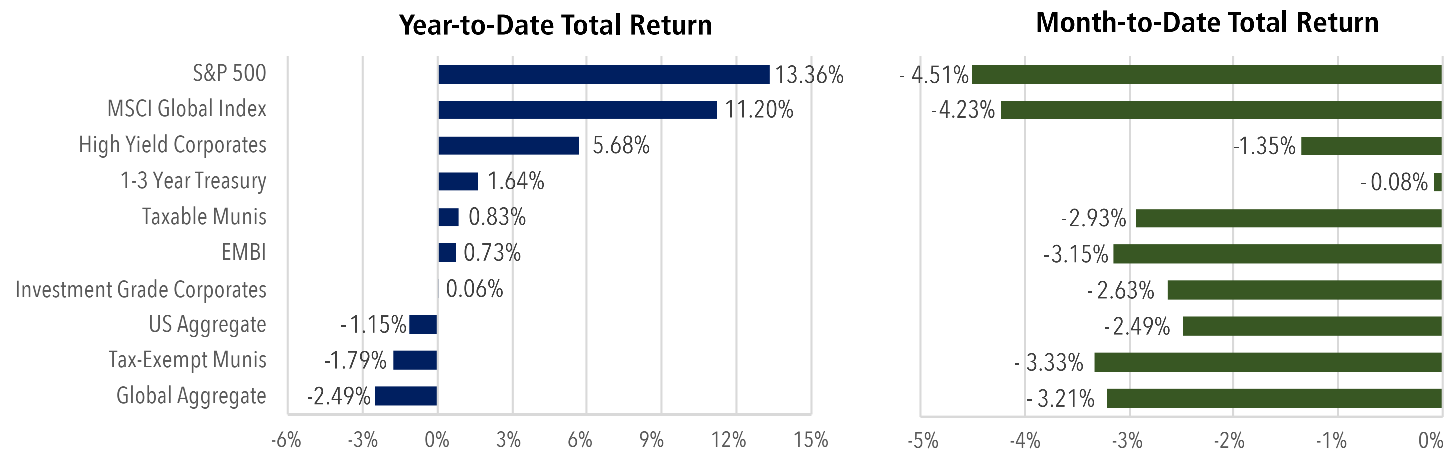
Week Ending: **September 29, 2023**

Been There, Done That

Economic Overview:

It's that time again for a U.S. Federal Government shutdown. From a macro perspective, the most significant impact could be the delay of government data reports. Beyond that, there are a few items worth considering. First, government shutdowns have been frequent over the past four decades (we tallied 21 since 1976). Second, most shutdowns are short-lived, with an average of just nine days and a median of five. The 2019 shutdown lingered on. Third, a Federal Government shutdown is not an economic shutdown a la Covid; instead, the Federal Government spending is ~6.5% of GDP for an entire year, so even less on a quarterly, monthly, weekly, or hourly basis (depending on how long the shutdown extends). Finally, markets have been mainly unaffected by shutdowns beyond daily volatility. Those expecting government bond rallies due to Washingtonian strife may be disappointed: 10-year yields rallied after the 2019 shutdown more due to the Fed's pivot and Covid than anything fiscal-related. As for equities? History is unequivocal: buy the dip.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: High-yield bond yields are once again approaching 9%, a level not seen since November of 2020, as rising interest rates and backup in spreads have pushed prices lower. Given the historically high correlation between yields and long-term returns within the asset class, 9% could be an interesting entry point, particularly for investors hungry for income.

Corporates: Amidst a volatile week for interest rates, there was still $19 billion in new issue supply. September issuance is capped off at $126 billion, in line with dealer expectations for the month but under the four-year September average of $138 billion. Corporate spreads widened four basis points to an option-adjusted spread of 120, partly due to the $3.3 billion in outflows for investment-grade funds, which marks the second-largest outflow week this year.

Municipals: The yield on the 10-year benchmark AAA-rated municipal bond rose to 3.4669%, within just .0073 basis points of its record high of 3.472% in January 2011. The higher yield highlights the relative value for high-income individuals as municipals underperformed taxable alternatives this week.

Equities: The U.S. equity market ended the week unchanged despite posting gains in four of the five trading days. Market volatility increased over the period as higher rates weighed on investor sentiment. Energy, communications, and materials were the best-performing sectors, while utilities, consumer staples, and real estate were the worst-performing.

Securitized Products: Just as the commercial mortgage-backed securities new issue market began to show signs of resuscitation post-Federal Reserve rate hike pause, the 10-year Treasury yield rose to multi-year highs due to inflation and deficit-driven Treasury supply concerns. The volatility escalation has dampened the commercial real estate outlook for the remainder of the year as concerns around property valuations loom. People often say that misery loves company, but as investors, we believe that dislocation brings opportunity. AAA-rated single asset single borrower (SASB) and commercial real estate collateralized loans(CRE CLO) are credit risk remote and may offer attractive relative value with yields at 7%+.

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