CROSSMARK
GLOBAL INVESTMENTS

QUARTERLY UPDATE: 4Q 2021
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

Over the last two quarters, we believed that growth and increased inflation expectations would push the longer end of the yield curve higher, matching or slightly surpassing the high of the year back on March 31 when the U.S. 10-year Treasury yield closed at 1.74%. We neared that level in October with a close of around 1.70%, but otherwise, it has been mostly a downward trend for yields further out the Treasury curve from the March level. Although no one explanation is provided, a combination of new COVID variants, concern over global growth, negative global sovereign yields, and periods of short covering on Treasury notes all added to the push longer-term yields lower. With the change in expectation that the Federal Reserve would end tapering sooner than expected, and rate hikes might begin as soon as the first quarter of 2022, shorter-term yields pushed higher. This resulted in a much flatter curve than investors anticipated for this part of the market cycle. For the year 2021, although sprinkled with volatility, the 10-year Treasury yield moved from 0.91% on January 4 to 1.51% on December 31. With this backdrop, all but one of the taxable fixed income model portfolios continued to outperform their respective indexes year-to-date, with mixed performance across the model portfolios for the quarter due to yield volatility.

Positive and Negative Contributors to Performance

In December, we saw 10-year Treasury yields move higher by 11 basis points. This favored our more conservative approach of a shorter duration positioning within the strategies. The two most consistent positive contributors to performance for all taxable fixed income model portfolios were the effects of duration and income. As yields moved higher late in the quarter, the overall shorter duration positioning worked as a positive contributor to model performance compared to the Index. Just as we witnessed in previous quarters this year, the Treasury allocation for our strategies had a much shorter duration than the Treasury allocation of the indexes. This was the most significant positive contributor to performance. Our overweight to the corporate allocation and the addition of fixed-rate preferreds in some strategies provided a higher level of income generation to the model portfolios compared to the indexes. The income component of total return was one of the most prominent positive contributors for the model portfolios. The negative contributor most consistent across the taxable model portfolios was the yield curve effect. With the Federal Reserve (and other central banks around the world) laying out plans to quicken tapering and raise rates in 2022, the short end of the curve rose dramatically while the longer end of the curve remained more stagnant. This flattening of the yield curve driven by the shorter maturities was a drag on performance for many model portfolios, especially the Corporate Fixed Income model portfolio – the only strategy to lag its benchmark in 2021.

Looking Ahead

As described in our CIO, Bob Doll's Annual 10 Predictions, we anticipate that yields will continue to trend higher to start 2022. In our opinion, the long end of the curve has been mispriced for some time. With volatility predicted to dominate the next few quarters, we need to focus on quality and interest-rate sensitivity for our taxable strategies. Therefore, a shorter duration and investment-grade focus remain appropriate for the near term. As yields approach the 2.0% level (which is getting near the Federal Reserve's terminal rate), our duration positioning will shift to neutral versus the benchmarks.

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