THE MERGANSER FLASH

FIXED INCOME INSIGHTS

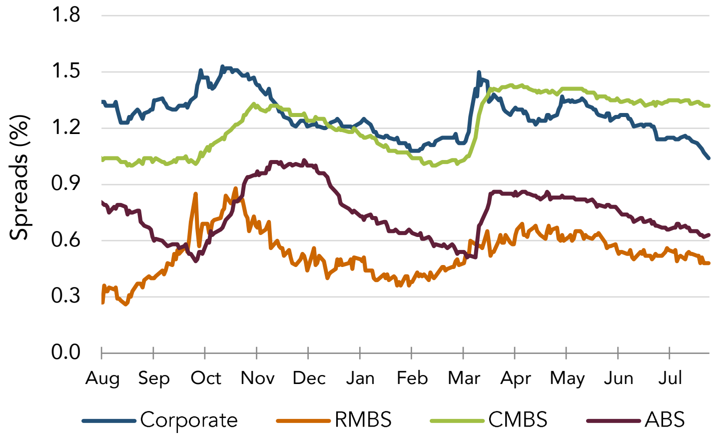
As of July 31, 2023

MERGANSER
CAPITAL MANAGEMENT

MARKET COMMENTARY

- As anticipated, the Fed hiked its target rate by 25 basis points (bps) at the July meeting. Market reaction to the announcement was muted but participants continue to focus on messaging from Fed Chair Powell regarding where the Fed will go from here. Late in the month, longer tenor US Treasury (UST) yields increased. The 10 year and 30 year UST yields ended the month 12 bps and 15 bps higher, respectively.
- In investment grade spread sectors, risk-on sentiment continued, with most sectors outperforming USTs. Among corporate credit, utilities posted the strongest excess returns, followed by financials, and industrials. The notable laggard was the communications subsector, where headlines emerged regarding lead cables used by telecom companies and their impact on surrounding soil, waterways, and populations. Market participants wrestled to quantify the ultimate cost to the affected companies, which is likely to take years to determine. Among financials, spreads for office REITs found their footing and several regional banks returned to the new issue market, reflecting improving confidence in the banking sector.
- The structured sectors all posted positive excess returns, led by Agency RMBS. Lower interest rate volatility provided a tailwind to the thirty-year mortgage basis and spreads tightened, particularly those of lower coupons. Fifteen-year paper outperformed due to a dearth of issuance and strong demand for short duration assets.
- ABS spreads were modestly tighter as market participants continued to exhibit strong demand for the sector, particularly in the new issue market. ABS collateral performance remains bifurcated, with delinquencies for subprime borrowers increasing at a significantly faster pace than prime.
- Non-Agency CMBS spreads tightened as the soft-landing narrative gained traction. Though down vs. last year, new issuance resumed in July, providing liquidity and transparency to the market. Strong labor data and the notion of a peak in interest rates were both supportive of commercial real estate valuations. Agency CMBS spreads widened from very tight levels and the subsector underperformed USTs.

SPREADS TO TREASURIES



Source: Bloomberg

TREASURY YIELD CHANGES

	YTM	Change From Previous Month
3 Month	5.40%	+0.12%
1 Year	5.38%	-0.01%
2 Year	4.88%	-0.02%
3 Year	4.53%	-0.01%
5 Year	4.18%	+0.02%
10 Year	3.96%	+0.12%
30 Year	4.01%	+0.15%

Source: Bloomberg

BLOOMBERG SECTOR PERFORMANCE

	Total Return MTD	Excess Return* MTD	YTM
Corporates	0.34%	0.90%	5.46%
Financials	0.72%	0.94%	5.67%
Industrials	0.15%	0.84%	5.33%
Utilities	0.26%	1.12%	5.46%
RMBS	-0.07%	0.28%	4.85%
CMBS	0.22%	0.21%	5.74%
ABS	0.42%	0.23%	5.49%
Agencies	0.18%	0.06%	4.96%

*Month-to-date performance of spread bearing bonds versus duration-matched Treasuries