Third Quarter 2021 Bond Market Review and Outlook

Cincinnati Asset Management, Inc.
Investment Grade & High Yield Bond Specialists

"The overall inflation story is being driven by supply chain disruptions and a swift rise in prices due to the labor shortage" (source: *Wall Street Journal* 10/13/21)

September Summary of Economic Projections

	2021	2022	2023	2024	Longer Run
Real GDP	5.9%	3.8%	2.5%	2.0%	1.8%
June Projection:	7.0%	3.3%	2.4%		1.8%
Unemployment Rate	4.8%	3.8%	3.5%	3.5%	4.0%
June Projection:	4.5%	3.8%	3.5%		4.0%
Core PCE Inflation	3.7%	2.3%	2.2%	2.1%	
June Projection:	3.0%	2.1%	2.1%		
PCE Inflation	4.2%	2.2%	2.2%	2.1%	2.0%
June Projection:	3.4%	2.1%	2.2%		2.0%
Federal Funds Rate	0.1%	0.3%	1.0%	1.8%	2.5%
June Projection:	0.1%	0.1%	0.6%		2.5%

Source: Federal Reserve, CreditSights. September FOMC Meeting. Median values. Real GDP & Core PCE Deflator = 4Q/4Q YoY%.

Inflation concerns remain low at the end of the third quarter with the 10-year Treasury closing at 1.49%. This is just slightly higher than the 1.47% yield posted on 6/30/21. Looking out over the next few years, growth and inflation expectations in the above chart are tame. (source: *Bloomberg*).

The High-Yield Index year to date return was 4.53% with the third quarter contributing a 0.89% return. The "moderation" can be seen in spread widening to Treasuries. The High-Yield Index option adjusted spread increased 21 basis points to 298. The long-term average is 497 and the all time low was 233 set in mid 2007 (source: *Credit Sights*).

The Investment Grade Bond Index spread closed the quarter at 89 basis points, compared to the long term average of 133. Over the past 24 years the spread has ended the year tighter than the long term average 13 times, while ending tighter 4 times over the past 5 years (source: *Credit Sights* 10/6/21).

However demand for corporate bonds remains strong. Year to date through September Investment Grade Bond Funds posted net positive flows from investors of $153 billion for $2,763 billion of assets under management. For the same time period High-Yield Bond Funds posted net positive flows of $14 billion for $457 billion of assets under management. However for the week ended 10/13/ 21 High-Yield reversed course with outflows of $1.8 billion, the largest since June. Investment Grade Bond funds posted positive flows of $882 million following outflows of $2.5 billion the prior week (source; *Bloomberg* 10/14/21).

The chart on page three details the excess returns over the risk free rate and total returns across the spectrum of credit ratings and maturities for the year through September. Of note is the small losses in Investment Grade Corporates of less than ten years to maturity. Also, the resiliency of the High Yield Bond sector to the rise and outlook for rates illustrates the rationale for a bond portfolio diversified across the credit quality spectrum.

U.S. inflation continued to surprise to the upside in September with the CPI rising 0.4% from August and 5.4% from a year ago (source: *Bloomberg* 10/13/21). However, unusually high demand with spending soaring 11.9% in the second quarter is a signifi-

(Continued on page 3)

Yields* on 09/30/2021	**Yield***
CAM Broad Market (corporate core plus) Strategy (7.6 year maturity; 6.0 duration)	**2.54%**
CAM Investment Grade (100% corporate bonds) Strategy (7.6 year maturity; 6.5 duration)	**2.01%**
CAM High-Yield Strategy (only BA & B rated purchased) (7.7 year maturity; 4.8 duration)	**3.70%**
CAM Short Duration Strategy (4.2 year maturity; 3.1 duration; 50% IG & 50% HY)	**2.19%**
CAM Short Duration Investment Grade Strategy (3.7 year maturity; 3.3 duration)	**1.06%**
U.S. Treasury** (10 year maturity)	**1.49%**
U.S. Treasury** (5 year maturity)	**0.97%**
U.S. Treasury** (2 year maturity)	**0.28%**

* The lower of yield to maturity or yield to worst call date ** Source: Bloomberg Barclays

Contact us: Artie Awe, Mike Lynch, & Bill Sloneker are always available to assist.
Phone: (513) 554-8500 — Website: www.cambonds.com
Email: aawe@cambonds.com, mlynch@cambonds.com, & wsloneker@cambonds.com

CAM's Key Strategic Elements

- Bottom-up credit analysis determines value and risk.
- Primary objective is preservation of capital.
- Larger, more liquid issues preferred.
- Target is always intermediate maturity.
- No interest rate forecasting.
- All clients benefit from institutional trading platform and multi-firm competitive bids and offers.

CAM returns are after CAM's average management fee & all transaction costs but before any broker, custody or consulting fees. **The indices are unmanaged and do <u>not</u> take into account fees, expenses, and transaction costs.**	**Total Return (%)**	**Annualized Returns (%)**			
	3Q '21	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	0.23	3.03	6.93	4.36	4.61
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	1.10	8.44	7.49	5.74	5.15
Bloomberg Barclays US Corporate High Yield Index	0.88	11.27	6.91	6.52	7.42
CAM Investment Grade Strategy—Net 100% corporate bonds	-0.16	0.70	6.72	3.73	4.35
Bloomberg Barclays US Corporate Index	0.00	1.75	7.45	4.61	4.87
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	0.51	4.87	5.42	4.03	3.50
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	0.08	1.17	4.26	2.58	2.94

Relative Performance Review 09/30/2021

CAM's **Investment Grade Strategy** ("**IG**") produced a gross total return of -0.10% in the quarter ended September 30, 2021, compared to 0.00% for the Bloomberg Barclays U.S. Corporate Index. CAM always positions a majority of the portfolio within intermediate maturities. Longer dated securities (10+ years) returned -0.14% for the period, slightly underperforming the broader index. CAM's zero weighting in this duration bucket produced a +5 basis point contribution to excess return. The YTD return for the CAM IG strategy was -0.91% compared to the Index return of -1.27%. Similar to the quarter, longer dated securities underperformed the broader index. CAM's zero weighting produced a +50 basis point contribution to excess return, highlighting the benefit of a consistent allocation to intermediate maturities.

The **High Yield Strategy** ("**HY**") delivered a gross total return of 1.17% in Q3 while the Bloomberg Barclays High Yield Index returned 0.88%. CAM's security selection and overweight within the Airlines, Automotive, and Aerospace & Defense industries produced +15, +14 and +6 basis point contributions to excess return, respectively. The HY YTD return was 3.80% while the Bloomberg Barclays High Yield Index returned 4.53%. In this period, the allocation effect of CAM's structural avoidance of credit rated Caa and lower was a -53 basis point contribution to excess return.

Our **Broad Market Strategy ("BM")** – a 67%-33% blend of IG-HY bonds – produced a gross total return of 0.30% for the quarter ended September 30, 2021 compared to 0.29% for the Bloomberg Barclays blended Index. It is important to note that our BM strategy achieves its Baa average credit quality via a barbell strategy of higher and lower rated securities. On average through the second quarter 16.7% of the portfolio was positioned in Baa-rated credit subsectors, while the Index's exposure was 33.2%. The net effect of this structural allocation accounted for +4 basis points of outperformance versus the Index. The YTD return for the CAM Broad Market strategy was 0.54% compared to blended Index return 0.64%. For this period, our barbell strategy produced a +28 basis point contribution to excess return.

The CAM **Short Duration Strategy** ("**SD"**) blends equal weights of IG and HY short duration bonds with a target duration of 3 years. The strategy's gross total return in the quarter ended September 30, 2021 was 0.57% while the Index, a similar blend of the intermediate components of Bloomberg Barclays IG and HY corporates, returned 0.45%. CAM's positioning within the Airlines and Automotive industries had the largest positive impacts on performance relative to the index, with +11 and +4 basis point contributions to excess return, respectively. The YTD gross total return was 2.23% compared to the blended Index return of 2.26%. Notably, Caa credit dramatically outperformed during the period, and CAM's avoidance of these lower quality tiers produced a combined -37 basis point contribution to excess return during the period.

The **Short Duration Investment Grade Strategy ("SD-IG")** delivered a gross total return of 0.14% for Q3 while the Bloomberg Barclays U.S. Corporate 1-5 Index returned 0.11%. CAM's weighting and positioning within the Airline industry was the largest positive contributor to performance with a +2 basis point contributions to excess return. Over the YTD period, SD-IG outperformed the Index, by delivering 0.19% gross total return versus an Index return of 0.21%. Again, CAM's weighting and positioning within the Airline industry was the largest single positive contribution to performance, which generated a +19 basis point contribution to excess return.

Bloomberg Barclays Bond Indices Returns vs. CAM Gross (annualized %)

Periods ended 09/30/2021	10-yrs	20-yrs
U.S. Aggregate	**3.01**	**4.33**
U.S. Corporate	**4.87**	**5.56**
CAM Investment Grade Strategy	**4.60**	**5.40**

<u>Better Asset Allocation Might Result from More Exacting Analysis</u>

The chart to the right shows that BA rated bonds returned approximately 40% of S&P 500 stocks for the 5 and 10-year periods and modestly underperformed the returns of the S&P 500 over the last 20-years. Lower rated CAA bonds have approximated the S&P 500 for the 20-year period, while the lowest rated (CA & D) have produced negative returns for the 10-year and 20-year periods.

The chart also indicates that CAA rated securities outperformed B rated and BA rated bonds for all periods. However, not shown in the table is the pronounced volatility that has characterized the CAA subsector. For example, during 2008, when the High Yield Index was down 26%, CAA rated bonds were down 44%, and during 2009, the Index was up 58% while CAA bonds were up 91%. In each calendar year since 1997, CAA rated bonds ranked either best or worst in Credit Sights Annual Excess Return Rankings for US corporate credit tiers, a trend that was finally upset in 2019, although it returned in 2020 and 2021.

Finally, BA rated bonds have outperformed the Bloomberg Barclays US Aggregate Index for all periods shown. Even inclusive of the annualized double digit S&P 500 returns over the past 10-years, they modestly underperformed the S&P 500 for the 20-year period. Notably, they have done so with about half the volatility of that Index (Ibbotson), suggesting that better credit quality high yield bonds deserve consideration as a core holding in an investor's portfolio allocation.

Total Return of High-Yield Bonds by Credit Quality

(periods ended 09/30/2021) Source: Credit Suisse First Boston

(annualized %)

High-Yield Bond Sectors	5-years	10-years	20-years
BA-rated bonds	**6.21**	**6.97**	**7.85**
B-rated bonds	**5.89**	**6.78**	**7.59**
CAA-rated bonds	**9.22**	**8.98**	**8.99**
CA & D-rated bonds	**-2.17**	**-6.15**	**-1.63**

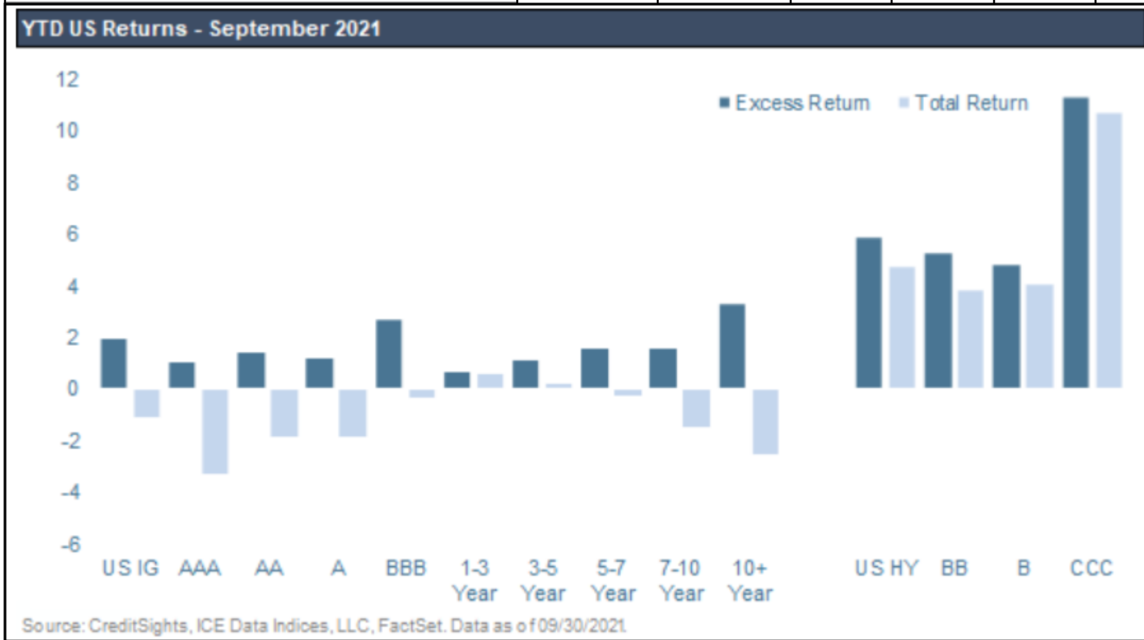
Performance of Other Asset Classes

(periods ended 09/30/2021) Source: Bloomberg Barclays & Lipper

S & P 500 Stocks	**16.89**	**16.63**	**9.47**
Bloomberg Barclays U.S. Aggregate	**2.94**	**3.01**	**4.33**

The September 30 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. The 10-year U.S. Treasury ended Q3 2021 at 1.49% compared to 1.47% at Q2, representing a 2 basis point increase over the quarter. There was some volatility along the way as the benchmark rate closed as low as 1.17% near the beginning of August with much of its move higher coming in the last week of September. As of 9/30/2021, absolute spreads for all credit subsectors tightened versus 12/31/2020.

Credit Rating	20-Year Average Spread	09/30/21	12/31/20	12/31/19	12/31/18	12/31/17	Tightest This Decade
A	1.22%	0.67%	0.73%	0.70%	1.18%	0.73%	0.69%
BAA	1.92%	1.04%	1.21%	1.20%	1.97%	1.24%	1.12%
BA	3.80%	2.03%	2.64%	1.82%	3.54%	2.11%	1.30%
B	5.26%	3.27%	3.79%	3.24%	5.31%	3.43%	2.28%
CAA	9.50%	5.65%	7.15%	9.20%	9.89%	6.15%	3.78%



(Continued from page 1)

cant factor driving price increases (source: *Wall Street Journal* 10/13/21).

A labor shortage is contributing to inflation through higher wages that are then passed through to consumers. The labor participation rate is at 61.6% in September versus the pre-pandemic level of 63.3% in February 2020. That translates to a loss of 4.3 million workers (source: *Wall Street Journal* 10/14/21). Participation has dropped broadly, but the decline is sharpest among women, workers without a college degree (it is actually up among workers with a BA) and those in low paying service industries such as hotels, restaurants and child care (source: *Wall Street Journal* 10/14/21). Some point to the recently terminated Federal extended unemployment benefits as a cause of the labor shortage persistence.

The three charts on page four show two of the more significant drivers of inflation. Both seem to point to the transitory nature of the higher levels of inflation we are currently experiencing. Personal consumption spiked earlier this year. However recent September retail sales figures while still elevated at 13.9% versus a year ago, have cooled from earlier in the year (source: *Wall Street Journal* 10/15/21).

The chart of the index of commodity prices shows moderating prices. So for many goods, price inflation should moderate.

However one major concern is the surge in oil and natural gas prices both in the US and Europe and Asia. The chart on page four of natural gas prices in the US show a steep rise throughout the year and a moderate decline recently. Most forecasts expect elevated prices for natural gas through the winter, when seasonal demand is highest.

(Continued on page 4)

Footnotes and disclosure

Cincinnati Asset Management, Inc., ("CAM") an independent privately held corporation established in 1989, is registered with the United States Securities and Exchange Commission as an investment advisor. The CAM High Yield, Investment Grade, Broad Market, Short Duration, and Short Duration-Investment Grade composites consist of all discretionary portfolios under management, including all securities and cash held in the portfolios, and have been appropriately weighted for the size of the account. All accounts are included after they are substantially invested.

Returns are calculated monthly in U.S. dollars and include reinvestment of dividends and interest. Figures for periods of less than one year are cumulative returns. All other figures represent average annual returns. Past performance is no guarantee of future results.

When compared to indices' performance, CAM results are after deduction of all transaction costs and CAM advisory fees. CAM advisory fees used are the composite averages. Accounts managed through brokerage firm programs usually will include additional fees. "Net of fees" herein refers only to CAM's management fee. Returns audited annually. Most recent audit available upon request.

S&P 500 averages are published quarterly in Barron's as supplied by Lipper Analytics.

The indices and information shown for comparative purposes are based on or derived from information generally available to the public from sources believed to be reliable. No representation is made to its accuracy or completeness.

High yield bonds may not be suitable investments for all individuals. Before investing a thorough reading of all materials and consultation with an independent third party financial consultant may be appropriate. Fixed Income securities may be sensitive to changes in prevailing interest rates. When rates rise the value generally declines. For example, a bond's price drops as interest rates rise. For a depository institution, there is also risk that spread income will suffer because of a change in interest rates. The Indices are referred to for informational purposes only and the composition of the Index is different from the composition of the accounts included in the performance shown above. Index returns do not reflect the deduction of fees, trading costs or other expenses.

This material was not intended or written to be used, and it cannot be used, by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

This information is intended solely to report on investment strategies and opportunities identified by CAM. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. This material is not intended as an offer or solicitation to buy, hold or sell of any financial instrument. References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

(Continued from page 3)

Oil prices appear to show no reasons to fall. The Saudis are maintaining current production levels and demand looks to increase as the rise in natural gas prices (and coal, too) is leading users to switch from gas to oil where possible. In the US, new regulations have stifled expansion of drilling for both gas and oil.

Inflation is certainly here, but markets and experts seem to consider it transitory. Federal Reserve Chair, Jerome Powell still feels the higher level of inflation as transitory: "These effects [supply bottlenecks] have been larger and longer lasting than anticipated, but they will abate, and as they do, inflation is expected to drop back toward our longer-run 2% goal" (source: *Bloomberg* 9/27/21).

We appreciate your interest & confidence. Best Regards and Happy Holidays from The CAM team.

Sharpe Ratios (risk & reward relative value) Inception-Q3 2021

CAM Investment Grade Strategy 0.49
Bloomberg Barclays U.S. Corp Bonds 0.46

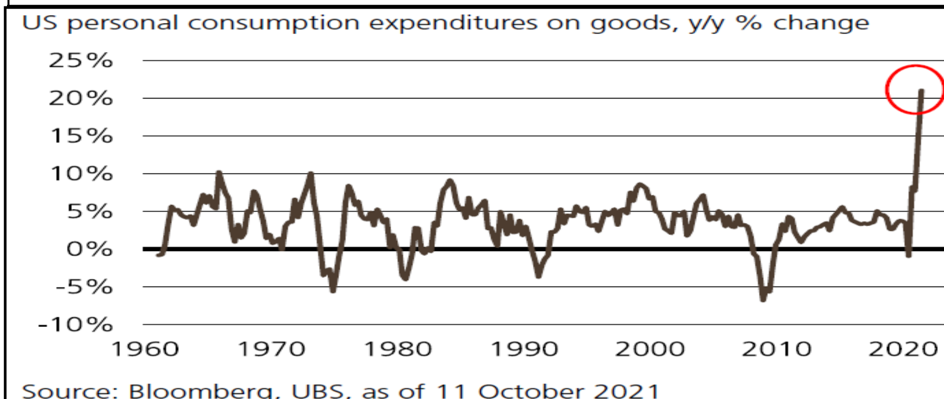
CAM High Yield Strategy 0.56
Bloomberg Barclays High Yield Corp Bonds 0.51

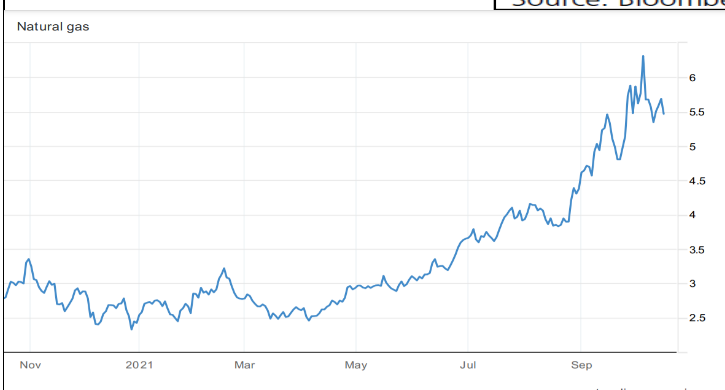
CAM Short Duration 0.56
Bloomberg Barclays Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.64

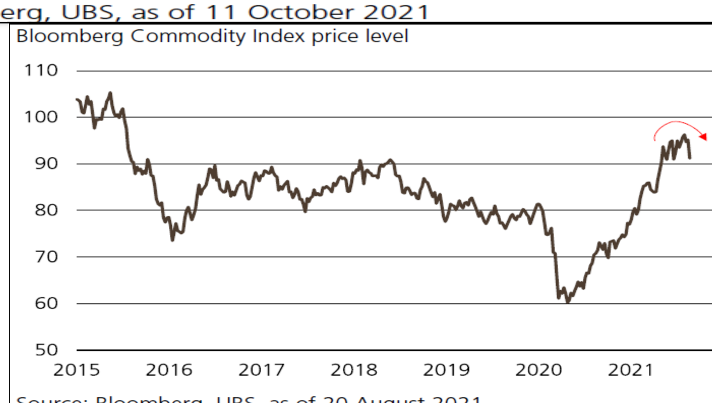
CAM Short Duration IG Strategy 1.15
Bloomberg Barclays U.S. Corporate 1-5 Yr 1.17

CAM Broad Market Strategy 0.78
Bloomberg Barclays Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.77

An important objective for all Cincinnati Asset Management investment strategies is to deliver superior risk-weighted returns. A quantitative indication of our success is the Sharpe Ratio that calculates total return per unit of risk. The data on the left indicates we have largely been successful. Sharpe Ratios of the Investment Grade and High Yield Strategies exceeded their respective benchmarks by approximately 7% and 10%, respectively. The Short Duration Investment Grade and Broad Market strategies approximated their benchmarks. The Short Duration Strategy's Sharpe Ratio trailed the benchmark primarily due to total return underperformance in the 5-year and older periods.







Rating	BA	B	CAA
Avg Spread	367	525	953
Std. Dev.	170	228	429
09/30/2021	**203**	**327**	**565**
Lowest Spread	151	228	378

Spreads to Treasuries by Credit Rating show significantly lower risk of BA and B rated bonds. Source: Bloomberg Barclays Capital (12/31/99 to 09/30/21)