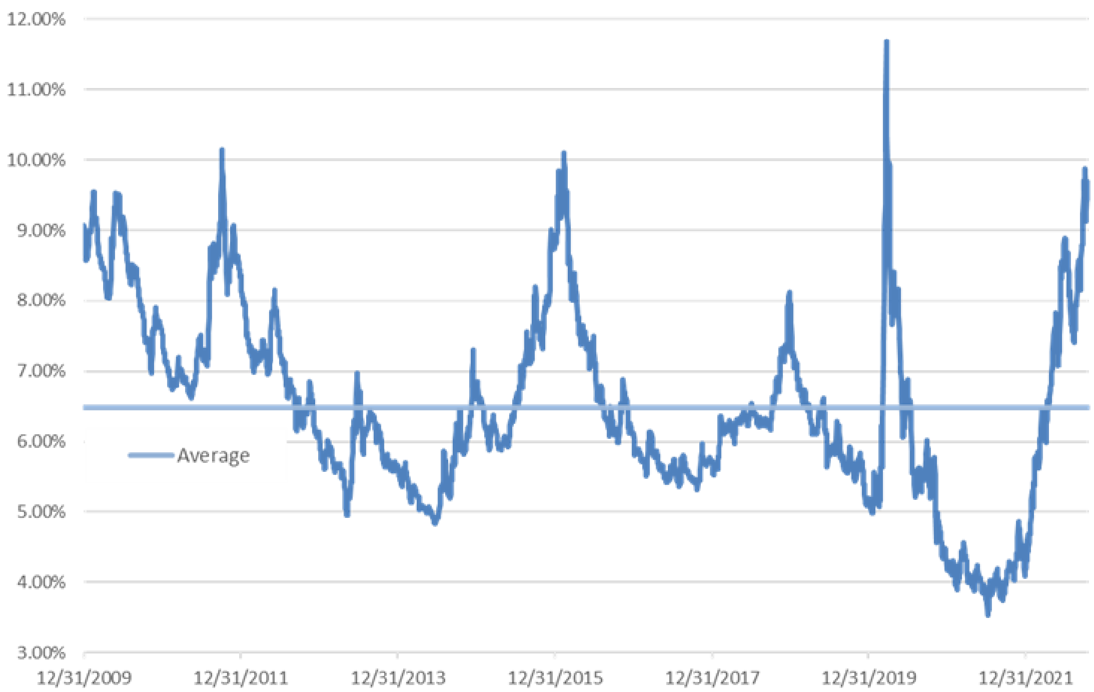
MARKET COMMENTARY

Fig. 1: Bloomberg US Corporate High Yield Bond Index: Yield to Worst



Sources: Bloomberg, Mill Creek.

The accelerated pace of Federal Reserve interest rate hikes has caused the level and shape of the Treasury yield curve to change significantly in 2022. Rates have moved higher by +200 to +400 basis points and the curve has become deeply inverted. The 10-year –2-year Treasury spread is now -42 basis points, the most negative since 2000. While disheartening from a total return perspective, higher absolute rates and the Treasury inversion/general flattening of credit curves creates unique opportunities for bond investors. For example, we've highlighted in past commentaries that higher rates on short-dated bonds allow investors to earn 4% to 6% on investment grade debt maturing in under two years.

To take advantage of these dynamics across our broader fixed income program, last week our Investment Committee approved the addition of a credit barbell to MCCA's taxable fixed income model portfolios when appropriate for clients based on their specific circumstances. The tactical trade, implemented by pairing an actively managed high yield bond fund (currently 10.6% YTW and 3.2 duration) with a 7-10 year Treasury ETF, aims to lock in a positive carry advantage versus the Barclays Aggregate Index while maintaining a defensive posture as the likelihood for a 2023 recession increases. If rates stay range bound from here or drift higher, we expect the credit barbell will outperform on a relative basis as its higher starting yield helps buffer against price declines. At the same time, a 'hard landing' scenario or an unforeseen event that sparks greater demand for safe-haven assets will likely result in attractive returns from the Treasury allocation. In this scenario, we'd have the option to harvest gains from the Treasury ETF and redeploy them into other areas of the bond market, including potentially upsizing our high yield position, to take advantage of the price dislocation. Either way, we believe the credit barbell positions us well for additional Fed rate hikes while providing flexibility to shift exposures should market dynamics change.

QUICK LINKS

- Preparing for a Recession with Low Volatility Equities
- The Faintest Glow at the End of the Tunnel
- Q4 2022 Outlook
- A Lehman Moment in Europe?

This week's contributor: *Nora Pickens, CAIA*