NEWFLEET ASSET MANAGEMENT

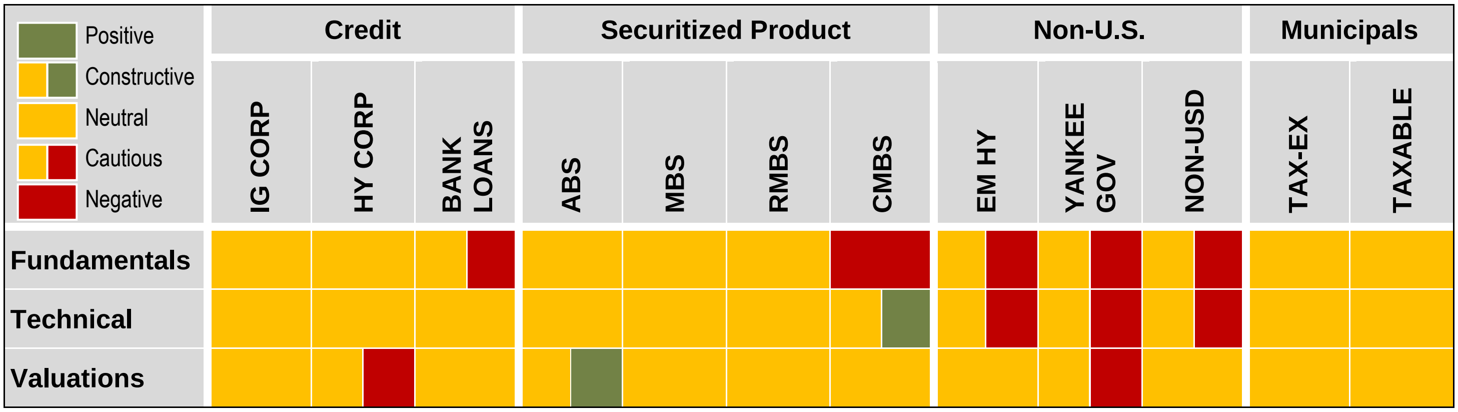
Fixed Income Sector Review

As of December 31, 2022

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- We remain neutral on the direction of risk markets and continue to add exposure on dips.
- A tough year in 2022 left bonds in a better place after the worst selloff since 1949. The result? Bonds now have meaningful value. Bond markets have stabilized at more attractive levels as growth concerns hang over equity markets. Bonds also now have a favorable income advantage over equities.
- We think financial markets (both equities and fixed income) have transitioned from a sharp drawdown to a more range-bound state.
- The key risk to our view on economic fundamentals is that what we have been classifying as mild stagflation persists but does not translate into a hard landing. While the Fed is unlikely to pivot, we have held the view that it will begin to slow the pace of tightening as growth continues to slow, and as the inflation outlook grows more benign.
- Looking ahead, we believe the Fed will pivot only when the labor market starts to weaken, and ex-post inflation (not forecasts) shows clearer signs of decline.
- All-in, we keep our view that the case is building for a soft landing, and, if the economy enters recession, it will be mild. As a result, we think the worst-case scenarios for the economy are already priced in.

SECTOR ASSESSMENTS



🟩 Positive
🟨🟩 Constructive
🟨 Neutral
🟨🟥 Cautious
🟥 Negative

	Credit			Securitized Product				Non-U.S.			Municipals	
	IG CORP	HY CORP	BANK LOANS	ABS	MBS	RMBS	CMBS	EM HY	YANKEE GOV	NON-USD	TAX-EX	TAXABLE
Fundamentals	🟨	🟨	🟨🟥	🟨	🟨	🟨	🟥	🟨🟥	🟨🟥	🟨🟥	🟨	🟨
Technical	🟨	🟨	🟨	🟨	🟨	🟨	🟨🟩	🟨🟥	🟨🟥	🟨🟥	🟨	🟨
Valuations	🟨	🟨🟥	🟨	🟨🟩	🟨	🟨	🟨	🟨	🟨🟥	🟨	🟨	🟨

Newfleet's assessments of non-government spread sectors as of December 31, 2022. Assessments are determined by analyzing a sector's fundamental data, technical indicators, and relative valuations. Sectors (l to r): **Credit**: Investment Grade (IG) Corporate Bonds, High Yield (HY) Corporate Bonds, Bank Loans. **Securitized Product**: Asset-Backed Securities (ABS), Agency Mortgage-Backed Securities (MBS), Non-Agency Residential MBS (RMBS), Non-Agency Commercial MBS (CMBS). **Non-U.S.**: Emerging Markets HY, Yankee Government, Non-U.S. Dollar. **Municipals**: Tax-Exempt, Taxable.

SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds

- Fundamentals remain supportive of the market overall and yields are compelling – they will enter the new year at 5.42%, the highest starting point for yields since 2009.
- With recessionary risks elevated, current spread levels leave something to be desired. However, we continue to see pockets of value, particularly in high-quality financial institutions where valuations are still at more extreme levels.
- December issuance of $6 billion was the lightest month in more than twenty years. For the full year, gross and net supply were both 16% below 2021 issuance.

Continued

High Yield Corporate Bonds

- Despite posting a near-flat return of -0.62%, the high yield market experienced a volatile month due to mixed economic data, the Federal Open Market Committee (FOMC) meeting in December, and FOMC commentary.
- Though December marked the slowest month of issuance in four years, there was a slight supply surplus due to outflows and limited activity overall.
- Heading into the new year, we will keep focused on economic data, the FOMC's reaction to this data, and fourth quarter earnings.

Bank Loans

- In a year marked by volatility, the loan market posted only its third annual loss (-0.60%) in the history of the Morningstar LSTA Loan Index and its first loss in seven years. For December, loans returned 0.44% as coupon more than offset slightly lower prices amid thin liquidity.
- Current market consensus puts the probability of recession at 65%. However, certain inflation prints have been trending lower, December's jobs report exceeded estimates, and capital markets access has stayed open. Do these signs point to a mild recession, or even a soft landing?
- That said, concerns remain around an increasingly tenuous fundamental backdrop. However, at current valuations, a meaningful amount of cushion (8%+ current market coupon) is priced into the loan market.

Securitized Product

- Credit spreads tightened for the majority of securitized product in December, which translated into positive total returns for ABS and CMBS.
- Reduced issuance for 2023 is expected for ABS, CMBS, and RMBS, which is a positive technical for those asset classes.
- High-quality securitized assets are now yielding 5.5% to 7.50%. We continue to emphasize short average life securitized paper within our portfolios due to its relative value versus corporates.

Emerging Markets Debt

- Emerging markets debt (EMD) posted a slightly positive total return of 0.38% for the month.
- We see value in EM debt after the 2022 selloff, and we continue to believe that markets have transitioned to a more sideways pattern versus last year's relentless decline.
- We still see better value in high yield EMD than in investment grade, and we remain positioned that way. However, we now see pockets of value in investment grade; particularly in the weak BBB-rated space on the cusp of investment grade and high yield.

Municipal Bonds

- Amid a challenging year for fixed income, municipal bonds posted record outflows in 2022 of $121.6 billion as of December 28, 2022.
- However, thanks to seasonal trends that typically result in a favorable technical environment, the Bloomberg Municipal Bond Index posted gains of 4.1% for the quarter.
- The yields on 2-year and 10-year AAA-rated bonds closed 2022 at 2.67% and 2.64%, respectively.

Continued

Newfleet Asset Management
One Financial Plaza
Hartford, Connecticut 06103
877-332-8172