



Portfolio Commentary

Navigator® Taxable Fixed Income

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Rapid Moves and Repricing Risk

Market Review

The first quarter saw the Fed begin to raise rates and start conversations on quantitative tightening. They have been much more aggressive in their plans for raising rates than the market was expecting to begin the quarter. The Fed dot plot, which reflects where individual members believe the Fed Funds rate will be, moved to a median rate of 2.75% by the end of 2023 as inflation continued to rise and cause issues for the economy.

The Consumer Price Index (CPI) rose to 7.9% year-over-year in March, which was the main driver for the more aggressive Federal Reserve as they attempt to bring inflation under control. This unanticipated aggressiveness, coupled with the war in Ukraine, caused the market to reprice interest rate risk and drove yields higher. The 2-year/10-year Treasury yield curve continued to flatten and closed the quarter slightly inverted for the first time since 2019.

The 2-year Treasury jumped from 0.73% at the start the quarter to 2.34% to end the quarter. This rapid move and repricing of risk resulted in one of the worst quarters of performance in the last 20 years. The Bloomberg Barclays U.S. Aggregate Bond Index was down -5.93% for the quarter while the Bloomberg Barclays Intermediate Corporate Index was down -5.25%.

First Quarter Performance Highlights

- Duration remained less than the benchmark at slightly under 4 years. Bonds continued to be called and exchanged as companies aimed to get ahead of the Fed and rising interest rates.
- Credit fundamentals continued to be strong as multiple names were upgraded from high yield to investment grade and added to the index during the quarter.
- The best performing sector from a total return basis was Materials, which saw one of the bigger upgrades moved into the index. Consumer names were the largest detractors as fears of supply chain issues coupled with higher inflation costs continued to weigh on the market.
- Banks added the most value to the portfolio as higher interest rates should help them to increase their interest income.
- A premium beer, wine and spirits producer detracted the most value from the portfolio as inflation and transportation costs continued to rise and have a negative impact on their margins.

Positioning and Outlook

The portfolio moved to a more neutral position in banks, especially the larger national banks, during the quarter. The overweight in metals and insurance continues as we see higher rates helping insurance companies while the metals sector is showing a continued credit improvement, which has been reflected in the upgrades in the sector. Underweights are focused on pharmaceuticals and the Technology sector as more

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M&A is expected from both throughout this year.

Positioning along the yield curve shifted during the quarter to increase the exposure to short 1 to 2-year bonds. With expectations for rising interest rates, we believe lower duration bonds should perform well from a total return perspective. This increased positioning in short bonds has been coupled with an increase in longer 10-year paper as the portfolio has been moving toward a barbell strategy. We believe that part of the yield curve won't see interest rates move substantially higher and the curve will continue to invert.

From a credit quality perspective, the portfolio has gotten stronger as the high yield portion has been reduced either from upgrades, bonds being tendered, or a few targeted sales. As volatility in the market has increased, liquidity has become more important and reducing these positions has helped to increase the liquidity of the portfolio.

As the Fed attempts to tame inflation, risks remain that they will go too far and slow the economy more than expected. Moving the portfolio into more liquid, higher quality bonds should enable us to navigate these markets and continue to outperform the index going forward.

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The volatility (beta) of a client's portfolio may be greater or less than its respective benchmark. It is not possible to invest in these indices.

Index returns include the reinvestment of income and dividends. The returns for these unmanaged indexes do not include any transaction costs, management fees or other costs. It is not possible to make an investment directly in any index.

Fixed income securities are subject to certain risks including, but not limited to: interest rate (changes in interest rates may cause a decline in market value or an investment), credit, prepayment, call (some bonds allow the issuer to call

a bond for redemption before it matures), and extension (principal repayments may not occur as quickly as anticipated, causing the expected maturity of a security to increase).

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

The Bloomberg Barclays US Intermediate Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers that have between 1 and up to, but not including, 10 years to maturity.

Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities.

The 2-Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 2 years.

The 10-Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 10 years.

The Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The CPI reflects spending patterns for each of two population groups: all urban consumers and urban wage earners and clerical workers.

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