57	3.34
5 Year	3.84	3.57	3.33	3.12
10 Year	3.95	3.67	3.42	3.21
30 Year	5.80	5.39	5.03	4.72

Returns were positive across all the "Other" bond categories. Global Treasuries and convertibles had the strongest absolute returns in the quarter.

OTHER SECTOR RETURNS (%)[1,4]

	Duration (years)	Yield	Q1 Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
Emerging Markets	5.24	11.11	1.43	-1.25	1.43	-1.25
Global Investment Grade Treasuries (Unhedged)	7.66	2.84	3.08	0.11	3.08	0.11
S&P/LSTA Leveraged Loan Index	–	9.35	2.94	–	2.94	–
S&P Preferred Stock Index	–	6.44	2.47	–	2.47	–
U.S. Convertibles	0.76	2.02	4.47	–	4.47	–

[1]Source: Bloomberg.
[2]Source: Bank of America Merrill Lynch.
[3]Hypothetical yields are calculated as the AA municipal yield divided by (1-tax rate). Actual tax-adjusted yields will depend on individual tax circumstances.
[4]Source: Standard & Poor's.