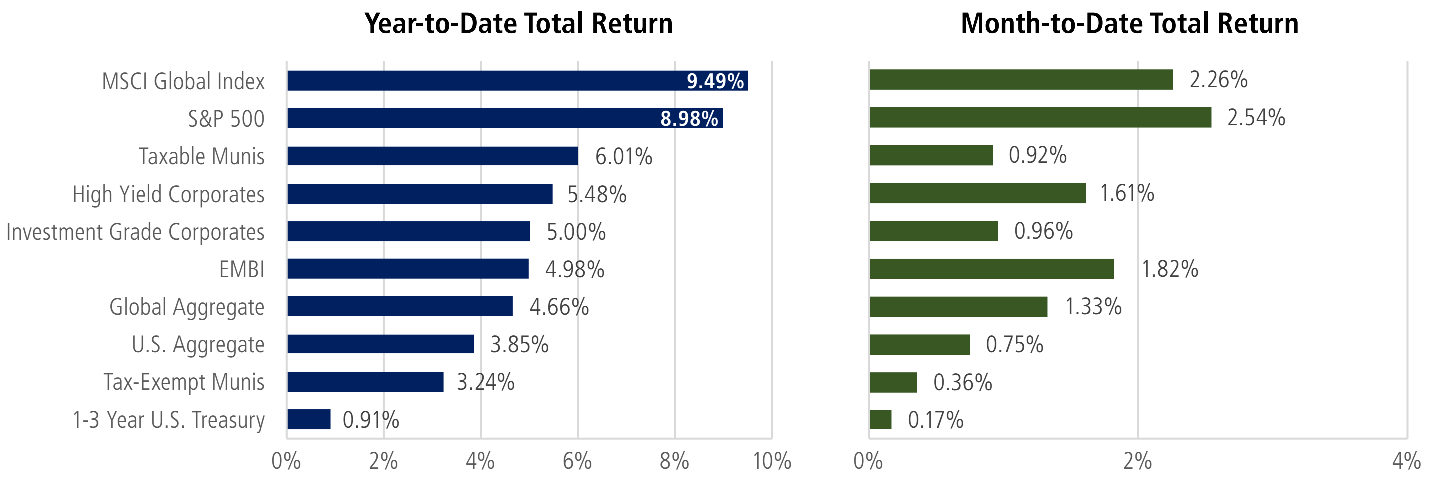
Week Ending: **February 3, 2023**

High Bar

Economic Overview:

Jerome Powell strode to the podium this week after the February FOMC meeting, and investors anticipated a fight. Instead, Powell acknowledged the well-known divergence between the Fed and the bond market. Fed officials hiked by 25 basis points and expected "ongoing increases" would be necessary before a pause at elevated rates for the rest of the year. However, the bond market implies that the peak rate is near and that cuts may soon follow. Powell chalked up the divergence to different opinions and said, "I'm not going to try to persuade people who have a different forecast." Of course, we'd frame the situation differently: we can quibble about where rates peak, but history says rate cuts only happen when both core inflation decelerates and job growth slumps. January 2023 data does not support such a conclusion. Nonfarm payrolls averaged 356k growth over the last three months. Ongoing increases in the fed funds rate, yes. Pausing? Not yet. Cuts? Very unlikely.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: Increased volatility is a feature of 2023 as the +5.60% year-to-date return echoes the market's price action last July when wide starting valuations combined with better-than-expected economic and earnings data resulted in a strong market rally.

Corporates: Thursday was a memorable day in the investment-grade new issue market; just one day after a 25 basis points Fed rate hike, five deals hit the market for $10.5 billion. Insatiable demand pushed books as high as 12x while 4 out of 5 deals repriced through guidance, with deals being walked back by 40 basis points. While re-launches have occurred before, seeing this happen for 80% of the day’s deals is rare.

Securitized Products: The agency mortgage market has enjoyed a strong performance run as volatility abates and interest rates decline on signs of moderating inflation and the market’s reaction to the Federal Reserve meeting. Investors in mortgage-backed securities also have enjoyed a more favorable shift in the supply/demand landscape and a manageable prepayment outlook, with most of the outstanding loan universe not eligible to refinance.

Municipals: The American Dream Mall, a $5 billion complex located in the Meadowlands of New Jersey, continued missing its debt payments. Following a failure to pay in August, the complex, which features an indoor ski slope, water park, and amusement park, also missed its February semi-annual interest payment.

Equities: U.S. equities rallied sharply for the week, extending their strongest start to the year. Better-than-feared corporate earnings results and the Fed meeting being seen as dovish by market participants drove an aggressive rotation into 2022 losers (communications, technology, consumer discretionary) and out of 2022 winners (utilities, health care, consumer staples, energy).