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June 2023

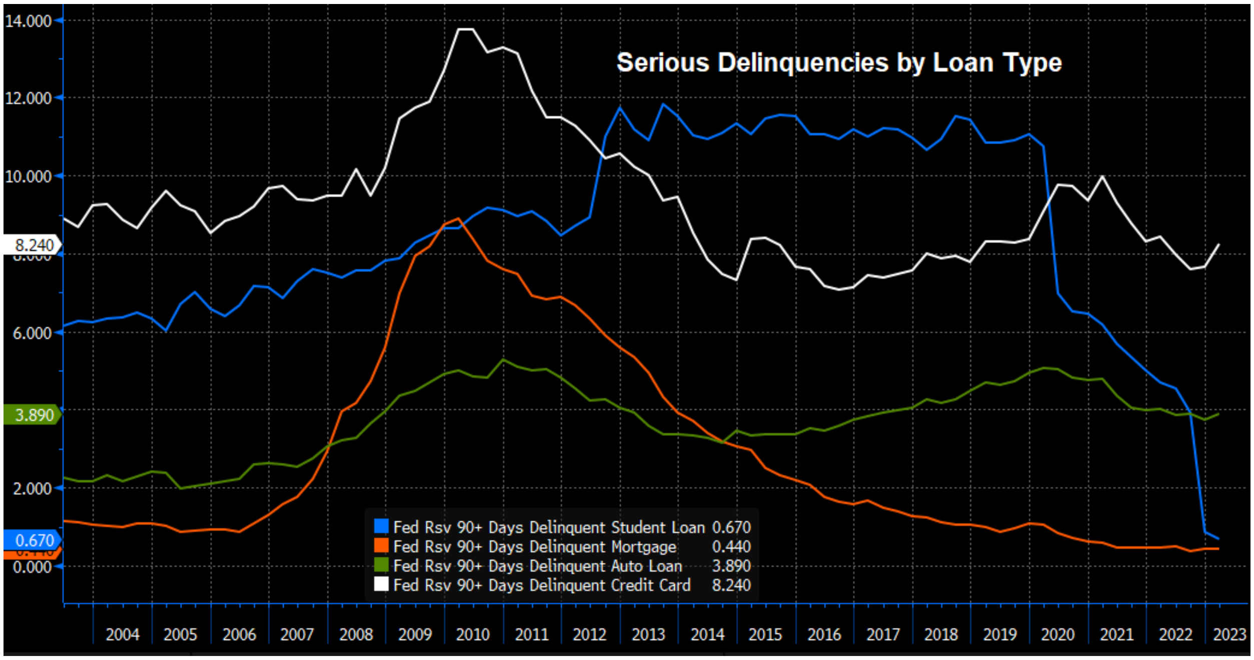
The resolution of the debt ceiling issue this month successfully removed one risk from the equation, but our overall outlook remains largely unchanged. We continue to observe worrisome trends in key factors we have previously discussed, such as bank credit tightening and leading indicators, which do not bode well for a soft landing of the economy. The repercussions of the most aggressive tightening cycle since 1980 are bound to catch up with the economy eventually.

Looking ahead, we anticipate a continued downward trend in year-over-year inflation until June, benefiting from the diminishing effects of the spike observed in June 2022. Lagging indicators like CPI and PCE have fallen behind more real-time measures like Truflation. On the geopolitical front, our Geopolitical Intelligence Group does not foresee an immediate escalation in the conflicts in Ukraine or Taiwan. However, it is crucial to acknowledge that an unexpected turn of events could add further challenges to inflation dynamics.

While the overall notional amount may not be a major factor in the broader picture, we are closely monitoring the impact of resuming student loan payments on consumer sentiment, delinquencies, and spending. This could act as a catalyst for a softer consumer outlook. Admittedly, the consumer remains solid due to the overall strength of the labor market, though the mixed report on Friday has us watching for signs of divergence.

Recent headlines indicating a potential increase in capital requirements for banks raise concerns about the implications for lending activities, particularly in the context of mortgage lending. When assessing the residential real estate market, we do not foresee a significant breakdown in this sector. While there is reduced demand driven by affordability concerns, the market continues to be sustained by persistent supply shortages, which have both market-based and structural underpinnings. However, it is worth noting that the commercial mortgage market may be more susceptible to vulnerabilities. It is important to emphasize that this market represents only half the size of the residential market, thus reducing the likelihood of a crisis resembling the one witnessed in 2008.

Overall, we maintain the belief that the economy is facing multiple headwinds, and we remain vigilant in monitoring various indicators that could signal an economic slowdown. Regardless, the likelihood of easing in 2023 has diminished unless there is significant damage, such as a notable deterioration in the banking system.



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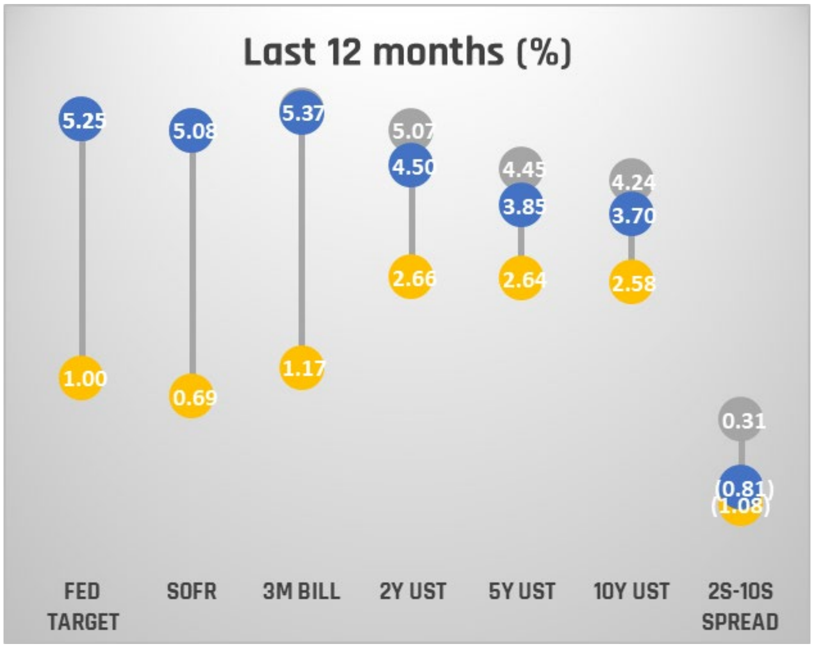
Product Views

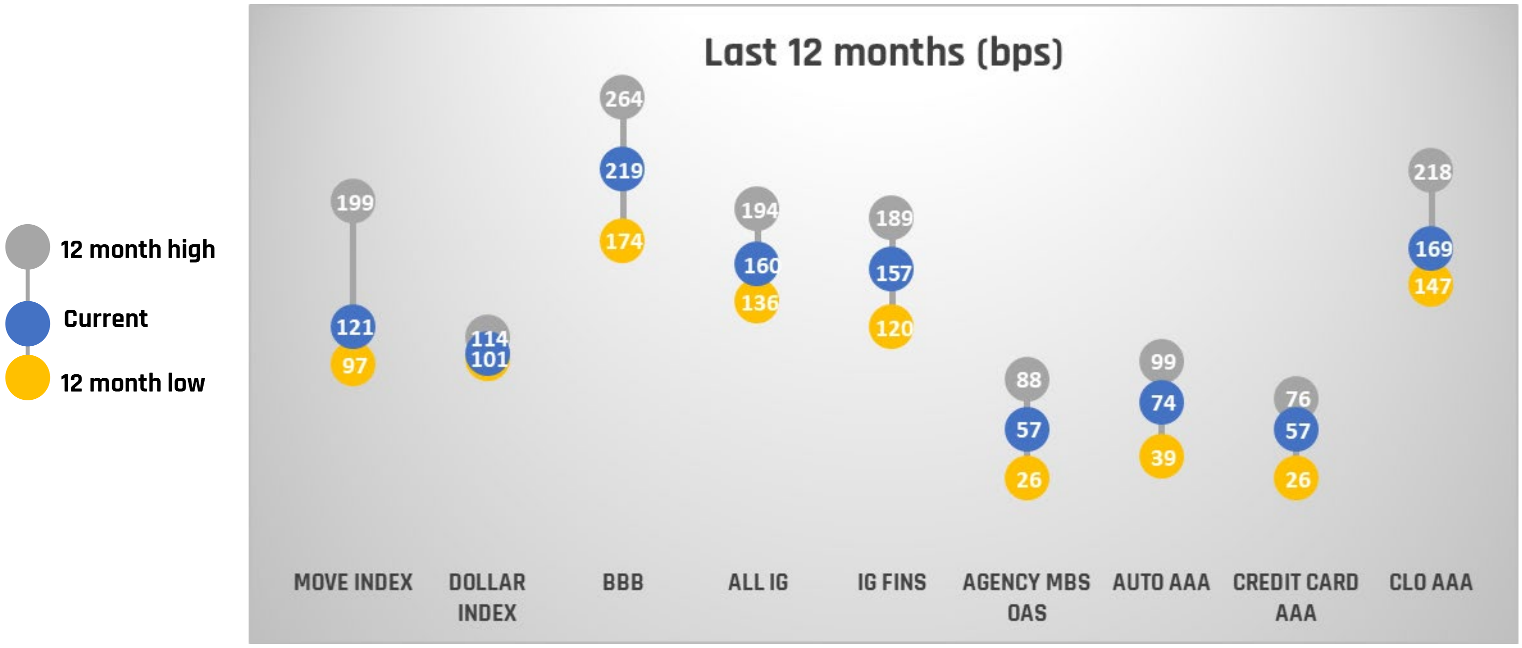
Rates- Following the resolution of the debt ceiling, anticipated Treasury supply has had an impact on pricing, leading to relative cheapness compared to market expectations for Fed Funds. It is worth noting that the market anticipates potential easing later this year, a scenario we believe is a lower probability. This expectation serves as an offsetting factor. Consequently, we maintain a neutral stance on rates.

Credit- The narrowing of credit spreads reflects a reduction in concerns surrounding banks, contributing to improved market conditions. While we maintain a positive outlook for corporations overall and believe that the risk of defaults remains contained, we emphasize a preference for higher-quality assets and sectors that demonstrate resilience in the face of an economic downturn. When assessing financials, a careful and discerning approach is advisable, recognizing that not all firms within this sector possess equal strength.

Securitized- We maintain a favorable view on mortgage-backed securities (MBS), considering them appealing when compared to other asset classes. MBS exhibits attractive value in terms of both nominal spreads and option-adjusted spreads (OAS).

Municipals- Taxable municipals look modestly cheap to corporates, especially when comparing the historical spreads and default rates of these two sectors.





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Investments in bonds and other debt securities will change in value based on changes in interest rates. If rates rise, the value of these investments generally drops. Some investors may be subject to the Federal Alternative Minimum Tax and to certain state and local taxes.

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