RICHMOND CAPITAL MANAGEMENT

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BOND MARKET REVIEW FOURTH QUARTER 2022

Volatility was the hallmark across asset classes during the first three months of the year. Following a firm market tone in January and February led predominantly by the tech sector, markets were gripped by a meltdown in banking led first by Silicon Valley Bank and followed by certain other regional and European banks. At a sector level, the selloff was relatively contained. The KBW Bank Index lost more than 18% during the quarter, while the S&P 500 rose more than 7% over the same period, a remarkable divergence. Significant pressure in the banking sector led to a natural tightening in financial conditions, a dynamic that bond market participants watch as it affects the need for further tightening in monetary policy.

As one would expect, Fed Funds terminal rate expectations fell precipitously during the worst of the volatility. And what was previously expected to be a 50 basis point rate hike at the Fed's March meeting turned into a 25 basis point hike as Chairman Powell acknowledged the ongoing turmoil and subsequent economic effects. However, the Fed remains committed to taming inflation at all costs. While both headline and core CPI continue to decelerate on a year-over-year basis, we are still a long way from the Fed's stated inflation target of 2.0%. Following recent economic data releases, the market is currently pricing in a 50% chance of another 25 basis point hike at the Fed's May meeting. The market is now pricing in Fed Funds cuts in the back half of the year.

During the quarter, rising recession risks and further rate hikes filtered through the yield curve. The yield differential between the 3-month U.S. T-Bill yield and the 10-year U.S. Treasury yield further inverted from -53 basis points on December 31st to -134 basis points on March 31st. Long-dated Treasury yields fell. On a yield basis, the 5-year Treasury note was the outperformer during the quarter, falling 43 basis points to end the quarter at 3.57%. Remarkably, both investment-grade and high-yield credit spreads ended the quarter roughly where they began. However, this masks the considerable spread volatility across all corporate credit markets during March. The Agency MBS basis also saw significant intra-month swings but ended March largely unchanged versus year-end. Recent volatility has provided us the opportunity to selectively add risk in portfolios.

1509A Belleville Street
Richmond, Virginia 23230
Telephone: (804) 419-2149
Website: www.richmondcap.com
Marketing Contact: O. Gregory Glatt III