



Year End Outlook and Update

December 15, 2021

On The Horizon

There is plenty to be concerned / excited about for 2022, we are highlighting our focus items

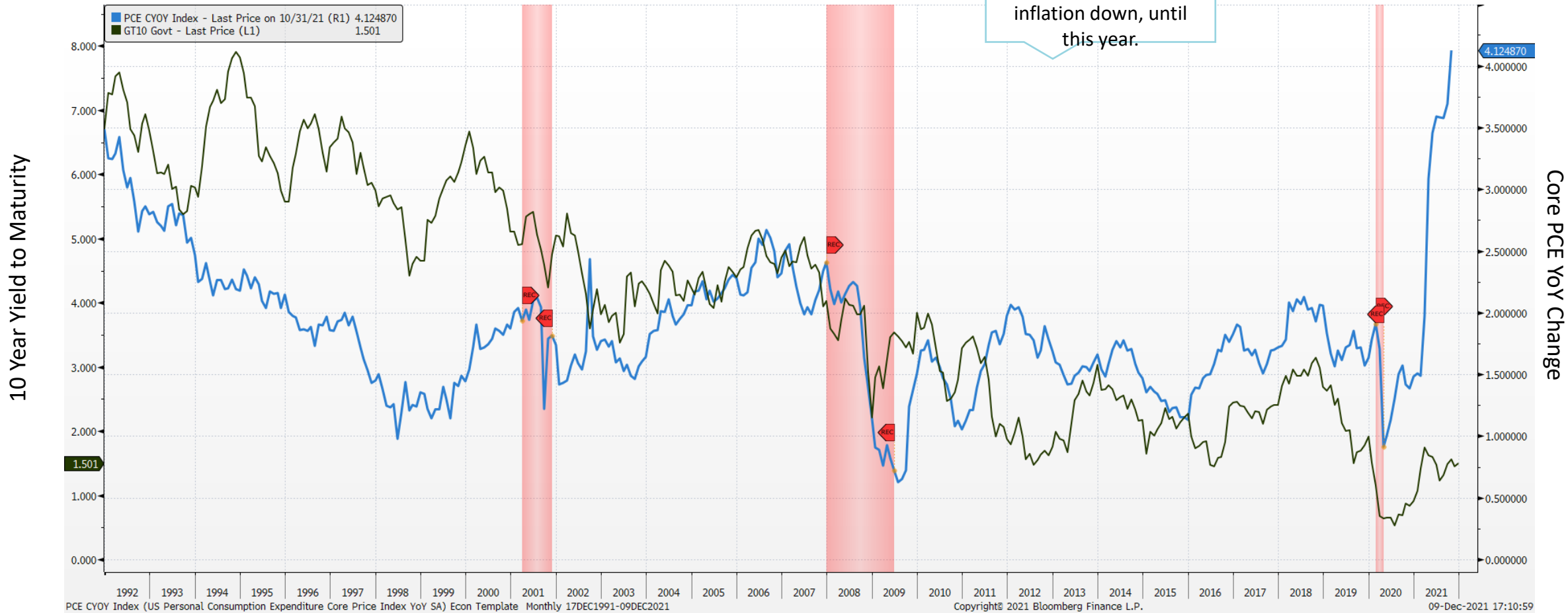
- Vaccine distribution and variants present challenges: Winter is Coming
- Inflation is here and the Fed is on the job
- Will rising short term rates and high inflation translate to higher long-term rates?
- Will an activist Fed cause a recession?
- Can we dismiss Modern Monetary Theory now?
- <https://www.cnn.com/2021/11/17/perspectives/inflation-high-prices-economy/index.html>

Good piece by Mark Zandi at Moody's.

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The Inflation Concern

Core Inflation vs US 10 Year Treasury



See Explanatory Notes and Disclosures

Source: Bloomberg LP

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Energy Driving Inflation

Oil up 49% over last year



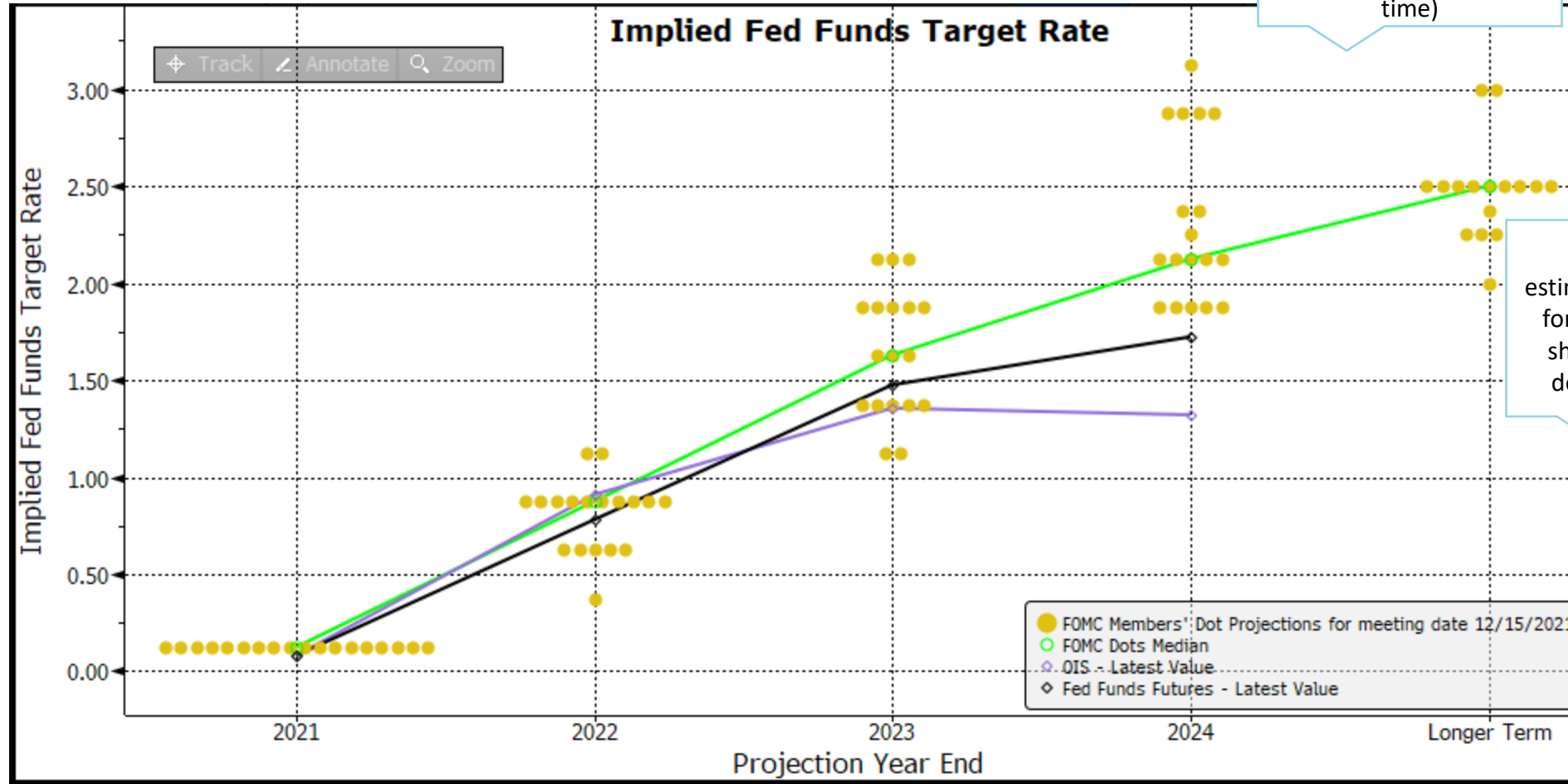
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FED DOTS

6 Rate Increases in 2 Years

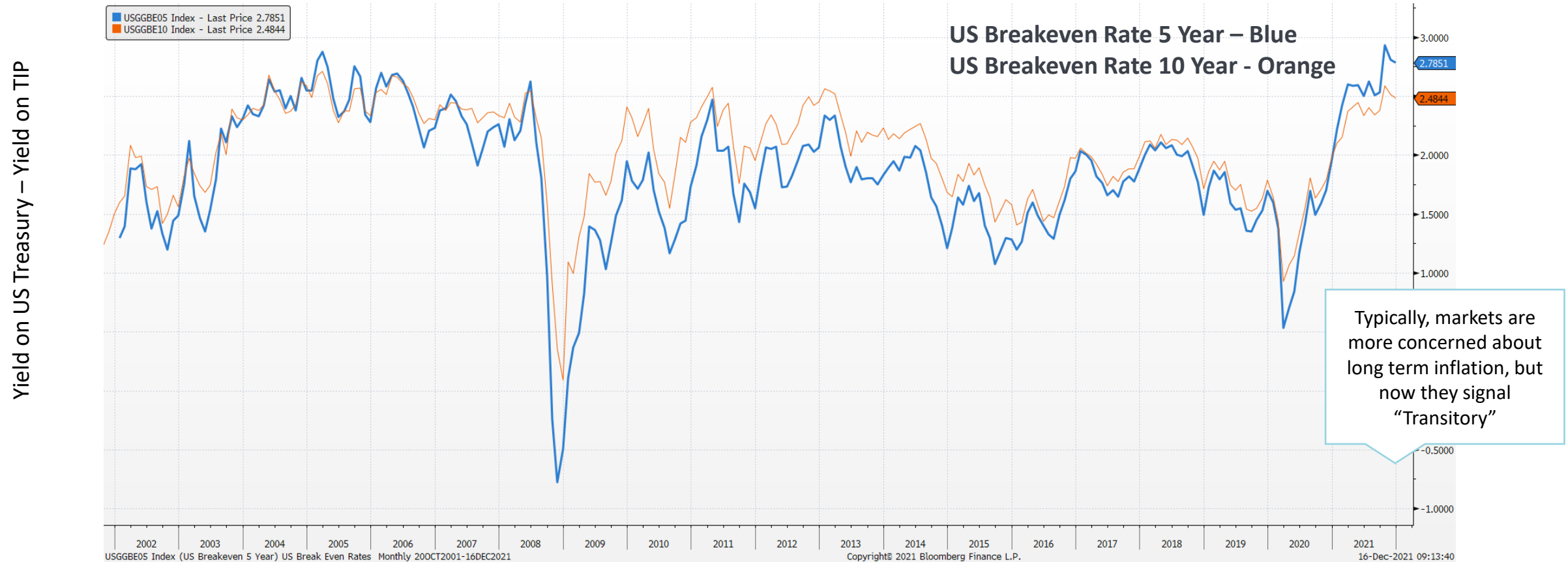


The Fed Governors' now estimate increases in the Fed Funds rate. 3 next year, 3 more in 2023 (Assuming 0.25% each time)

Publishing their estimates is a handy tool for the Fed. They can show conviction and deny that it's policy.

Inflation Expectations Rise

The difference between the Treasury Inflation-Protected Securities (TIP) yield and the US Treasury yield



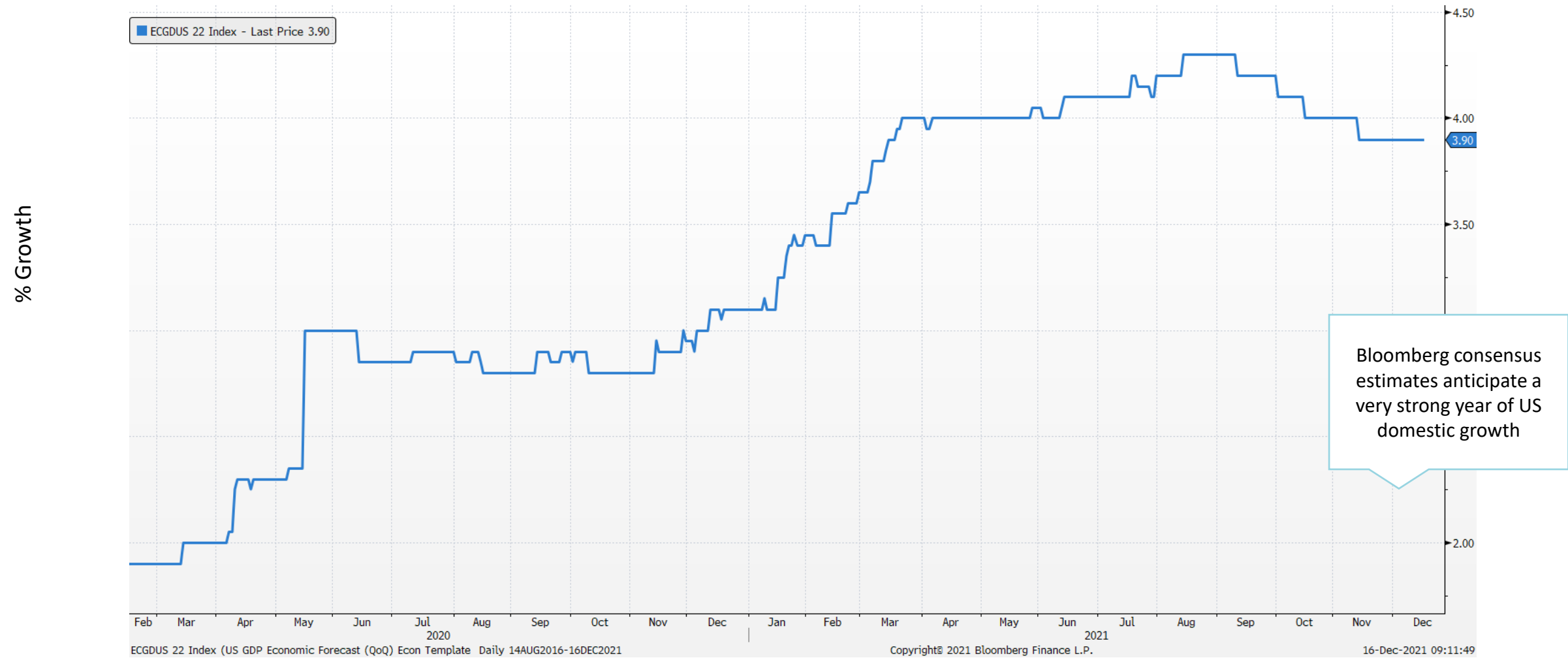
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The New Normal

Economists Estimates of 2022 GDP Year-Over-Year (YOY) Growth adjusting to New Normal



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Source: Bloomberg LP

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World Rates

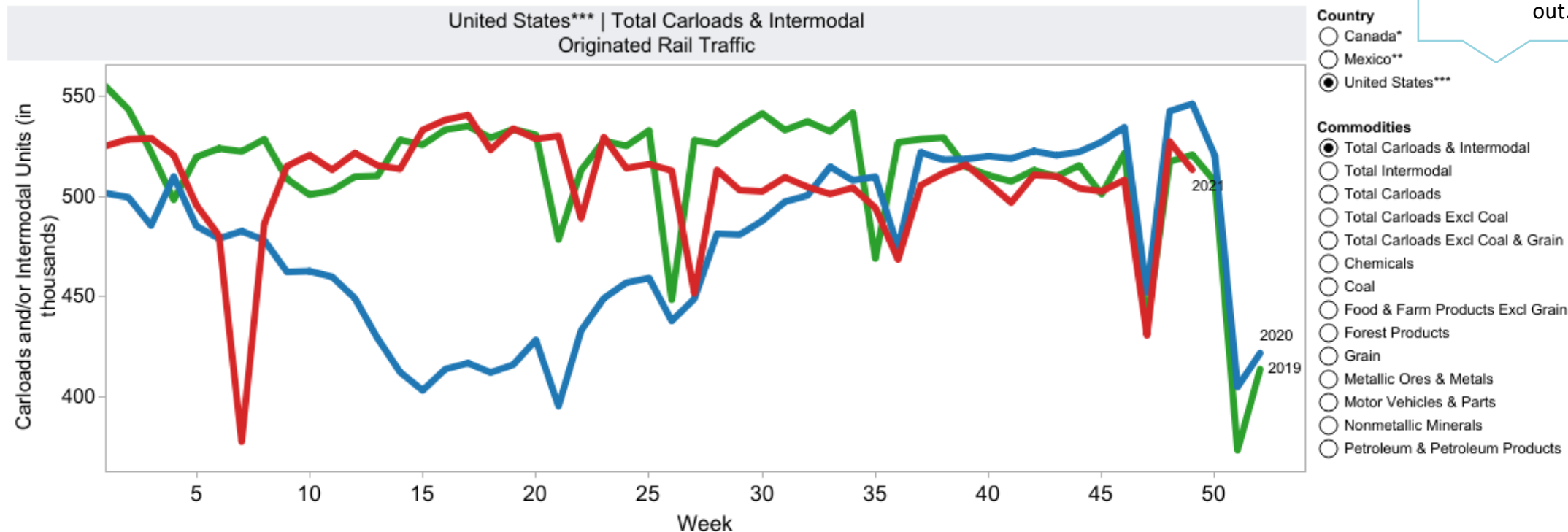
US Rates Still Among the Highest

| Country | Issue | Yield to Maturity |
|-------------|--------------------------|-------------------|
| US | T 1 $\frac{3}{8}$ 11/31 | 1.429 |
| Canada | CAN1 $\frac{1}{2}$ 06/31 | 1.373 |
| Uk | UKT0 $\frac{1}{4}$ 07/31 | 0.772 |
| France | FRTR 0 11/31 | -0.002 |
| Germany | DBR0 08/15/31 | -0.359 |
| Italy | BTPS 0.95 31 | 0.956 |
| Spain | PGB 0.3 10/31 | 0.379 |
| Switzerland | SWISS 2 $\frac{1}{4}$ 31 | -0.307 |
| Japan | JGB 0.1 09/31 | 0.039 |
| Australia | ACGB 1 11/31 | 1.558 |
| China | CGB3.02 05/31 | 2.892 |

Low rates around the world continue to contribute to low rates in the US.

Rail Traffic

Rail Traffic Recovers



The recovery happened, then we hit a snag. It appears some of the snags are being worked out.

* Canadian traffic includes the U.S. operations of Canadian railroads.
** Mexican traffic includes the U.S. operations of Mexican railroads.
*** United States traffic excludes the U.S. operations of Canadian and Mexican railroads.



Source: <https://www.aar.org/data-center/rail-traffic-data/>

Fed Funds Futures

CME's FedWatch Tool Shows Futures Contracts are Indicating Fed Fund Rate Increases

The market is anticipating what the Fed is signaling.

October 15, 2021

| MEETING PROBABILITIES | | | | | | | |
|-----------------------|-------|-------|-------|--------|---------|---------|---------|
| MEETING DATE | 0-25 | 25-50 | 50-75 | 75-100 | 100-125 | 125-150 | 150-175 |
| 11/3/2021 | 99.5% | 0.5% | 0.0% | 0.0% | 0.0% | 0.0% | |
| 12/15/2021 | 99.5% | 0.5% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 1/26/2022 | 94.5% | 5.4% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 3/16/2022 | 90.9% | 8.9% | 0.2% | 0.0% | 0.0% | 0.0% | 0.0% |
| 5/4/2022 | 82.8% | 16.2% | 1.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 6/15/2022 | 58.0% | 36.2% | 5.5% | 0.3% | 0.0% | 0.0% | 0.0% |
| 7/27/2022 | 46.9% | 40.3% | 11.4% | 1.3% | 0.1% | 0.0% | 0.0% |
| 9/21/2022 | 30.0% | 42.7% | 21.8% | 4.9% | 0.5% | 0.0% | 0.0% |
| 11/2/2022 | 25.4% | 40.7% | 25.0% | 7.6% | 1.2% | 0.1% | 0.0% |
| 12/14/2022 | 10.8% | 31.9% | 34.0% | 17.6% | 4.8% | 0.7% | 0.1% |
| 2/1/2023 | 8.9% | 28.1% | 33.6% | 20.5% | 7.1% | 1.5% | 0.2% |

December 15, 2021

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|-----------------------|-------|-------|-------|--------|---------|---------|---------|---------|---------|
| MEETING DATE | 0-25 | 25-50 | 50-75 | 75-100 | 100-125 | 125-150 | 150-175 | 175-200 | 200-225 |
| 12/15/2021 | 94.5% | 5.5% | 0.0% | 0.0% | 0.0% | 0.0% | | | |
| 1/26/2022 | 87.4% | 12.2% | 0.4% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 3/16/2022 | 55.2% | 39.9% | 4.7% | 0.2% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 5/4/2022 | 32.6% | 46.2% | 19.1% | 2.0% | 0.1% | 0.0% | 0.0% | 0.0% | 0.0% |
| 6/15/2022 | 12.3% | 37.7% | 35.9% | 12.7% | 1.3% | 0.0% | 0.0% | 0.0% | 0.0% |
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| 11/2/2022 | 3.1% | 15.1% | 29.3% | 29.5% | 16.7% | 5.3% | 0.9% | 0.1% | 0.0% |
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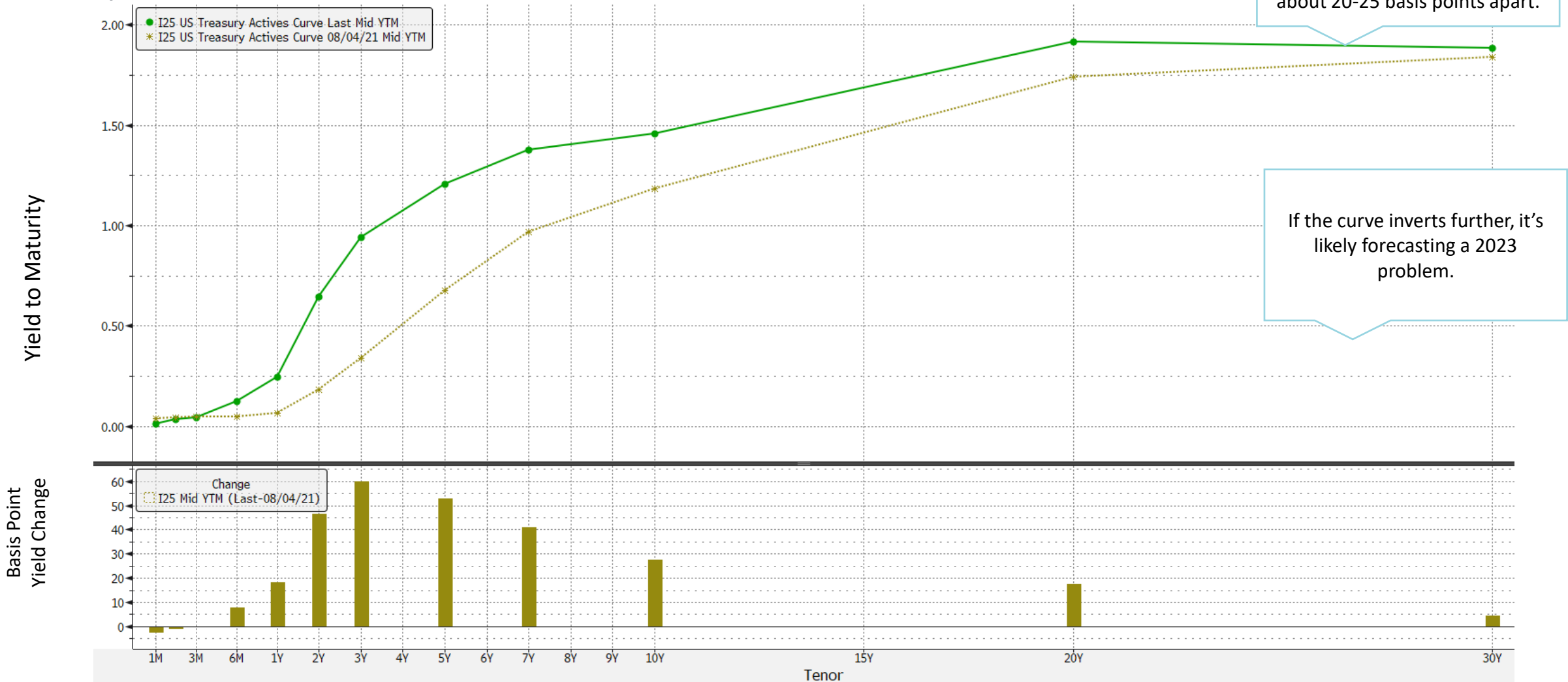
Source :<https://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html>

See Explanatory Notes and Disclosures

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Yields Higher

Treasury Curve Flattens as Short Term Rates React to Fed Hawkishness



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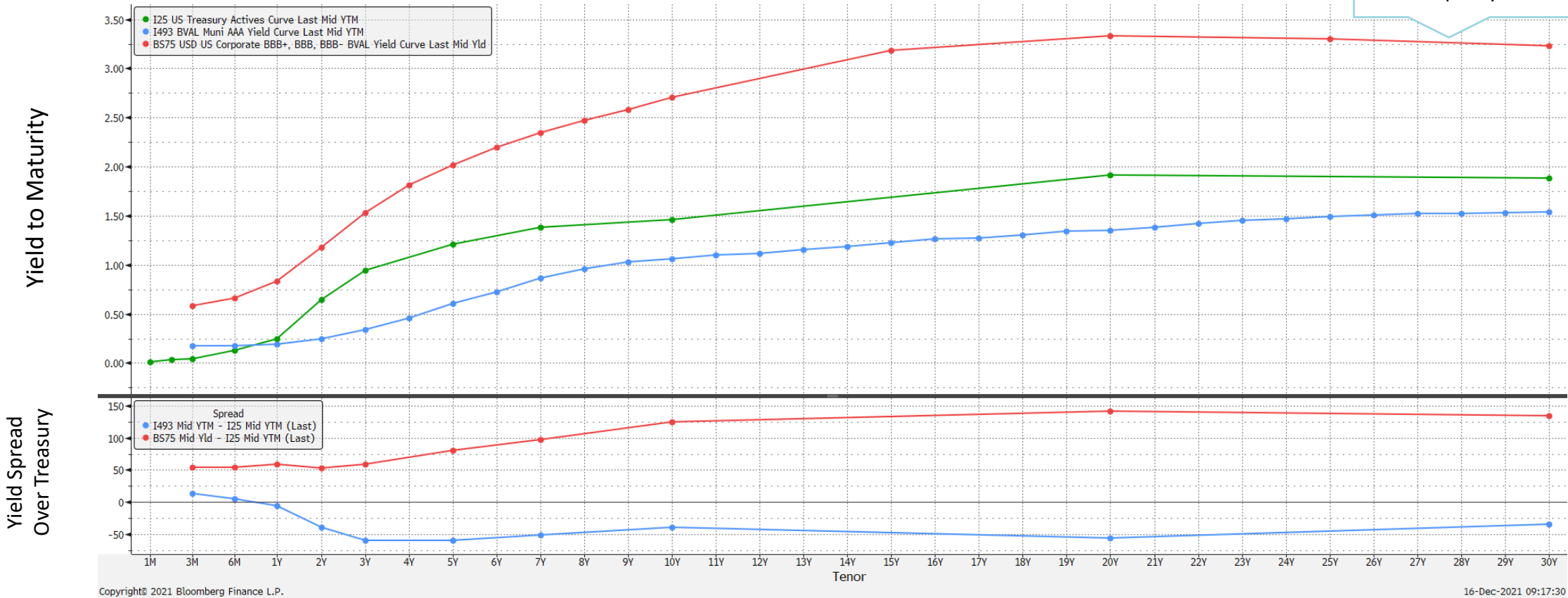
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Opportunity in Corporate Bonds

US Treasury Yields (Green) vs Muni (Blue) and BBB Corporate Bonds (Red)

Municipal bonds remain solid as taxes drive valuations. The credit curve has steepened as concerns mount about possible policy mistakes.



See Explanatory Notes and Disclosures

Source: Bloomberg LP

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Final(?) Thoughts

Migrate to quality,
avoid the coming
volatility and have a
Great 2022!

- 2021 showed continued recovery, but stoking consumer demand without a healthy supply chain caused inflation to spike
- The Fed is signally they are on the job and the market believes it
- Growth should continue in 2022, but the possibility of policy mistakes cloud 2H2022 and 2023
- Municipal bonds continue to have strong demand and new issue supply should moderate
- IG Credit spreads are widening from historic lows, focus on improving credits, watch out for companies financial engineering stock returns at the expense of bond holders
- HY spreads are widening. Higher short term interest rates is not good news for leveraged borrowers.

Explanatory Notes and Disclosures

The U-3 unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed).

Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country's economic health. This is seasonally in the chart shown. Seasonal adjustment is a statistical technique designed to even out periodic swings in statistics or movements in supply and demand related to changing seasons. Seasonal adjustments provide a clearer view of nonseasonal changes in data that would otherwise be overshadowed by the seasonal differences.

Year-over-year (YOY) is a method of evaluating two or more measured events to compare the results at one period with those of a comparable period on an annualized basis.

US CPI Urban Consumers Less Food & Energy YoY NSA Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Core PCE Price Index is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services.

The Federal Funds Rate is the target interest rate set by the Federal Open Market Committee (FOMC) at which commercial banks borrow and lend their excess reserves to each other overnight.

The 5-year breakeven inflation rate is the difference between the 5-Year Treasury Constant Maturity Rate and the yield on an inflation protected security with 5-years remaining to maturity.

Yield to Maturity describes the rate of return an investor will receive if a long-term, interest-bearing security, such as a bond, is held to its maturity date.

A yield spread is the difference between yields on differing debt instruments of varying maturities, calculated by deducting the yield of one instrument from the other.

Tenor refers to the length of time remaining before a financial contract expires.

The FedWatch tool calculates unconditional probabilities of Federal Open Market Committee (FOMC) meeting outcomes given the trading levels of the contracts to generate a binary probability tree. See: <https://www.cmegroup.com/education/demos-and-tutorials/fed-funds-futures-probability-tree-calculator.html>

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