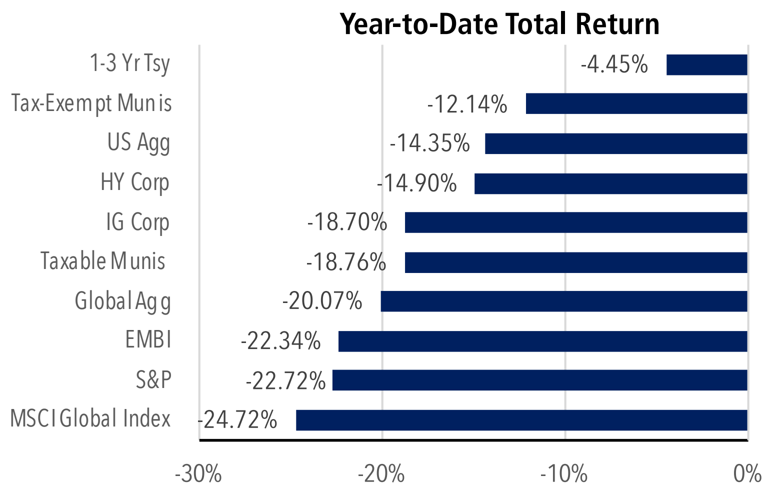
Week Ending: **September 30, 2022**

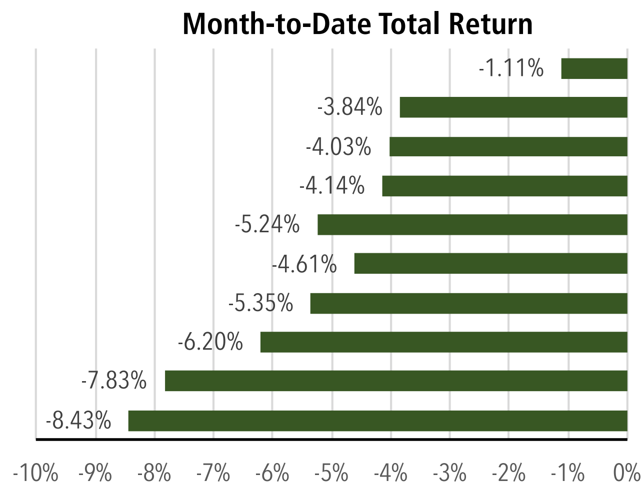
Gilt-y Despite A Sterling Reputation

Economic Overview:

Ten-year U.K. gilt yields surged more than 40 basis points on Tuesday—the biggest daily move in yields on record. Some analysts blame inflation, as the U.K. clocked one of the fastest inflation rates among peers. Other commentators flagged fears of fiscal profligacy due to the new government's plans as a reason for the rout. But, in our view, it's a mistake to attribute violent market moves to investor clairvoyance. Instead, financial system dynamics are likely to blame, at least for the size of the moves. In a prescient 2017 speech, Hyun Song Shin, Head of Research at the BIS, warned that central bank policies had forced European pension and insurance funds to hold more "duration" (longer maturity securities) as rates fell to hedge interest rate risk, not to reflect macro views. Under Shin's theory, a move higher in rates could spark the opposite effect, with yields spiraling up. Shin's advice: "If you have ever caught yourself saying that 'the market expects this or that,' you have committed the same mistake." Moreover, the Bank of England's ballyhooed bond-buying is not to stimulate an overstimulated economy but to serve as the "dealer of last resort" and restore market functioning.

Total Returns by Asset Class





Source: Bloomberg

Highlights of the Week:

High Yield: Since 2009, the correlation between the high yield index yield and subsequent 5-year returns is 0.96. If history continues to hold, long-term high yield investors should be well positioned as the index yield approaches 9.4%.

Corporates: The volatility in global markets continues to pressure investment grade corporate spreads, as they have reached year-to-date highs this week with the Bloomberg US Corporate Index OAS widening to 164 basis points. According to Lipper, in the week ended September 28th, investment grade bond funds experienced $10.3 billion in outflows, the 3rd largest outflow ever, only behind the latter weeks of March 2020.

Securitized Products: House prices are finally seeing the lagged effect of the Fed's increase in rates as the broad national average of home prices started declining on a monthly basis. Both the FHFA and the Case-Shiller indices of average US home prices declined this month. And with mortgage rates near 7%, this deceleration will likely continue until the supply and demand balance in the housing market normalizes.

Municipals: Lipper Refinitiv reported another $3.6 billion of outflows from municipal bond funds for the week ending September 28th. This marks 8 consecutive weeks of outflows, bringing the year-to-date total to a record $91.5 billion.

Equities: The equity market was down for the third consecutive week, ending the week near year-to-date lows. Market volatility remained elevated as investors continued to be sensitive to macro headlines. Defensive sectors utilities, real estate, and consumer staples provided little protection after ending the week as the worst performers, while energy, materials, and health care managed to post positive returns.