BOND MARKET REVIEW — SECOND QUARTER 2023

By almost all measures, the second quarter was marked by strong 'risk on' sentiment. Equity indices powered higher as credit spreads tightened in sympathy. There was a notable decline in volatility, particularly in June, following the banking-induced volatility spike earlier in the year. At a sector level, focus shifted from domestic banking woes to the technology space, where headlines around developments in artificial intelligence contributed to the NASDAQ's 13% surge during the quarter. The S&P 500 rose 8.3%.

Domestic bond market performance proved shakier, with the U.S. Aggregate Index falling 0.84% during the period driven by moves in government bonds. Treasury yields rose across all tenors. The yield curve flattened as investors priced in further rate hikes by the Federal Reserve. The widely-followed differential between 2-year and 10-year Treasury yields further inverted from -56 basis points on March 31st to -106 basis points at quarter-end. Importantly, there was a modest shift in policy. The Fed 'paused,' opting not to hike rates at their June meeting. However, Jerome Powell reiterated his intention to tighten policy further should economic data and inflation data continue to prove resilient. While the year-over-year change in the Consumer Price Index has fallen consistently since mid-2022, the most recent print of 4.05% remains well above the Federal Reserve's stated target of 2.0%.

Buyers of corporate debt remained undeterred. In fact, the lowest quality rungs of the corporate bond universe outperformed higher quality counterparts. The credit spread curve steepened modestly as intermediate-dated corporates tightened in more than long-dated bonds. This was driven in part by the outperformance of financials credit, composed mostly of intermediate-dated bank bonds, versus industrials and utilities. In fact, the recent and swift tightening in corporate bonds has led many investors to prefer the relative value in other areas of spread product, particularly agency MBS, which has lagged. In many ways the opportunity set coming into the second half of the year has shifted. However, pockets of value remain.

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