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Fourth Quarter Fixed Income Letter to Clients

Inflation, as measured by the Consumer Price Index, finally stopped growing during the fourth quarter of 2022. As such, interest rates on investment grade bonds finally ceased their upward trend and have since moved relatively sideways in a range bound pattern. Throughout 2022, the Fed has been forced to tighten aggressively, outpacing all tightening cycles over the past 30 years. For 2023, with inflation already showing signs of softening, the Fed is expected to slow down the pace of tightening. Consequently, the great unknown for investors is whether inflation can roll over into a downward trend or not.

High inflation has certainly led to cost-of-living problems for many, and while the Fed has aggressively raised rates to combat inflation, strength in growth and jobs continues to remain. So, is a recession coming? We do see inflation continue to cool in the near term but longer term inflation will likely persist above the Fed's policy targets.

The total return of the S&P Municipal Bond Index was +3.70% for the quarter, and the 2022 annual total return to -7.50%. We continue to feel that given the material increase in yields on bonds over the past year, there are reasons to be constructive in investing at these levels.

The US Treasury 10-year bond kicked off the fourth quarter with a yield of 3.67% and ended at 3.88%; while the 30-year bond, the bellwether for long term duration, began the quarter at around 3.75% and ended at 3.97%.

Within fixed income, we see attractive opportunities to earn income in investment grade credit on short and intermediate term bonds. As far as long-term bonds, we are underweight long duration as our view of the risk reward outlook is unfavorable in that yields will rise further over the next few quarters as investors demand more term premium for the risk of holding long duration amid the inflation and higher rates.

Evan Slater
Fixed Income Portfolio Manager