



## Portfolio Commentary

## Navigator® Taxable Fixed Income

## Portfolio Manager



**Oliver Chambers**  
Senior Portfolio Manager

## Inflation and Inversions Mark Another Volatile Quarter

### Market Review

Inflation stayed elevated throughout the quarter, remaining above 8%. This caused the Federal Reserve to continue their aggressive rate hiking in an effort to bring inflation back under control. During the quarter, the Fed hiked rates twice by 75 basis points each time, bringing the Fed Funds rate to a range of 3-3.25%. The Fed is now expected to raise rates another 125 basis points by the end of the year. They also ramped up quantitative tightening to the full amount that was announced earlier in the year, letting \$95 billion mature off the balance sheet each month going forward.

Interest rates continued to move higher and now sit at the highest they've been since 2008-2009. The 10-year Treasury rose to 3.83%, up 81 basis points on the quarter, while the 2-year Treasury rose 132 basis points to 4.28%. This is the largest inversion in rates since 2001. These outsized interest rate moves continue to be the main driver in the total return of the bond market for the year. The Bloomberg Barclays U.S. Aggregate Bond Index returned -4.75% for the quarter, bringing the year-to-date return to -14.61%, while the Bloomberg Barclays Intermediate Corporate Index returned -3.11% for the quarter and -11.81% for the year. Corporate spreads continued to be volatile during the quarter with the Option-Adjusted Spread (OAS) trading in a range from 131 basis points to 164 basis points, but closed out the quarter only 4 basis points wider than where it started at 159 basis points.

### Third Quarter Portfolio Highlights

- The duration of the portfolio remained just under 4 years and just over a quarter year shorter than the index. The large move in interest rates continued to slow the pace of companies issuing new debt as the primary market ground to a halt.
- Upgrades into investment grade from high yield continue to outnumber downgrades, but the pace of upgrades has started to slow as inflation remains a headwind for earnings.
- The best performing sectors from a total return basis were industrials and energy. Energy names continued to outperform as the market continued to expect higher oil prices than a year before, but discounted demand destruction as gas eased off the highs we saw over the summer. The worst performing sectors were Software and Telecom. Telecom underperformed as earnings in European companies, deteriorated.
- Energy added the most value for the quarter, as the portfolio remained overweight the index in this sector. Technology was the biggest detractor as the portfolio continued to hold longer duration names in this sector.

*Past performance is not indicative of future results.*

*This is not a recommendation to buy or sell a particular security. Please see attached disclosures.*



## Positioning and Outlook

The main theme of the portfolio and its positioning continued to be the same during the quarter. The drive to higher quality, shorter bonds was the prevailing view during the quarter. The portion of the portfolio invested in high yield continued to be reduced, both through sales and through upgrades to investment grade. Energy continued to be added to the portfolio to increase the overweight while exposure to REITS was reduced significantly during the quarter.

Along the yield curve, the portfolio continued the strategy of buying higher yielding short paper (1-3 years to maturity) while also buying what we believe is higher quality longer paper (7 years to maturity). With the inversion in interest rates, the highest yielding part of the

corporate bond market is the 5-7 year part of the curve. The main focus has been adding bonds in this part as opposed to 10 year portion of the curve in order to limit interest rate risk, while still maintaining the same yield.

We believe the portfolio continues to be positioned to take advantage of the belief that the Fed will need to raise rates more than expected and will slow the economy and company earnings. It is our belief that keeping the portfolio shorter and more liquid should enable it to continue to navigate the volatile markets and 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 option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is then adjusted to take into account an embedded option. Typically, an analyst uses Treasury yields for the risk-free rate.

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.

Quantitative tightening (QT) refers to the process the Fed is using to reduce the size of its balance sheet. It is allowing the bonds that it holds on its balance sheet to mature without replacing the full amount.

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