CROSSMARK GLOBAL INVESTMENTS

QUARTERLY UPDATE: 2Q 2022
TAXABLE FIXED INCOME COMMENTARY

(Core Fixed Income, Corporate Fixed Income, Current Income Portfolio, Intermediate Fixed Income and Income Opportunities)
Separately Managed Accounts

written by
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Markets and Performance

At the beginning of the year, Crossmark spoke about the expectation for a very volatile 2022. The second quarter lived up to that prediction, with both equity and fixed income markets experiencing historic swings as inflation surprised to the upside, economic reports began to moderate, growth slowed, and central banks around the globe began hiking rates and reducing bond purchase programs. We saw 10-year Treasury yields hit their highest levels of 2022 at 3.50%, then fall below 3.00% by quarter-end as growth concerns hovered over the markets. The inflation versus growth headlines will continue to dominate until the Federal Reserve raises rates to a point where markets believe financial conditions have tightened enough to slow the economy and calm inflation fears; the hope is we have a slowdown and not a recession. In this environment, all but one of the Crossmark taxable fixed income model portfolios outperformed their respective benchmarks during the second quarter.

Positive and Negative Contributors to Performance

With a slowing economy, inflation fears still high, and consumers still supporting demand, Crossmark maintained its more conservative positioning in the taxable fixed income strategies with a shorter duration. However, following the peak in yields earlier in the quarter, we have begun moving duration closer to neutral. Reducing our exposure to the changes in interest rates allows us to mitigate some of the volatility in the markets. The duration positioning was the largest contributor to the outperformance of our taxable model portfolios, followed by the income effect and the yield curve placement of our holdings. The main negative contributor to performance came from the allocation effect, primarily due to our under-allocation to U.S. Treasury notes as yields came down from the 3.50% level. For the Current Income Portfolio (CIP) Strategy, the combination of poor performance by one of our tech holdings (Oracle), and the preferred allocation, led this model portfolio to underperform its benchmark index by 64 basis points last quarter. Even though there was volatility in the preferred sector, the income component was the most significant positive contributor to performance for the quarter in the CIP model portfolio.

Looking Ahead

The markets eagerly await subsequent inflation reports and central bank meetings. These should determine sentiment and momentum going forward. We anticipate yields may move higher from the approximately 3.0% level currently reflected in the 10-year Treasury but may become range-bound between 3.00% and 3.25%, with the 3.50% peak from earlier this quarter serving as a strong resistance level. If inflation expectations begin to recede over the coming months, we could see the Federal Reserve soften their hiking plans, allowing fixed-income yields to moderate. In anticipation of such a move later this year, we plan to continue moving our duration closer to neutral (although still shorter than the Index) to be well-positioned for that environment. Quality is key, and we will continue to favor investment-grade securities with solid balance sheets that can better withstand volatile markets. In addition, our 4-step investment process focused on duration, yield curve placement, sector, and security selection remains in place. This should allow us to be prepared for a shift in the market environment as we move into the second half of the year.

Our Firm

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The strategy's values-based screening policies which exclude certain securities issuers from the universe of otherwise available investments. As a result, the strategy may not achieve the same level of performance as it otherwise would have in the absence of the screening process. If the strategy has invested in a company that is later discovered to be in violation of one or more screening criteria and liquidation of an investment in that company is required, selling the securities at issue could result in a loss to the strategy. Further, the strategy's values-based screening policies may prevent the strategy from participating in an otherwise suitable investment opportunity.

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