CLINTON
INVESTMENT MANAGEMENT

CIM Q2 Market Brief

June 2023

Given recent events, we thought it would be helpful to provide a brief update regarding current economic and market conditions and offer insight regarding rising risks and opportunities given the outlook for the rest of the year.

- The US debt ceiling crisis is now be behind us with Biden's signature on the Fiscal Responsibility Act.
- The US fixed income markets have responded positively, 10-year Treasury Bond yield rallied over 20 basis points this past week.
- The Fiscal Responsibility Act reduces nondefense discretionary spending by over $50 billion over the next year, which will have a negative impact on GDP growth of -0.3% adding yet another barrier to GDP growth going forward, according to Barclays research.
- We expect financial markets to return their focus to fundamentals over time. We anticipate risk assets to better reflect slowing growth and rising unemployment, illustrated in the most recent household survey showing an increase in May unemployment to 3.7% from 3.5% in April.
- The St Louis Fed Nowcast GDP estimate indicates an expected contraction GDP of -0.34% for Q2 2023.

Risks

- Reinvestment rate risk is the largest risk facing individual investors, in our view. The temporary nature of high short-term yields are tempting investors to hold too much cash, risking the ability to lock-in higher interest rates for the long-term, before interest rates fall further.
- Short-term municipal bonds continue to underperform consistent with our expectations as yields have risen meaningfully, +0.45% to 0.50%, in 2 years, illustrating the risk to investors overweight short-intermediate high quality municipal bonds.
- Public equity market valuations have gravitated upwards even as corporate earnings continue to fall.
- Chapter 11 bankruptcies are rising in 2023, which is shaping up to be the biggest increase in filings in more than a decade, according to the New York Times.
- The credit outlook for the state of California has been downgraded to Negative by Moodys.

- High-net-worth investors in California can buy bonds that are not exempt from state tax, yet still pick up yield, after-tax, given extremely low yields of bonds exempt from CA state taxes.
- Investors should carefully consider issuer credit quality, even for large established issuers, like the State of CA, as the economy continues to slow.
- Active, ongoing, portfolio oversight and credit research should provide confidence to investors seeking to navigate the next leg of the business cycle.

Opportunity

- Fixed income has historically performed well in decelerating growth, inflation, and declining corporate earnings environments.
- The absolute level of longer-term municipal bond yields are largely unchanged from the start of the year. This presents an opportunity for investors, who share our view that rates are likely headed lower over the remainder of the year, as they can now lock-in equity-like returns from the tax-free cash flow offered by longer-intermediate and long-term bonds.
- Stable A and BBB rated municipal issuers offer substantial value in our view on a risk-adjusted basis. This is traditionally an area where most investors are substantially underweighted.
- Investors, able to extend duration, earn the added benefit of higher total returns over time should interest rates continue to fall.

If we can offer any further perspective regarding the insights shared above, please let us know.

Best Regards,

Andrew

Important Disclosure Information

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