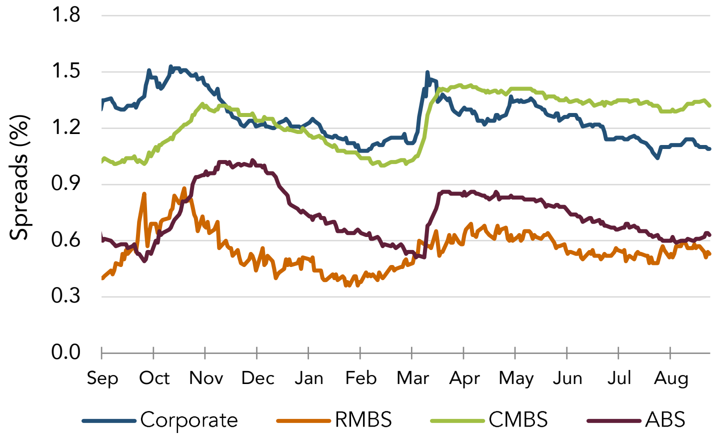
THE MERGANSER FLASH
FIXED INCOME INSIGHTS
As of August 31, 2023

MERGANSER
CAPITAL MANAGEMENT

MARKET COMMENTARY

- On August 1st, Fitch downgraded the US Government to AA+ from AAA. The argument for the downgrade included the probable future deterioration of finances and weaker governance stemming from political gridlock that has continually threatened default. The market reaction was sanguine, especially relative to the chaos that ensued after S&P downgraded the US Government to AA+ in August of 2011.
- Economic data, including historically low unemployment, strong retail sales and resilient housing activity, all point to continued economic growth in the third quarter. Inflation, while modestly declining, is still running above the Fed's 2% target. Later in the month, weaker than expected jobs data fueled speculation that the Fed will keep rates steady at its September meeting.
- In investment grade spread sectors, market sentiment was risk-off, with most sectors underperforming USTs. Among corporate credit, industrials, utilities, and financials all underperformed. In early August, Moody's downgraded a swath of banks, citing funding risks, weaker profitability, and declining asset quality. Later in the month, S&P followed suit by downgrading five banks by one notch.
- ABS was the best performing structured sector, posting modest excess returns. Entering the month, spreads in high quality ABS remained attractive relative to other sectors. There was significant primary market issuance during the first two weeks of August and most deals were oversubscribed, a reflection of strong investor demand for a sector that's demonstrated lower spread volatility in recent months.
- CMBS also produced modest excess returns. Continued economic strength combined with the "higher for longer" interest rate outlook paints a mixed picture for commercial real estate valuations. Larger loans have proven more difficult to refinance in this environment.
- Agency RMBS spreads, primarily those of new production, widened in response to increasing interest rates and rate volatility. The absence of demand from banks in the 30-year mortgage sector also contributed to the weakness. The 30-year basis has widened to a level not seen since March 2020.

SPREADS TO TREASURIES



Source: Bloomberg

TREASURY YIELD CHANGES

	YTM	Change From Previous Month
3 Month	5.44%	+0.04%
1 Year	5.38%	+0.01%
2 Year	4.86%	-0.01%
3 Year	4.55%	+0.03%
5 Year	4.25%	+0.08%
10 Year	4.11%	+0.15%
30 Year	4.21%	+0.20%

Source: Bloomberg

BLOOMBERG SECTOR PERFORMANCE

	Total Return MTD	Excess Return* MTD	YTM
Corporates	-0.78%	-0.08%	5.61%
Financials	-0.48%	-0.17%	5.82%
Industrials	-0.89%	-0.03%	5.49%
Utilities	-1.17%	-0.10%	5.64%
RMBS	-0.82%	-0.33%	5.02%
CMBS	-0.05%	0.02%	5.81%
ABS	0.26%	0.05%	5.50%
Agencies	0.17%	0.06%	4.97%

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