

General Commentary

Brent Crude futures surged to over \$100, up more than 40% over the past two weeks since the Iran conflict began. The geopolitical uncertainty and flow-through effects of higher oil prices to inflation led both the equity and fixed income markets to continue their sell off. Treasury yields jumped 17bps up front and 14bps in intermediate and longer tenors as the 10y is now off 32bps over the two-week timeframe. Economic data pointed to a mixed picture with the CPI report showing core inflation running at 2.5% and core PCE nudging up to 3.1%. Consumer spending barely rose, Q4 GDP was revised lower, and consumer sentiment declined to a 3-month low. Regardless, as the conflict has spread across the Middle East resulting in significant cuts to oil production, the Fed will likely be on hold for some time. Fed fund futures moved from a 100% probability of the next cut occurring by September to now just a 90% chance they cut at all this year.

IG Munis

The muni market continued its cautious tone this week as continued inflows were met with elevated BWICs and a heavy primary calendar. The benchmark AAA curve outperformed in the wings, but the belly of the curve struggled after the 10y tenor was cut by 17bps. Like last week, new issues in the 6-15y part of the curve saw very little investor demand. Dealers were left with significant balances and struggled to offload paper. While the 10y ratio hit YTD wides, dealers reported several inquiries for longer duration paper, particularly in the 4.60%-4.90% yield range, indicating there will likely be a floor to how far prices may fall if volatility continues. To further illustrate the demand, Lipper reported \$612mm of inflows this week, with almost all of it comprising of IG, intermediate, and long duration funds. While we can't predict the news cycle, we believe caution is warranted despite the recent adjustment in absolute yields. The inquiry range noted above is still a solid 20-25bps away from reality, so we think investors have some time before beginning to leg back in.

HY Munis

With the pent-up cash stockpiles sitting in HY funds, the market continued to sell off in an orderly manner. As has been the case for weeks, there just aren't many reasons for sellers to hit weaker bids. Inflows slowed down to just \$18mm but still remained positive and the new issue market was nonexistent. Benchmark names outperformed the IG market, with Buckeye Tobacco bonds off ~10bps, while Cofina yields only rose 4bps. Less common names fared similarly, with a block of a nonrated charter school trading just 4.5bps worse than last week. HY new issuance is finally set to pick up next week and will serve as a better indication of where demand truly lies. We will be closely tracking fund flows as we suspect investors will look to rotate up in quality as the Middle East conflict drags on. If cash cushions fall and funds begin selling, liquidity will likely dry up quickly and lead spreads to gap wider. However, if flows remain resilient, we may see a general decrease in risk appetite and some deals struggle, but the market otherwise may soldier on.

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Market Commentary

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