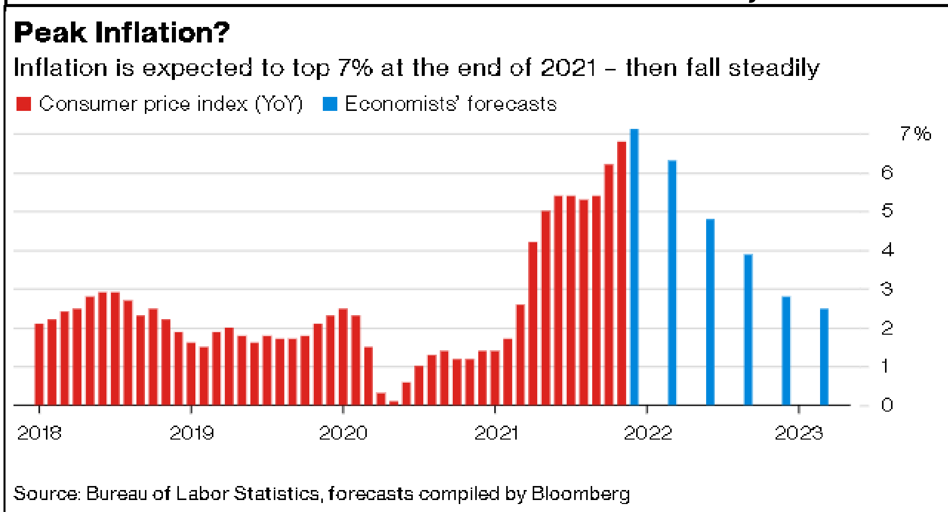
Fourth Quarter 2021 Bond Market Review and Outlook

Cincinnati Asset Management, Inc.

Investment Grade & High Yield Bond Specialists

"We can begin to see that the post-pandemic economy is likely to be different in some respects. The pursuit of our goals will need to take these differences into account." (Fed Chairman, Jerome Powell source: *Wall Street Journal* 1/10/22)



Inflation outlooks show near term increases, but significant declines as the economy normalizes, moving beyond the abnormalities generated by the pandemic. At the end of the 4th quarter the 10-year Treasury closed at 1.51%, an insignificant increase from 1.49% at the end of the 3rd quarter. Looking out over the next year, the chart above shows inflation expectations on a steady downward decline. (source: *Bloomberg*).

Since year end, recent reports on CPI, wages and consumer prices have increased expectations of higher near term inflation and a quicker FED response with rate increases. The Bloomberg consensus of economists is now forecasting 3.5 quarter point hikes in the overnight rate in 2022, starting in March. This outlook is being driven by the perception of a more hawkish FED, revealed in the minutes of the December FOMC meeting, which cited tight labor markets driving wages higher as a major concern. As of 1/18/22 the 10-year Treasury yields 1.82%.

However, the transitory anomalies created by the Covid-19 pandemic are largely responsible. Supply chain disruptions and huge increases in consumer demand for goods has driven the CPI higher, rising 7% in December, the 3rd consecutive month exceeding 6%, the fastest pace since 1982 (source: *Wall Street Journal* 1/12/22).This is expected to abate as consumers shift more spending from goods to services (e.g. vacation travel, restaurant dining and entertainment) as the pandemic fades.

Another significant anomaly is the shortage of workers. There have been more than 10 million job openings every month since June 2021 (source: *Wall Street Journal* 1/6/22). Also, the labor force participation rate at 61.8% in November, remains well below the 63.4% pre pandemic rate in January 2020 (source; ibid). Child care shortages, unpredictable public school schedules, vaccine mandates and juiced social welfare payments that go beyond the completed Pandemic Unemployment Assistance Relief Program are considered causes of the labor shortages.

There are two significant social welfare programs that may lead to less motivation to work. One is the annual increase in the child tax credit from $2,000 to $3,600 per child for every child younger than six and $3,000 for older children with the maximum age increased from 16 to 17. A study re-

(Continued on page 3)

Yields[*] on 12/31/2021	**Yield***
CAM Broad Market (corporate core plus) Strategy (7.6 year maturity; 6.0 duration)	**2.73%**
CAM Investment Grade (100% corporate bonds) Strategy (7.6 year maturity; 6.5 duration)	**2.18%**
CAM High-Yield Strategy (only BA & B rated purchased) (7.7 year maturity; 4.9 duration)	**3.90%**
CAM Short Duration Strategy (4.2 year maturity; 3.1 duration; 50% IG & 50% HY)	**2.41%**
CAM Short Duration Investment Grade Strategy (3.7 year maturity; 3.4 duration)	**1.49%**
U.S. Treasury[**] (10 year maturity)	**1.51%**
U.S. Treasury[**] (5 year maturity)	**1.26%**
U.S. Treasury[**] (2 year maturity)	**0.73%**

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

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.

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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 not take into account fees, expenses, and transaction costs.**	Total Return (%)	Annualized Returns (%)			
	4Q '21	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	-0.06	0.28	7.18	4.85	4.26
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	0.45	4.03	8.94	5.80	4.61
Bloomberg US Corporate High Yield Index	0.71	5.28	8.83	6.29	6.83
CAM Investment Grade Strategy—Net 100% corporate bonds	-0.30	-1.38	6.38	4.44	4.09
Bloomberg US Corporate Index	0.23	-1.04	7.59	5.26	4.70
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	-0.17	1.85	5.56	4.02	3.15
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	-0.85	-0.85	3.66	2.75	2.68

Relative Performance Review 12/31/2021

CAM's **Investment Grade Strategy** ("**IG**") produced a gross total return of -0.24% in the quarter ended December 31, 2021, compared to 0.23% for the Bloomberg U.S. Corporate Index. CAM always positions a majority of the portfolio within intermediate maturities of 5-10 years. Longer dated securities (10+ years) returned 1.55% for the period, dramatically outperforming the broader index. CAM's zero weighting in this duration bucket produced a -48 basis point contribution to excess return. The YTD return for the CAM IG strategy was -1.15% compared to the Index return of -1.04%. Over this period shorter dated securities (1-3 years) outperformed the broader index. CAM's zero weighting produced a -13 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 0.52% in Q4 while the Bloomberg US Corporate High Yield Index returned 0.71%. The modified duration of CAM's portfolio was 4.9 while that of the index was 3.8. The allocation effect of CAM's maturity profile served as a -10 basis point impact to CAM's portfolio relative to the index during the quarter. The HY YTD return was 4.34% while the Bloomberg US Corporate High Yield Index returned 5.28%. In this period, the allocation effect of CAM's structural avoidance of credit rated Caa and lower was a -46 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 0.01% for the quarter compared to 0.40% for the Bloomberg blended Index. Our BM strategy invests in intermediate maturities between 5-10 years, and currently less than 1% of assets are allocated to maturities 10 years and longer. The allocation effect of not investing in longer date maturities (10+ years) was a -30 basis point contribution to excess return. The YTD return for the CAM Broad Market strategy was 0.55% compared to blended Index return 1.04%. For this period, the allocation effect of our structural avoidance of Caa and lower rated credit produced a -31 basis point contribution to excess return.

The CAM **Short Duration Strategy** ("**SD**") blends equal weights of IG and HY bonds with a target duration of 3 years. The strategy's gross total return for the quarter was -0.11% while the Index, a similar blend of the intermediate components of Bloomberg IG and HY corporates, returned -0.01%. CAM's positioning within the Cable Satellite and Technology industries were the largest negative contributors, generating -15 and -6 basis point contributions to excess return, respectively. The YTD gross total return was 2.12% compared to the blended Index return of 2.24%. Notably, Caa credit dramatically outperformed during the period, and CAM's avoidance of these lower quality tiers produced a combined -38 basis point contribution to excess return during the period.

The **Short Duration Investment Grade Strategy ("SD-IG")** delivered a gross total return of -0.78% for Q4 while the Bloomberg U.S. Corporate 1-5 Index returned -0.68%. CAM's selection and weighting within the Banking and Technology industries were the largest negative contributors to performance with -4 and -2 basis point contributions to excess return, respectively. Over the YTD period, SD-IG underperformed the Index, by delivering -0.60% gross total return versus an Index return of -0.47%. Again, CAM's selection and weighting within the Banking and Technology industries was the largest negative contributors to performance, with -14 and -9 basis point contribution to excess return, respectively.

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

Periods ended 12/31/2021	10-yrs	20-yrs
U.S. Aggregate	2.90	4.33
U.S. Corporate	4.70	5.52
CAM Investment Grade Strategy	4.34	5.35

Better Asset Allocation Might Result from More Exacting Analysis

The chart to the right shows that BA rated bonds returned approximately 40% of S&P 500 stocks for the 10-year period 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 all periods presented.

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 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 over a complete market cycle.

Total Return of High-Yield Bonds by Credit Quality

(periods ended 12/31/2021) Source: Credit Suisse First Boston

(annualized %)

High-Yield Bond Sectors	5-years	10-years	20-years
BA-rated bonds	6.22	6.48	7.60
B-rated bonds	5.71	6.21	7.21
CAA-rated bonds	8.04	8.20	8.69
CA & D-rated bonds	-8.21	-7.58	-2.49

Performance of Other Asset Classes

(periods ended 12/31/2021) Source: Bloomberg & Lipper

S & P 500 Stocks	18.47	16.55	9.49
Bloomberg U.S. Aggregate	3.57	2.90	4.33

The December 31 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 12/31/2021 spreads for lower quality credit generally tightened more than upper tier, reflecting the risk-on attitude of market participants.

The 10-year U.S. Treasury ended Q4 2021 at 1.51% compared to 1.49% at Q3. There was much more movement within the full year number with the benchmark opening 2021 at 0.91% and closing as high as 1.74% at the end of the first quarter before retreating.

Credit Rating	20-Year Average Spread	12/31/21	12/31/20	12/31/19	12/31/18	12/31/17	Tightest This Decade
A	1.20%	0.74%	0.73%	0.70%	1.18%	0.73%	0.63%
BAA	1.87%	1.13%	1.21%	1.20%	1.97%	1.24%	1.00%
BA	3.67%	1.94%	2.64%	1.82%	3.54%	2.11%	1.82%
B	5.09%	3.13%	3.79%	3.24%	5.31%	3.43%	2.94%
CAA	8.95%	5.96%	7.15%	9.20%	9.89%	6.15%	4.91%

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
S&P 500 15.8%	US Gov't 9.1%	US Gov't 14.0%	High Yield 57.5%	High Yield 15.2%	Munis 11.2%	EM Sov 18.3%	S&P 500 32.4%	S&P 500 13.7%	Munis 3.6%	High Yield 17.5%	S&P 500 22.3%	Munis 1.0%	S&P 500 31.5%	S&P 500 18.4%	S&P 500 28.7%
High Yield 11.8%	Mtges 7.0%	Mtges 8.3%	Loans 52.5%	S&P 500 15.1%	US Gov't 9.8%	S&P 500 16.0%	High Yield 7.4%	Munis 9.8%	Mtges 1.5%	S&P 500 12.0%	EM Sov 10.0%	Mtges 1.0%	High Yield 14.4%	High Grade 9.8%	Loans 5.4%
EM Sov 10.6%	EM Sov 6.4%	Munis - 4.0%	EM Sov 27.2%	EM Sov 12.5%	EM Sov 8.2%	High Yield 15.6%	Loans 5.4%	High Grade 7.5%	S&P 500 1.4%	Loans 10.4%	High Yield 7.5%	US Gov't 0.8%	EM Sov 14.3%	US Gov't 8.2%	High Yield 5.4%
Loans 6.9%	S&P 500 5.6%	High Grade - 6.8%	S&P 500 26.4%	Loans 10.4%	High Grade 7.5%	High Grade 10.4%	Mtges - 1.4%	EM Sov 7.3%	US Gov't 0.8%	EM Sov 9.5%	High Grade 6.5%	Loans 0.6%	High Grade 14.2%	High Yield 6.2%	Munis 1.8%
Mtges 5.3%	High Grade 4.6%	EM Sov - 10.2%	High Grade 19.8%	High Grade 9.5%	Mtges 6.1%	Loans 9.8%	High Grade - 1.5%	Mtges 6.1%	EM Sov 0.6%	High Grade 6.0%	Munis 5.4%	High Grade - 2.2%	Loans 8.7%	Munis 5.3%	High Grade -1.0%
Munis 5.0%	Munis 3.3%	High Yield - 26.4%	Munis 14.5%	US Gov't 5.9%	High Yield 4.4%	Munis 7.3%	Munis - 2.9%	US Gov't 6.0%	Loans 0.1%	Mtges 1.7%	Loans 4.6%	High Yield - 2.3%	Munis 7.7%	EM Sov 4.8%	Mtges -1.2%
High Grade 4.4%	High Yield 2.2%	Loans - 29.3%	Mtges 5.8%	Mtges 5.7%	S&P 500 2.1%	Mtges 2.6%	US Gov't - 3.3%	High Yield 2.5%	High Grade - 0.6%	US Gov't 1.1%	Mtges 2.4%	S&P 500 - 4.4%	US Gov't7. 0%	Mtges 4.1%	US Gov't -2.4%
US Gov't 3.1%	Loans 2.0%	S&P 500 -37.0%	US Gov't - 3.7%	Munis 2.3%	Loans 1.5%	US Gov't 2.2%	EM Sov - 5.8%	Loans 1.8%	High Yield - 4.6%	Munis 0.4%	US Gov't 2.4%	EM Sov -4.6%	Mtges6. 5%	Loans 3.5%	EM Sov -2.6%

Source: CreditSights, BofA/ML, S&P/LSTA, Bloomberg … EM Sov is USD EM Sovereign BBB & lower index

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leased by the Becker Freidman Institute of The University of Chicago concluded that maintaining the child tax credit would result in 2.6% of all working parents (1.5 million workers) to leave the workforce (source: *Washington Times* 10/18/21). The second is the 25% permanent increase in food stamps enacted October1, 2021 (source: ibid).

Furthermore the stimulus payment can increase consumer demand, too. The first two rounds of stimulus payments lifted 11.7 million people out of poverty and built up an extra $2.7 trillion in extra savings (source: *Wall Street journal* 1/10/22). The personal savings rate catapulted to 33.8% in April 2020, after averaging under 8% for the prior two years (source: ibid). The graph on page four illustrates the extreme aberration, which has passed.

Another later reading of the impact on stimulus payments is JP Morgan's customers' checking account balances which were up more than 50% at the end of July 2021 from 2019 (source: ibid).

However the tide is already shifting with the end of a number of Covid centric programs, the waning Delta variant infections and knowledge that the new Omicron variant is much milder. ADP's December employment report stated that private employers added over 800,000 new jobs, following November's increase of 505,000 with service providers posting better growth than that of goods manufacturers. (source: *Barron's* 1/6/22).

December retail sales data released Friday, January 14 by the Commerce Department showed a sharp decline of 1.9%. (source: *Wall Street Journal* 1/14/22). Also a study by Goldman Sachs predicts that the incremental savings of households in the bottom 20% of income will burn through the extra money by the 3rd

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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.

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quarter of 2023 (source: *Wall Street Journal* 1/10/22).

There are several elements of the bond markets ignored by some investors. First is that about 18% of global debt trades at negative yields. This would appear to stand in sharp contrast to a future with permanent higher inflation (source: CreditSights 2022 Outlook, December 2021). The second is that 29% of U.S. corporate bonds are directly held by foreign entities (source: ibid). This significant source of demand for U.S. debt has remained through the recent periods of very low yields. Third is the huge growth in money market funds (see chart to the right by CreditSights).

The Bloomberg Barclays U.S. High-Yield Index year to date return was 5.28% with the fourth quarter contributing a 0.71% return. The demand for this paper is evidenced in the spread tightening to Treasuries. The High-Yield Index option adjusted spread decreased 6 basis points to 283. The long-term average is 497 and the all time low was 233 set in mid-2007 (source: CreditSights).

The Investment Grade Bond Index spread closed the quarter at 92 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: CreditSights 10/6/21).

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

Sharpe Ratios (risk & reward relative value) Inception-Q4 2021

CAM Investment Grade Strategy 0.49
Bloomberg U.S. Corp Bonds 0.47

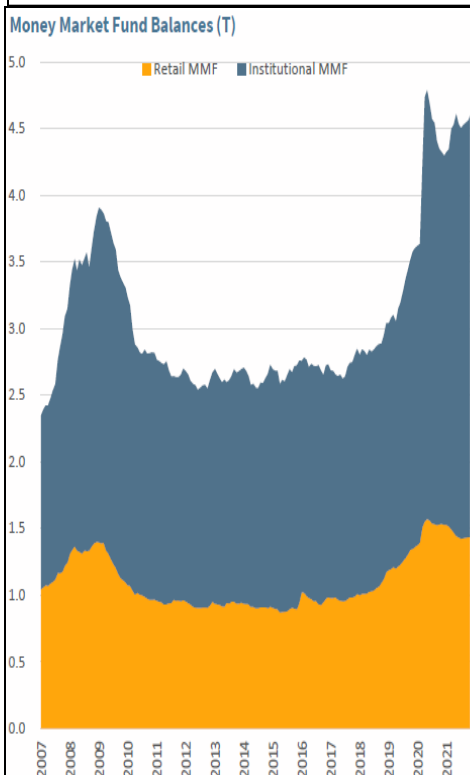
CAM High Yield Strategy 0.56
Bloomberg High Yield Corp Bonds 0.51

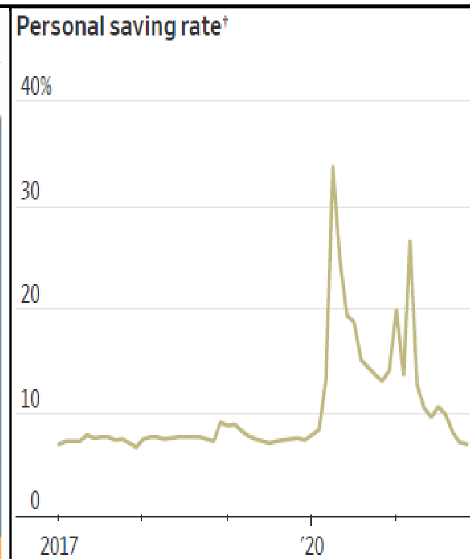
CAM Short Duration 0.56
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.63

CAM Short Duration IG Strategy 1.11
Bloomberg U.S. Corporate 1-5 Yr 1.13

CAM Broad Market Strategy 0.78
Bloomberg 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 4% 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.





†A measure of how much money people have left over after spending and taxes. Data are seasonally adjusted.
Source: Moody's Analytics (excess saving by household), U.S. Bureau of Economic Analysis (personal saving rate)

Rating	BA	B	CAA
Avg Spread	365	523	949
Std. Dev.	169	227	428
12/31/2021	**194**	**313**	**596**
Lowest Spread	151	228	378

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