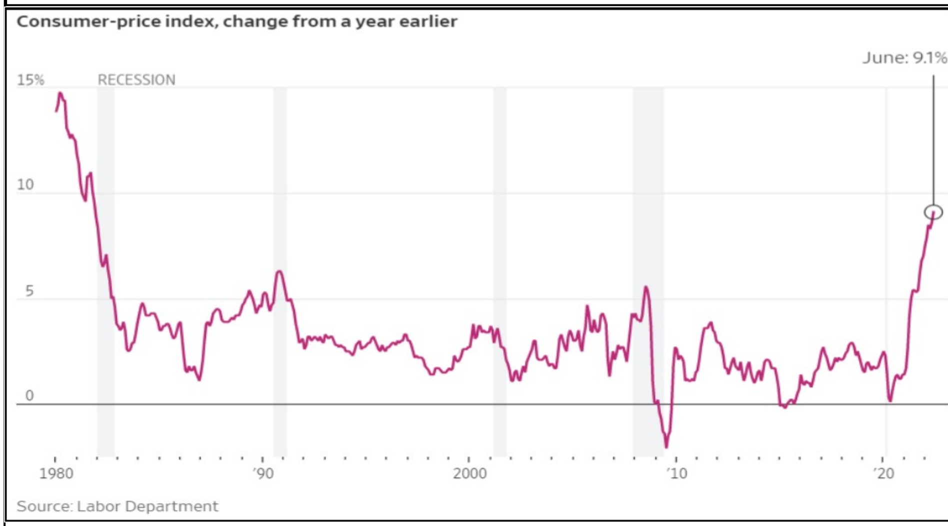
Second Quarter 2022 Bond Market Review and Outlook

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

"Long bond auction sees record investor buying...2s-30s has slightly inverted... expect the yield-curve recession watch clamor into a cacophony" (source: Macro Strategist 7/13/22 on Bloomberg)



The renewed interest by investors in longer dated U.S. Treasuries presages lower yields in 2023 and beyond.

This is coincident with the Department of Labor's report released the same morning (7/13/22) that the Consumer Price Index (year over year) rose further in June to 9.1% from 8.6% in May. Core prices also continued to rise month over month, another sign of inflationary pressures throughout the economy. "This report will make for very uncomfortable reading at the Fed" (source: *Wall Street Journal* 7/13/22 quoting Ian Sheperdson of Pantheon Macroeconomics).

The CPI data probably cements the Fed's next benchmark increase to another 75 basis points later in July. However, following Canada's 1% increase in their benchmark rate on 7/13/22 and the CPI report, the Fed may opt for a larger 100 basis point increase to signal an ardent hawkish stance. Swap markets today show a 50% chance of a 100 basis point hike later this month (source: *Bloomberg* 7/13/22).

So, what drives investor interest in the 30-year auction and longer maturities? They might be measuring the impact of present day Fed rate and monetary actions on future economic activity and inflation. Some strategists see the 2-10 year curve inversion signaling a recession. The 10-year Treasury yields 2.92% while the 2-year Treasury yields 3.14%, today (source: *Bloomberg* 7/13/22). The curve is inverted the most since August of 2000 (source: ibid).

The Fed's recent Beige Book, a compilation of economic anecdotes collected through July 13, noted that "increases in food, commodities and energy (particularly fuel) remained significant, though there were several reports that price inflation for these categories had slowed compared with recent months but remained historically elevated (source: Federal Reserve as reported by *The Wall Street Journal* 7/13/22). The Beige Book continued noting that "business contacts in several districts 'noted concerns over an increased risk of recession' and that much of the country saw a pullback in consumer spending due to higher gasoline and food prices" (source: ibid).

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Yields* on 06/30/2022	**Yield***
CAM Broad Market (corporate core plus) Strategy (7. 3 year maturity; 6.1 duration)	**5.63%**
CAM Investment Grade (100% corporate bonds) Strategy (7.3 year maturity; 6.3 duration)	**4.63%**
CAM High-Yield Strategy (only BA & B rated purchased) (7.2 year maturity; 5.5 duration)	**8.89%**
CAM Short Duration Strategy (4.0 year maturity; 3.4 duration; 50% IG & 50% HY)	**6.05%**
CAM Short Duration Investment Grade Strategy (3.4 year maturity; 3.1 duration)	**4.04%**
U.S. Treasury** (10 year maturity)	**3.02%**
U.S. Treasury** (5 year maturity)	**3.04%**
U.S. Treasury** (2 year maturity)	**2.96%**

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

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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.
- <u>All</u> 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 not take into account fees, expenses, and transaction costs.**	**Total Return (%)**	**Annualized Returns (%)**			
	2Q '22	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	-7.46	-13.35	-0.97	1.13	2.27
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	-10.44	-14.61	-0.69	1.36	2.31
Bloomberg US Corporate High Yield Index	-9.83	-12.82	0.20	2.10	4.47
CAM Investment Grade Strategy—Net 100% corporate bonds	-6.02	-12.77	-1.10	1.05	2.23
Bloomberg US Corporate Index	-7.26	-14.19	-0.98	1.28	2.62
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	-5.18	-8.82	0.43	1.51	1.77
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	-2.36	-7.35	-0.20	0.97	1.62

Relative Performance Review 06/30/2022

CAM's Investment Grade Strategy ("IG") produced a gross total return of -5.96% in the quarter ended June 30, 2022, compared to -7.26% 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 -13.30% for the period, dramatically underperforming the broader index. CAM's zero weighting in this duration bucket produced a +199 basis point contribution to excess return. The YTD return for the CAM IG strategy was -12.26% compared to the Index return of -14.39%. Over this period longer-dated securities returned -23.38%, widely underperforming the broader index. CAM's zero weight within that duration bucket produced a 317 basis point contribution to excess return.

The High Yield Strategy ("HY") delivered a gross total return of -10.37% in Q2 while the Bloomberg US Corporate High Yield Index returned -9.83%. The modified duration of CAM's portfolio was 5.5 while that of the index was 4.2. CAM's longer duration is a function of not owning CAA-rated and below securities which tend to have shorter call periods than higher quality companies. The allocation effect of CAM's maturity profile served as a -129 basis point impact to CAM's portfolio relative to the index during the quarter. The HY YTD return was -15.78% while the Bloomberg US Corporate High Yield Index returned -14.19%. In this period, the allocation effect of CAM's maturity profile was a -240 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 -7.40% for the quarter compared to -8.10% for the Bloomberg blended Index. Our BM strategy invests in intermediate maturities between 5-10 years. The allocation effect of not investing in longer dated maturities (10+ years) was a +118 basis point contribution to excess return. The YTD return for the CAM Broad Market strategy was -13.38% compared to blended Index return -14.30%. For this period, the allocation effect of not investing is longer dated maturities was a +220 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 -5.11% while the Index, a similar blend of the intermediate components of Bloomberg IG and HY corporates, returned -5.80%. CAM's duration profile is very similar to the blended index, but with underweights to the 1-3 year and 5+ year portions of the Index. Overall, the net allocation effect of our duration profile was a +51 basis point contribution to excess return. The YTD gross total return was -9.01% compared to the blended Index return of -9.63%. Similar to the quarter, the net allocation effect of our duration profile was a +58 basis point contribution to excess return.

The Short Duration Investment Grade Strategy ("SD-IG") delivered a gross total return of -2.30% for Q2 while the Bloomberg U.S. Corporate 1-5 Index returned -1.94%. CAM's selection and weighting within the Banking and Wireless industry groups drove -12 and -8 basis point contributions to excess return, respectively. Over the YTD period, SD-IG underperformed the Index, by delivering -6.51% gross total return versus an Index return of -5.60%. Given the move in interest rates, longer duration credit underperformed during the period, and CAM's positioning within the 3-5 and 5-7 year duration buckets produced a combined -39 basis point contribution to excess return versus the index.

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

Periods ended 06/30/2022	10-yrs	20-yrs
U.S. Aggregate	1.54	3.57
U.S. Corporate	2.62	4.59
CAM Investment Grade Strategy	2.48	4.55

Better Asset Allocation Might Result from More Exacting Analysis

The chart to the right shows that BA and B 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.

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.

Total Return of High-Yield Bonds by Credit Quality

(periods ended 06/30/2022) Source: Credit Suisse First Boston

(annualized %)

High-Yield Bond Sectors	5-years	10-years	20-years
BA-rated bonds	2.37	4.42	6.69
B-rated bonds	1.95	4.03	6.42
CAA-rated bonds	2.90	5.11	7.78
CA & D-rated bonds	-11.84	-9.45	-2.97

Performance of Other Asset Classes

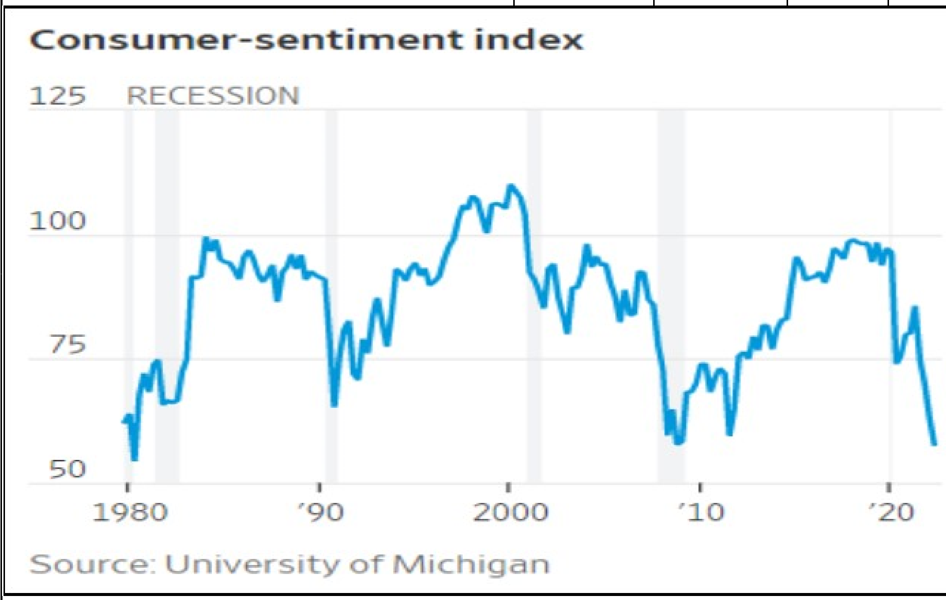
(periods ended 06/30/2022) Source: Bloomberg & Lipper

S & P 500 Stocks	11.31	12.96	9.04
Bloomberg U.S. Aggregate	0.88	1.54	3.57

The June 30 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 6/30/2022 spreads widened for credit quality of all stripes reflecting investors' uncertainty about growth and inflation. The 10-year U.S. Treasury ended Q2 2022 at 3.01% compared to 2.34% at Q1 2022. The 10-year yield has been rising since the low point of 0.52% on August 4, 2020.

Widening spreads and higher Treasury yields combine to provide a more compelling entry point into corporate bonds than has existed since the spring of 2019.

Credit Rating	20-Year Average Spread	06/30/22	12/31/21	12/31/20	12/31/19	12/31/18	Tightest This Decade
A	1.20%	1.26%	0.74%	0.73%	0.70%	1.18%	0.63%
BAA	1.87%	1.92%	1.13%	1.21%	1.20%	1.97%	1.00%
BA	3.67%	4.04%	1.94%	2.64%	1.82%	3.54%	1.82%
B	5.09%	6.31%	3.13%	3.79%	3.24%	5.31%	2.94%
CAA	8.95%	11.13%	5.96%	7.15%	9.20%	9.89%	4.91%



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The cross currents are confusing and concerning. Regarding gasoline prices, demand has recently fallen off a cliff. U.S. gasoline demand fell 14% last week according to the EIA (source: *Bloomberg* 7/14/22), They also report that demand over the last moving four week period is now at its lowest seasonally since 2000 (with the exception of the covid impacted 2020) (source: ibid). Also WTI oil prices are a bit more than 20% off their recent June highs (source: *Bloomberg* 7/14/23). Many feel that the fall off in gasoline sales is indicative of the consumer deciding to reduce spending.

Is this one of the first signs of a tapped out consumer? Since 70% of GDP is consumer spending a recession could easily develop through lower consumer spending. That's not the case right now. Currently, consumers continue spending a lot and on credit. Revolving credit is at its highest level in decades and is up 13.4% year over year (source: *Bloomberg* 7/14/22).

Consumer spending jumped in 2021 rising almost 7% adjusted for inflation- (source: *Wall Street Journal* 7/14/22). However, more recent data from March and May show spending slowing to a 2% growth rate from a year ago (source: ibid).

JP Morgan's CEO, Jamie Dimon noted on the 7/14/22 conference call discussing the bank's second quarter that, "the consumer right now is in great shape, so even if we go into a recession, they're entering that recession with less leverage and in far better shape than they did in '08 and '09" (source: *Bloomberg* 7/14/22).

Household finances are much sturdier. The Federal Reserve reported households held $18.5 trillion in savings, more than $5 trillion more than they had at the start of the pandemic in February 2020 (source: *Wall Street Journal* 7/14/22).

Household financial obligations are also historically low, as shown on the chart on page four. They include recurring bills such as mortgage payments, car loans and leases, and insurance. At the end of the first quarter of 2022 they were 14% of household disposable income. Heading into the recessions of 1991, 2001 and 2007 it

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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.

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.

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was 17% to 18% (source: *Wall Street Journal* 7/14/22).

These recent comments stand somewhat in contrast to his previous statements warning that a convergence of unprecedented factors could wreak havoc on the economy in the not too distant future. He referred to it as an "economic hurricane" (source: *Wall Street Journal* 7/14/22). So, perhaps he is looking beyond the consumers' current finances and is considering their future income growth and spending potential.

There are significant global risks to global growth including the Ukraine war, European GDP slowing amid increasing natural gas shortages and rate increases by many central banks to stifle inflation.

U.S GDP contracted by 1.6% in the first quarter of 2022 and the Atlanta Federal Reserve Bank estimates a 1.2% contraction in the second quarter of 2022 (source: *Wall Street Journal* 7/14/22). So, the current economy may well fit the definition of a recession, which is two consecutive quarters of negative GDP.

Retail sales just posted an increase in June of 1% (source: Commerce Department 7/15/22). However that increase did not keep up with inflation with the CPI monthly increase of 1.3% in June (source: Bureau of Labor Statistics 7/13/22). Also, indicative of consumers shrinking purchasing power is that real average hourly earnings fell 1% in June and are down 3.6% over the last 12-months (source: *Wall Street Journal* 7/15/22). These are more signs of economic weakness.

Also ominous is the collapse in consumer sentiment which hit its lowest level on record in June. The index near 50 is more indicative of levels associated with recessions according to conducting the surveys at University of Michigan. The survey also found that 5-year inflation expectations fell to a 12-month low of 2.8% from 3.1%, while the index of future expectations fell to 47.3, the lowest since 1980 (source: *Bloomberg* 7/15/22).

So, while the Fed will continue rate increases for the benchmark in its battle over inflation, rates of longer term maturities seem to be moderating. Investors are taking stock of the economic slowdown developing and the longer term outlook for inflation. The swiftest bond market rout may well prove to be at or very near its end.

Sharpe Ratios (risk & reward relative value) Inception-Q2 2022

CAM Investment Grade Strategy 0.37
Bloomberg U.S. Corp Bonds 0.34

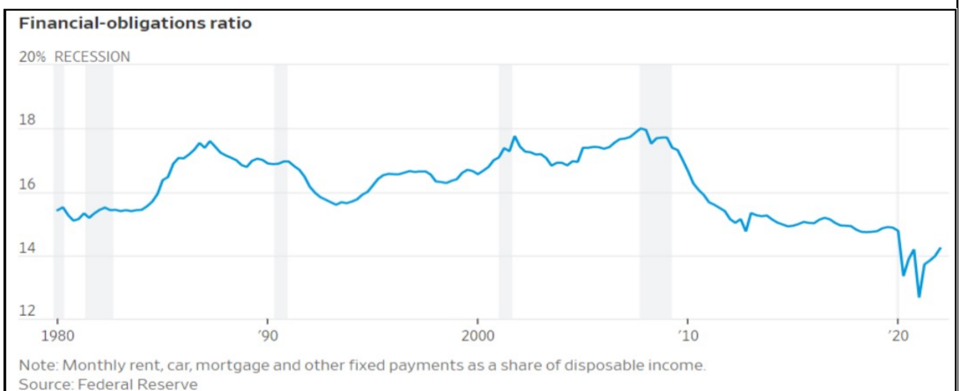
CAM High Yield Strategy 0.46
Bloomberg High Yield Corp Bonds 0.45

CAM Short Duration 0.42
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.51

CAM Short Duration IG Strategy 0.87
Bloomberg U.S. Corporate 1-5 Yr 0.88

CAM Broad Market Strategy 0.57
Bloomberg Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.59

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 9% and 2%, 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.



Note: Monthly rent, car, mortgage and other fixed payments as a share of disposable income.
Source: Federal Reserve

Rating	BA	B	CAA
Avg Spread	363	521	946
Std. Dev.	168	225	425
06/30/2022	**404**	**631**	**1113**
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 06/30/22)