Junior-Subordinated Capital Securities Markets

June 2022 Updates

The fixed income credit markets opened June under the pressure of soaring Fed hawkishness -- mainly, its potential to accelerate rate hikes above the more "customary" 25bp increments to as much as 75bps, which it did. Equity reached new lows by the middle of the month trading down over 11% before staging a 6% rally and then paring off some of the bounce to close over 8% lower this month (and over 20% lower for the year). Credit prices declined with a noticeable underperformance in below investment grade corporate paper and in hybrids, which is typical during periods of equity volatility leading into slower growth expectations. Indeed, the Fed has not said it directly, but it is not all that concerned about the risk of policy rates causing a recession. Instead, Chairman Powell talks in code, by saying it "*is not concerned about the yield curve*" which implies that it does not care about restrictive policy causing a recession – especially given the ongoing strength in the labor markets. This month we had a continuation of the divergences in price performance between hybrid sectors. For example, the below investment NoCo sector was down 1.61% more than the investment grade NoCo sector and the retail sector appears to be bottoming and converging with NoCos as the yield curve flattens and inverts.

The 30yr bond closed June yielding 3.12% (6bps higher). The 10yr note closed yielding 2.97% (13bps higher) -- the yield differential between the two longer US treasuries flattened by 7bps to +15bps. Real rates on the front end of the curve (e.g., UST 5yr TIPS) ended the month 56bps higher at +0.42%; the 5yr implied breakeven inflation rate (i.e., the difference in yields between the 5yr UST and the 5yr Treasury Inflation Protected Security) declined 34bps to close at 2.62%. The implication of such a sudden decline in the treasury market's view on 5yr average inflation is that the Fed still has control over inflation despite its grossly under guesstimating it as being transitory for most of last year – in fact, the UST bond market is still pricing inflation in being transitory (more on this later). The VIX (i.e., Chicago Board Options Exchange Volatility Index) rose 9.6% to 28.71 as the S&P 500 finished the month at 3785 which was down 8.4% this month and below the bright line of -20% off the highs which is the historical threshold of indicating a recession over the next 12 months.

Before we talk hybrids, the performance in some of the more senior corporate credit sectors for comparative references on returns and yield changes is shown below:

- The junk market (measured by the ICE BofA High Yield ***h0a0*** index) fell 6.81% to close yielding 8.88% (175bps higher).
- Global bank credit (measured by ICE BofA ***e0ba*** index) fell 1.95%% to close yielding 4.48% (52bps higher).
- The BBB rated 5-10yr corporate sector (measured by ICE BofA ***c6a4*** index) fell 2.62% to close yielding 5.19% (50bps higher).

Review of Market Structure:

The market for hybrids or **global junior-subordinated capital securities** (*i.e.,* "**Jsubs**") as we call them is comprised of two core sectors:

1. Preferred Securities, and
2. Contingent Capital Securities

Each sector has evolved with unique technical, structural, and fundamental features that are discussed and updated below:

Global junior subordinated capital securities are comprised of two sub-sets that represent a broad group of global junior-subordinated capital securities, which can be referenced by two ICE BofA indexes: 1) The ICE BofA US All Capital Securities Index (***i0cs***) and 2) The ICE BofA US Dollar Contingent Capital Index (***cdlr***).

Our litmus test for hybrids satisfies two core characteristics:

1) any non-payment of distributions would not accelerate an event of default (i.e., distributions are "junior-subordinated" to ordinary interest obligations) and,

2) balance sheet classification is something other than common stock under GAAP disclosure.

The US All Capital Securities (***i0cs***) benchmark of preferred securities represents $348 billion (face amount) of investment grade and below investment grade instruments in both the retail $25par market (37%) and the institutional $1,000par market (63%). The USD Contingent Capital Index of US dollar denominated junior-subordinated capital securities ***(cdlr)*** represents $149 billion (face amount) of investment grade and below investment grade fixed-rate instruments with contractual triggers that could subordinate them to common stock in a reorganization that would not fall into a receivership after the bail-in. These two benchmarks combine for a $497 billion universe of fixed-rate junior-subordinated USD capital securities with preferred securities (measured by ***iocs***) being a 69% subset and contingent capital securities (measured by ***cdlr****)* being a 31% subset of the total global USD junior subordinated group.

Preferred Securities

In the preferred securities sleeve, there are four sub-component indexes in the US All Capital Securities Index (***i0cs****)* – this entire index is comprised of global "preferred securities". A **"preferred security"** can represent a capital security issued either through charter amendment (i.e., as a stock) or through indenture (i.e., as a bond) typically within the context of a "gone-concern" statutory authority (*e.g.,* US banks). As a gone concern, a company reorganization would be processed through a bankruptcy court. Preferred security payments are in priority to common stock dividends, yet can be deferred (i.e., payments are cumulative) or eliminated (i.e., payments are non-cumulative) without causing an immediate event of default; any principal loss absorption on a preferred security would be forced only *ex-post* through a statutory resolution in a bankruptcy proceeding.

The four sub-components of the *i0cs* benchmark that consolidate into the retail and institutional sectors of rated preferred securities are:

1. **ICE BofA Fixed Rate Preferred Index (*p0p1*) @ 44% *of i0cs***
   - Comprised of IG $25par and IG $1,000par (incl. US AT1)

- ❖ The *p0p1* fell 4.02% this month to close yielding 6.19% (+68bps)
- ❖ Headcount was down 2; face value down $1.2billion

2. ICE BofA US Capital Securities Index (*c0cs*) @ 24% of *i0cs*

- o <u>Comprised of dated IG $1,000par dated hybrids (excl. US AT1)</u>
  - ❖ The *c0cs* fell 3.04% this month to close yielding 5.95% (+71bps)
  - ❖ Headcount was down 1; face value down $1.5billion

3.* ICE BofA High-Yield Capital Securities Index (*h0cs*) @ 5% of *i0cs

- o <u>Comprised of BIG $1,000par legacy Tier1 and BIG $1,000par hybrids</u>
  - ❖ The *h0cs* fell 5.98% this month to close yielding 7.16% (+79bps)
  - ❖ Headcount unchanged; face value unchanged

4. ICE BofA High Yield Fixed Rate Preferred Index (*p0hy*) @ 27% of *i0cs*

- o <u>Comprised of BIG $25par and BIG 1,000par (incl. US AT1)</u>
  - ❖ The *p0hy* fell 5.16% this month to close yielding 7.16% (+94bps)
  - ❖ Headcount down 3; face value down $1.0 billion

Overall, the ICE BofA All US Capital Securities Index (***i0cs***) fell 4.18% in June to close yielding 6.43%, which was 76bps higher than last month's closing yield and a spread of +347bps over comparable US Treasury securities (61bps wider).

<u>Contingent Capital Securities</u>

A **"contingent capital security"** (i.e., a "CoCo") represents a capital security issued through indenture typically within the context of a "<u>going-concern</u>" type regulatory regime for banking, which would reorganize a potentially insolvent bank through the contracts of its capital before falling into a conservatorship proceeding. CoCos payments are non-cumulative and *pari passu* to common stock dividends and can be reduced or eliminated without causing an event of default. Principal loss absorption on a CoCo could be forced ex-ante through a regulatory action in advance of any bankruptcy proceeding (note that an actual bankruptcy may not happen because enough loss absorbing bail-in capital, including tier-2 capital, could be available through the "living will" of the entity's core capital). The ICE BofA USD Contingent Capital Index (***cdlr***) is comprised of US dollar denominated constituents (exclusively), which represent 62% of the mature master multi-currency benchmark (*coco*). We will utilize the USD benchmark (*cdlr*) as it more meaningfully reflects the contingent capital currency primarily held in our portfolios. The ICE BofA USD Contingent Capital Index (***cdlr***) fell 4.95% this month to close yielding 7.57%, which was 121bps higher from last month and a spread of +460bps over comparable US Treasury securities (96bps wider).

Discussion of Retail and Institutional Sectors:

We report on the retail and institutional sectors using statistical tables in a *Spread Value Matrix* to provide readers with data on absolute and relative spread positionings. The data samples are sourced from ICE BofA benchmarks starting in March 2017, which is when retail benchmark calculations on yield-to-worst for currently callable $25par preferred securities were improved to reflect actual yields, even if negative. We provide measures of inflation coverage in a *Purchasing Power Matrix*; and a table for yield-to-worst, net of inflation and historical default in a *Real Yield Matrix* that compares hybrids, investment grade corporates and high yield bonds. Finally for each sector, we show data on prior credit cycles to give you a *Comprehensive Risk Estimate* to the average bottom of the last 3 credit cycles (2013, 2016 and 2018) -- the rationale here is to illustrate risk measures relative to prior down credit cycles, but not necessarily an outlook to that direction. By following these tables monthly (and sometimes as “pop-outs” in flash reports), investors should gain consistent insights to assist in making more informed and supportive asset allocation decisions using junior subordinated capital securities.

Snapshot of Junior Subordinated Spread Sector Moves vs. Global Financials:

	p0p4	p0p4-e0ba	stb8	stb8-e0ba	cdlr	cdlr-e0ba
Capital Securities Spread Value Matrix	(a)	(b)	(a)	(b)	(a)	(b)
	Retail	Retail	NoCo	NoCo	CoCo	CoCo
Sample Periods	03/31/2017 to Date		03/31/2017 to Date		03/31/2017 to Date	
Jr-Subs	***Absolute**	****Relative**	***Absolute**	****Relative**	***Absolute**	****Relative**
High	588	251	479	200	660	313
Low	-178	-267	174	53	223	143
Range	766	518	305	147	437	170
Average	52	-55	246	139	326	219
Stdev	121	106	47	28	61	34
Monthend	**211**	**62**	**330**	**181**	**403**	**254**
Spread Scores:						
(monthend-ave)/stdev	1.31	1.10	1.79	1.50	1.26	1.03
Δ from Last Month	0.33	0.17	0.81	0.57	1.13	1.37

Source: Bloomberg; ICE BofA Bond Indices

** Absolute = Option Adjusted US Government Spread; (current-ave)/stdev*

*** Relative = spread to global financials measured by e0ba ICE Bond Index; (current-ave)/stdev*

The way we interpret the above option adjusted spread table is by the statistical positioning of the *Spread Scores* where, **zero** = "*fair value*", **+/- 1stdev.** = "*undervalued*"/ "*overvalued*", respectively and **+/- 2stdevs** = "*very undervalued*"/ "*very overvalued*", respectively.

Spread performance this month was dismal for hybrids, but the poor performance makes for better values. All three hybrid sectors widened and are more statistically aligned above 1 standard deviation wide of average spreads, which makes hybrids "*undervalued*" in both the absolute and in the relative. In particular, the relative spreads for CoCos widened the most (by 1.37 standard deviations) in June, which brings them more in line with relative values found in the retail sector preferred securities. The rally in USTs against the backdrop of lower equity prices helped the absolute values and relative values in the 3 hybrid sectors reach "*undervalued*" positions across the board for the first time this year. Noco paper is the clear winner for the best values, though $25par paper and CoCos are among the same undervalued zone – just not scoring as good.

Implications of Market Activity:

$25par Retail Preferred Securities Sector

The retail preferred securities sector measured by *p0p4* fell $4.51 in June to $87.09, continuing the sector's heavy trend this year with 5 of 6 months being negatives. Using the p0p2 to look back more than 12yrs (and, also striking the Financial Crisis), the retail sector had a -2.5 standard deviation move (down) in June after a sizable bounce last month. June completes the worst 2-quarter streak since the Financial Crisis for the retail sector. The following table illustrates the retail sector's 3 prior credit cycles compared to month end valuations:

Retail Pfds. (p0p4)	Valuation Implosions			Average		Diff. to	
Credit Cycle Bottoms >	2013	2016	2018	Prior Bottoms	Current	Average	
GA10	2.98%	1.64%	2.74%	**2.45%**	3.02%	0.57%	
PCE DEFY	1.48%	0.59%	1.86%	**1.31%**	6.30%	4.99%	
Real UST10yr	1.50%	1.05%	0.88%	**1.14%**	-3.28%	-4.42%	
$25Coupon	6.64%	6.46%	6.05%	**6.38%**	5.45%	-0.93%	
$25Price	$94.06	$98.66	$93.09	**$95.27**	$85.26	-$10.01	
$25Current Yield	7.06%	6.55%	6.50%	**6.70%**	6.39%	-0.31%	
Mdur Worst	9.52	10.44	10.95	**10.30**	11.82	1.52	
CY Spread vs. T10yr	4.08%	4.91%	3.76%	**4.25%**	3.37%	-0.88%	
Source: Bloomberg; ICE BofA Bond Indices						-3.60%	Est. Price Risk to AveCY
				Comprehensive Risk Est.		2.79%	**Est. Price Risk + CY**
				Recapture Rate (yrs.)		0.56	Est. Price Risk / CY
					Memo:	-15.15%	Total Return YTD (p0p4)

The current yield of the retail sector closed June at 6.39%, which was 44bps higher than last month and 31bps lower than the average current yield at the bottom of the last three credit cycles. The current yield spread to the 10yr is 88bps less than the average of the last three credit cycle bottoms. The implication of a 0.31% yield increase to 6.70% (the average current yield of the prior bottoms) is an estimated 3.60% price decline using the average modified duration of 10.30; then adding back a current book yield (assuming a 12month path) of 6.39% makes the *Comprehensive Risk Estimate* for the retail sector positive again (for the second time this year) at 2.79% after returning to a negative position in May from being positive in April. So again, June retail valuations offer a cushioned or mitigated risk opportunity, which aligns with the undervalued *Spread Score* cited earlier. It would take 0.56yrs to recapture this assumed capital loss with book income, which implies that there is more value than risk in the retail sector.

$1,000par Institutional Preferred Securities Sector

The $1,000 par institutional sector of the preferred securities market fell $4.11 as yields rose by 68bps to 6.58% by the end of June. The following table illustrates the institutional preferred securities sector's 3 prior credit cycles compared to closing valuations in this month:

Institutional Pfds. (stb8)	Valuation Implosions			Average		Diff. to	
Credit Cycle Bottoms >	2013	2016	2018	Prior Bottoms	Current	Average	
GA10	2.94%	1.75%	2.74%	**2.48%**	3.02%	0.54%	
PCE DEFY	1.17%	0.59%	1.86%	**1.21%**	6.30%	5.09%	
Real UST10yr	1.77%	1.16%	0.88%	**1.27%**	-3.28%	-4.55%	
Coupon	6.77%	6.43%	5.88%	**6.36%**	5.18%	-1.18%	
Price	$103.96	$99.62	$97.23	**$100.27**	$91.46	-$8.81	
Current Yield	6.51%	6.45%	6.05%	**6.34%**	5.66%	-0.67%	
Mdur Worst	5.90	5.23	4.64	**5.26**	4.08	-1.18	
CY Spread vs. T10yr	3.57%	4.70%	3.31%	**3.86%**	2.64%	-1.22%	
Source: Bloomberg; ICE BofA Bond Indices						-2.75%	Est. Price Risk to AveCY
				Comprehensive Risk Est.		2.91%	**Est. Price Risk + CY**
				Recapture Rate (yrs.)		0.49	Est. Price Risk / CY
					Memo:	-13.00%	Total Return YTD (stb8)

The current yield of the institutional preferred sector closed June at 5.66%, which was 24bps higher than last month. This brings the current yield of the sector to 67bps less than the average current yield at the bottom of the last three credit cycles. The current yield spread is 122bps lower than the average of the last three credit cycle bottoms. The implication of a 0.67% yield increase to 6.34% (the average current yield of the prior bottoms) is an estimated 2.75% price decline using the modified duration of 4.08; then adding back a current book yield (assuming a 12month path) of 5.66% makes the *Comprehensive Risk Estimate* for the NoCo sector equal to a 2.91% horizon return to accept the risk. It would take 0.49yrs to recapture this capital loss estimate with book income. The combination of higher yields and some spread widening has moved the NoCo sector deeper into a more cushioned valuation this month (evidenced by the recapture rate of less than 1.00; and its decline from 0.70yrs last month) as well as the more positive Comprehensive Risk Estimate than last month.

Contingent Capital Securities Sector

The CoCo sector declined $5.31 as even as the European bank stocks fell over 12% to new lows on the year. The blow-off in high yield bonds and the general excess widening of below investment grade paper relative to widening investment grade paper added to the negative moods in CoCos this month.

The following table illustrates the contingent capital securities sector's 3 prior credit cycles compared to closing valuations in June:

CoCo Securities (cdlr)	Valuation Implosions			Average		Diff. to	
Credit Cycle Bottoms >	2013	2016	2018	Prior Bottoms	Current	Average	
GA10	3.01%	1.75%	2.88%	**2.55%**	3.02%	0.47%	
PCE DEFY	1.48%	0.59%	1.86%	**1.31%**	6.30%	4.99%	
Real UST10yr	1.53%	1.16%	1.02%	**1.24%**	-3.28%	-4.52%	
Coupon	7.63%	6.40%	6.78%	**6.94%**	6.14%	-0.80%	
Price	$105.04	$89.12	$96.21	**$96.79**	$90.20	-$6.59	
Current Yield	7.26%	7.18%	7.05%	**7.16%**	6.81%	-0.36%	
Mdur Worst	4.76	5.30	3.95	**4.67**	2.90	-1.77	
CY Spread vs. T10yr	4.25%	5.43%	4.17%	**4.62%**	3.79%	-0.83%	
Source: Bloomberg; ICE BofA Bond Indices						-1.04%	Est. Price Risk to AveCY
				Comprehensive Risk Est.		5.77%	**Est. Price Risk + CY**
				Recapture Rate (yrs.)		0.15	Est. Price Risk / CY
					Memo:	-13.57%	Total Return YTD (cdlr)

The current yield of the institutional preferred sector closed June at 6.81%, which was 38bps higher than May and 36bps lower than the average current yield at the bottom of the last three credit cycles. The current yield spread is 83bps lower than the average of the last three credit cycle bottoms. The implication of a 0.36% yield increase to 7.16% (the average current yield of the prior bottoms) is an estimated 1.04% price decline using the modified duration of 2.90; then adding back the current book yield (assuming a 12month path) of 6.81% makes the *Comprehensive Risk Estimate* for the NoCo sector 5.77% -- 154bps higher (i.e., lower risk) than last month. It would take 0.15yrs to recapture this assumed capital loss with book income. Since the Russian invasion of Ukraine, CoCo prices have underperformed NoCo prices even though NoCos have about 1yr of additional duration risk. Though last month CoCos crossed back over NoCos to bottom $0.76 higher than NoCos which realigns the price behavior to what their lower duration differences suggest, this month CoCos finished 77cents behind NoCos as they widened 27bps more than NoCos in June.

The notable CoCo issue placed this month was:

1. $1.65 billion (nr/B+/BB) Credit Suisse 9.75% 5yr fixed-to-refixed CoCo resettable at +638bps off the 5yr constant maturing US treasury yield.

The deal came right around the time of the Fed's 75bp rate hike, which was the bottom for USTs in June. So, not only was the yield high for this deal, but the tone of USTs was pivoting higher from a "buy the news" mentality of short covering. The deal closed the month at $101.75 after reaching as high as $103.50 in the few days that followed pricing.

<u>Outlook:</u>

The Fed meeting this month ended with a 75bp hike which was very well baked into the market as the Fed broadcast their intentions and the markets discounted the broadcast. It is uncanny how this pattern happens time and time again – Fedspeak talks the markets in the direction it wants in advance of the meeting (i.e., in the spirit of transparency) and then when the news comes that's in keeping with the message, the markets rally making everything seem wonderful and the Fed seeming in control. The key is that central banks are talking the right game. For example, talking the game of inflation being "transitory" last year was the wrong talk, but the markets believed the Fed because every trader under the age of 40 has never (ever) felt the scourge of inflation. But when "transitory" itself became transitory, the markets quickly reacted to engulf investors in the worst 6 months for UST bonds since the first half of 2009 – the difference this time was that the UST rout was also accompanied by a corporate bond rout and largely unrelated to any crisis, per se – well, except for inflation. So, now that bond markets have materially repriced, where do we go from here?

The Fed is very concerned that inflation expectations may become unanchored. It therefore contemplates a broad range of gauges like the University of Michigan Long-term Inflation Expectations number (3.05%), the UST 5yr Breakeven Inflation Rate (2.62%), and a new model of its own creation called the Common Inflation Expectations Index (2.15%). It appears that these indicators are still believing that inflation is transitory because the gap between them and reality is stark given inflation is 6.30% according to the Fed's favorite gauge (the PCE Deflator). In fact, the UST 5yr Breakeven Inflation rate used to have a very close association with the PCE – especially during times when the Fed was raising rates. But now, real inflation far exceeds everyday experience. So, are these indicators really that clairvoyant? No, they are not. In fact, they tend to be more like a 200day moving average of the past inflation than a clairvoyant look into the future. Therefore, like all moving averages they lag the actual price path of what they measure. The implication is that breakeven UST rates can still go higher while actual inflation is coming down. But why would this happen? It's because in the past when the Fed raises interest rates, it does not stop raising them until its policy rate crosses over its inflation measure (i.e., the PCE Deflator).

Consider this annual (transitory) path for the PCE: 2%-4%-6%-4%-2% inflation over 5yrs, where at the end of 5yrs bond investors have lost 8% of their purchasing power ([2+4+6+4+2] - [2*5] = 8) from this transitory inflation path compared to the Fed's desired 2% baseline. The simple math is that inflation averaged 3.60% (18%/5) over this 5yr period, which was 1.60% on average per year more onerous than the 2% baseline inflation objective. The implication here is that the UST 5yr Breakeven Inflation Rate (which used to track the PCE) needs to go up by another 98bps to align with this example of a transitory inflation path. We are not too far off that mark, but there is still more work to do for markets as these inflation expectation indicators rise. Indeed, a 4.25% UST5yr rate seems reasonable (if real rates are to be unchanged), perhaps even 5% if the Fed does navigate a softer landing.

In the meantime, a constructive way to help offset inflation is through credit exposure when spreads are undervalued (like now). Here's a look at the multiples of 5yr average inflation (by today's measure) that are available in hybrids compared to more senior financials:

	A	B	C	D=B/C	E=D/A
Purchasing Power Matrix: Financials	Mdur	YTW%	5yrBE Inflation%	Inflation Coverage	Inflation Coverage/ Mdur
Retail $25par (p0p4)	11.82	6.15	2.62	2.35	0.20
NoCos (stb8)	4.08	6.63	2.62	2.53	0.62
CoCos (cdlr)	2.90	7.61	2.62	2.90	1.00
More Sr. Fins (e0ba)	5.03	4.49	2.62	1.71	0.34

Source: Bloomberg; ICE BofA Bond Indices

The contingent convertible sector (CoCos) is the winner on *Inflation Coverage* and risk adjusted coverage when factoring duration. The Noco sector wins the silver medal, and the retail sector gets the bronze. Interestingly, more senior financials would just barely cover a 3.6% average inflation rate contemplated earlier in our example and would leave very little spread for credit risk. Junior subordination has more value than more senior financials not only from an inflation coverage perspective, but also from a credit premium perspective.

Defense continues to be our primary investment objective this year and positive real yields for hybrids helps us run the playbook. Real yields are still getting increasingly attractive for most hybrids and even more so when we adjust historical default risks from real yields. Below we assess a more comprehensive view of real yields net of inflation and net of default in a *Real Yield Matrix* to double risk adjusted yield comparisons in hybrids and corporates:

Real Yield Matrix	Hybrids		Corporates	
	Preferreds	CoCos	IG Corps	BIG Corps
Bloomberg Index	*cips+hips*	*cdlr*	*c6c0*	*h0a0*
Mod.Duration	4.08	2.9	6.34	4.56
Yield-to-Worst	6.63	7.61	4.92	8.94
Inflation[1] Adjustment	2.62	2.62	2.62	2.62
Real Yields	4.01	4.99	2.30	6.32
Default[2] Adjustment	-0.11	-0.11	-0.04	-2.57
YTW, net, net adj.	**3.90**	**4.88**	**2.26**	**3.75**
Composite Rating	*BBB2*	*BB1*	*BBB1*	*B1*
Last Month End:	Hybrids		Corporates	
	Preferreds	CoCos	IG Corps	BIG Corps
YTW, net, net adj.	1.91	2.90	1.09	1.13
Change from Last	☆ 1.99	☆ 1.98	☆ 1.17	☆ 2.62

Source: Bloomberg; ICE BofA Bond Indices

[1] *Inflation assuption based on the UST5yr breakeven inflation rate*
[2] *Sprectrum's 10yr annual default study through 2020*

Hybrids offer the most positive double-net real yield opportunity in credit. The changes from May are noteworthy with below investment grade corporates (BIG corps) yields moving up the most and CoCos now offering almost 5% YTW (i.e., 4.88%), net-net. The positive real yield opportunities that made hybrids worthy inflation combatants last month have made them more attractive this month – the climb is likely to be ongoing as the Fed begins reducing its balance and accelerates the process in 2 months. The inverting yield curve is the second order effect on the UST curve this month and reflects concern over a recession. But the Fed has stated that it does not have concern for the yield curve because risk of inflation becoming unanchored is more important – in other words, the Fed does not have concern for a recession if inflation persists. In fact, it will focus more on labor (i.e., one of its policy objectives) than it will on recession. In the press conference Chairman Powell said, when asked of lowering inflation, "*There is a path for us to get there while maintaining a strong labor market.*" The implication here is that the Fed feels it can be aggressive in moving up the policy rate, so we are still a long way away from neutral. Nonetheless, there are still some compelling values in hybrids and all three sectors flag as being undervalued.

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