Federated Hermes

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Municipal yields declined in the fourth quarter, with demand dramatically outpacing supply amidst an improving inflationary backdrop. The ten-year AAA MMD yield began the fourth quarter at 3.30% and finished at 2.63%, after topping out at 3.41% in late October. Municipals outperformed their taxable counterparts as ten-year Treasuries began the quarter at 3.64% and finished at 3.88%, after peaking at 4.24% on October 24.

Ten-year prime municipal/Treasury ratios started in the fourth quarter at 88% and fell to 68% at quarter end, driven by the aforementioned supply/demand imbalance. Two-year MMD yields began the quarter at a very attractive yield of 3.09% but declined to 2.60% at the end of the quarter. Ratios closed the year at 59%, after starting the quarter at 74%.

The municipal yield curve bull flattened in the fourth quarter. Two-year municipal yields fell 49 basis points, while ten-year yields fell by 67 basis points. Conversely, the Treasury curve bear flattened with two-year Treasuries rising by 30 basis points, while ten-year yields rose 24 basis points respectively.

Open end municipal mutual funds, apart from a couple of weeks, continued their massive outflow cycle in the fourth quarter. Lipper weekly and monthly reporting indicating outflow of 30.1 billion in the fourth quarter, bringing year-to-date outflow to a record of 121.6 billion. Yet municipal ETFs continued to see sizable inflows. A key driver of this divergence is likely tax loss harvesting as investors avoid the wash sale rule by booking the loss in open end funds and maintain market exposure in a different but similar product, in this case ETF's.

New issue supply for Q4 was just $70.67 billion with 10% being taxable. Although rates slipped in the interim, higher absolute yields combined with market uncertainty kept a lid on supply as 2022 issuance totaled $384.08 billion, which was only 79% of the preceding year. Even with the constrained primary market, the secondary continued its heavy selling volume averaging $1.7 billion daily.

Federated Hermes CW Henderson remained active buyers in the ten-year portion of the yield curve and clients benefitted as the market rallied in November and December. We also continued to be active sellers of poorly structured inherited positions and continued to generate significant alpha through tax harvesting transactions.

With the close of its December 14 meeting, the Federal Reserve raised interest rates by 50 basis points to the 4.25% to 4.50% range. Officials gave a clearer sign that they expect higher rates to impact the economy. They cut their 2023 median growth forecasts to 0.50%, rising to 1.60% in 2024. The Fed increased their projection for unemployment next year to 4.60% from the current 3.70%. Fed officials see PCE inflation at 3.10% in 2023 up from last quarter's estimate of 2.80%. Policymakers projected rates would end 2023 at 5.10% (terminal), before being cut to 4.10% in 2024 and 3.10% in 2025. The Committee will continue to reduce its holdings of Treasury and Agency debt at the same $95 billion monthly pace as previous meetings.

Looking ahead, municipals seem poised to perform well in 2023. Credit quality of upper echelon credits are strong, and the product remains very much in favor with good market fundamentals. Demand should continue to be robust due to higher absolute yields and limited issuance early in the first quarter will contribute to more net negative supply seen much of 2022. Opportunity could present itself once the seasonal reinvestment cycle weakens February-April, especially if the primary market normalizes from its recent trend of below average origination.

Market Yields				
	12/31/2022	**9/30/2022**	**6/30/2022**	**3/31/2022**
1 year. AAA Muni	2.86	3.06	1.60	1.55
5 year. AAA Muni	2.52	3.12	2.22	1.97
10 year. AAA Muni	2.63	3.30	2.72	2.18
30 year. AAA Muni	3.58	3.90	3.18	2.53
10 year. U.S. Treasury	3.88	3.79	2.98	2.32
10 year. Muni/UST Ratio	68%	87%	91%	94%

Sources: Bloomberg and the Bond Buyer

Key Market Points & Commentary

- 4Q2022 supply was $70.67 billion.
- 4Q2022 mutual fund net outflows totaled $30.1B.
- In Q4, the municipal yield curve “bull flattened” with two-year yields falling by 49 basis points and ten-year yields falling by 67 basis points.
- As always, Federated Hermes CW Henderson’s focus remains on high quality, liquid, thoroughly researched credits with good management teams in place. Credits owned are monitored on a regular basis.
- Intermediate Product portfolio durations are targeted at about 4.00 years.
- Short Product portfolio durations are targeted at about 0.60 years.

DISCLOSURES

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Bond credit ratings measure the risk that a security will default. Credit ratings of A or better are considered to be high credit quality; credit ratings of BBB are good credit quality and the lowest category of investment grade; credit ratings of BB and below are lower-rated securities; and credit ratings of CCC or below have high default risk.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Duration is a measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

Alpha measures the excess returns of a portfolio relative to the return of a benchmark index.

For more information on the Federated Hermes CW Henderson SMAs, visit the Product section of FederatedInvestors.com.

Effective 9/30/22, CW Henderson & Associates, Inc. was acquired by Federated Hermes, Inc. and renamed Federated Hermes CW Henderson.

Federated Hermes CW Henderson, a division of Federated Investment Counseling

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