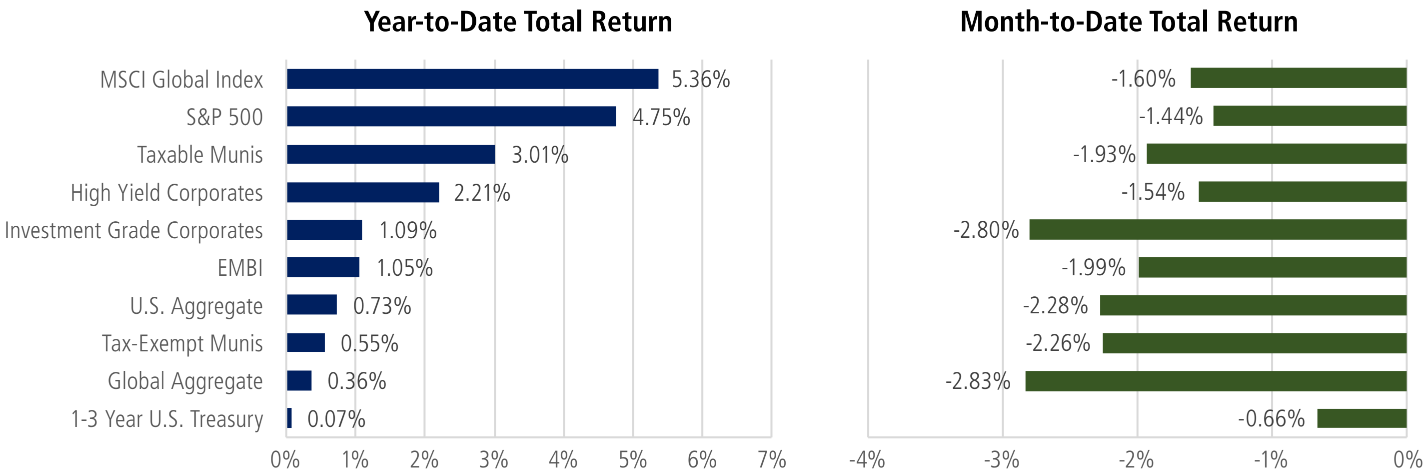
Week Ending: **February 24, 2023**

Blind Spots

Economic Overview:

In investing, as in life, the most surprising scenarios are the ones you failed to consider. Case in point: many investors envisioned an inevitable recession and a Fed pause (or even pivot!) in 2023. However, few considered growth and inflation could accelerate, keeping central banks in an inflation battle. January's FOMC meeting minutes betray similar blind spots among policymakers. Most saw evidence of slowing growth in 2023, with "several participants" noting that "real private domestic final purchases (PDFP) had nearly stalled in the fourth quarter." With demand weakening, policymakers expected the unemployment rate to rise, and, as a result, inflation to subside. Policymakers are further blinded by wanting their policies to work ("Look, all our efforts have the desired effect!"). It's still early in the year, but data so far in Q1 shows a sharp rebound in consumer spending, a near-record low unemployment rate, and an acceleration in inflation (core PCE jumped 0.6% in January!). So, take off the blinders and consider other possible scenarios.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: The rates tailwind that helped boost high yield performance in January has mostly unwound in February as the market repriced to a higher for longer rates regime. Higher rates accounted for all of the high yield market's -1.6% return so far in February. Meanwhile, leveraged loans, a floating rate asset class, are up +0.6% on the month.

Corporates: Corporate spreads have steadily leaked wider over the last two weeks, as investors analyze earnings data and rate volatility picks up, with markets starting to price back in a higher terminal fed funds rate. The Bloomberg Issuance has remained elevated, with this month's new supply being the largest February on record, and still a few more days for potential issuance left to go.

Securitized Products: U.S. CLO primary issuance year to date was around $19 billion compared to over $30 billion over the same period last year. On the secondary front, CLO spreads tightened across the capital stack year to date. Firmwide, our demand has been mostly focused on the front end of the curve and the top part of the capital structure.

Municipals: Lipper reported the second combined weekly and monthly outflows in the past six weeks equal to -$1.7 billion for the period ending February 22nd, turning positive inflow numbers for the year into $1.1 billion of outflows.

Equities: U.S. equities ended lower for the third consecutive week as economic data pushed interest rates higher, which weighed on market sentiment. All sectors ended the week lower, with the consumer discretionary, communication, and real estate sectors being the worst performers, while the energy, material, and consumer staple sectors were the best performers.