Talking Points

Commentary

For the month ended April 2023

2023 APR

Fixed Income Outlook

TD Asset Management emphasizes capital preservation in our active fixed income portfolios while seeking to maintain a yield advantage relative to the benchmark. We expect U.S. growth real Gross Domestic Product (GDP) to be near 0.0% in 2023, with slight improvement in 2024. A possible recession in 2023 is due to elevated inflation, higher interest rates, reduced private-sector consumption, tighter financial conditions, and geopolitical events. Elevated inflation and a strong U.S. labor market are factors contributing to higher short-term rates, via Federal Reserve (Fed) fund rate hikes. The bond market will be subject to heightened volatility due to persistently high inflation, tighter financial conditions, and geopolitical events. We expect yields to move higher from current levels, mostly in the front end, as the Federal Open Market Committee (FOMC) is committed to a more restrictive policy framework by increasing the target rate on Fed funds and reducing its balance sheet. We remain constructive, and very selective toward credit and are comfortable with our strategic credit positioning. Corporate bonds continue to offer some value over government bonds; thus, we maintain our preference for high-quality investment grade corporates. We continue to be positioned with an emphasis on liquidity and quality.

Focal Points

- Economic data shows a slowing U.S. economy. Near 0.0% growth is expected in 2023 with the possibility of a recession as the FOMC tightens financial conditions, consumer demand wanes and business investment declines as corporate profits fall.
- The FOMC's median federal funds forecast for year end 2023 is 5.125%. A 0.25% hike is expected in May, setting the range at 5.00%-5.25%. The FOMC will keep its policy rate restrictive until it believes inflation is on a sustained downward path to two-percent which will take time.
- U.S. Treasury yields were mixed during the month as investor focus partly shifted from regional bank failures, and fears of contagion in the banking system, back to U.S. economic data. The belly of the curve performed best as investor focus is now on the timing of an FOMC easing cycle (first federal funds rate decrease).
- Corporate bond spreads tightened during the month as bank spreads recovered some of last month's widening as investors became selective buyers of the sector. Concerns over tighter lending standards and the duration of the FOMC's restrictive policy framework continue to negatively affect corporate bond valuations.

Investment Professionals:

Glenn Davis, CFA
Managing Director

Dennis Woessner, CFA, CAIA
Vice President & Director

Source: TD Asset Management, TD Economics & Bloomberg Financial L.P.; April 30, 2023

Macro Update

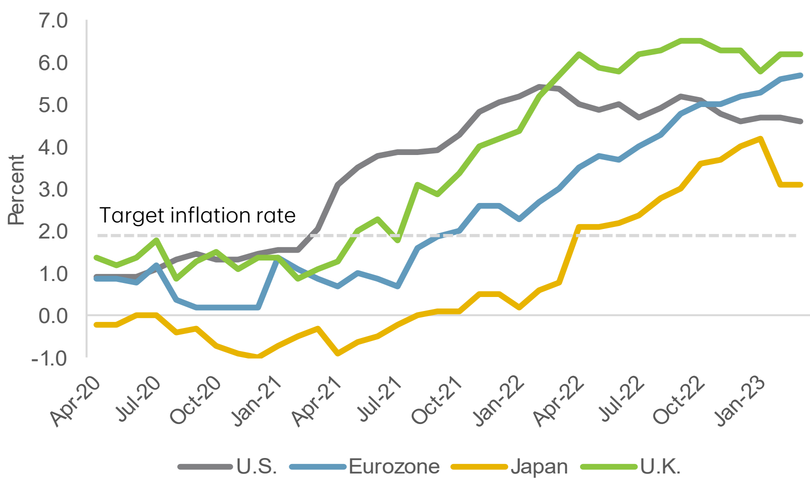
- U.S. real GDP increased 1.1% in Q1 2023 (2.6% in Q4 2022). Positive contributors were personal consumption, government consumption, and net exports. Negative factors were business spending and inventories. Domestic demand rebounded on a sequential basis. Inflation remains elevated.
- Timely economic data continues to indicate a broad-based slowdown. We expect U.S. growth in 2023 near 0.0% with the likelihood of a U.S. recession as the FOMC tightens financial conditions, consumer demand wanes and business investment declines as corporate profits fall; however, the labor market remains strong.

Source: TD Economics & Bloomberg Financial L.P.; April 30, 2023

Our Long-Term Views:

- U.S. and global economic growth remain uncertain and recessionary risks are high in certain regions. A broad economic slowdown driven by higher short term interest rates, elevated inflation, and a broader contraction in credit could lead to muted returns.
- The Fed policy framework will be restrictive in order to ease inflation. Tighter financial conditions, as nominal and real interest rates move higher, is expected.
- Heightened inflation in developed markets is more persistent due to some supply chain disruptions, higher wages, higher food prices, and geopolitical events.

Inflation



Source: Bloomberg Financial L.P.; April 30, 2023

Headline inflation has peaked, and is slowing, in the U.S. while core prices remain elevated, especially within the services component. We expect inflation to decline over the next twelve months; however, achieving the FOMC's two-percent target may take longer than the market and FOMC expect.

Heightened core inflation is prevalent in numerous developed economies as demand for services continues to be very strong.

U.S. Central Bank Update

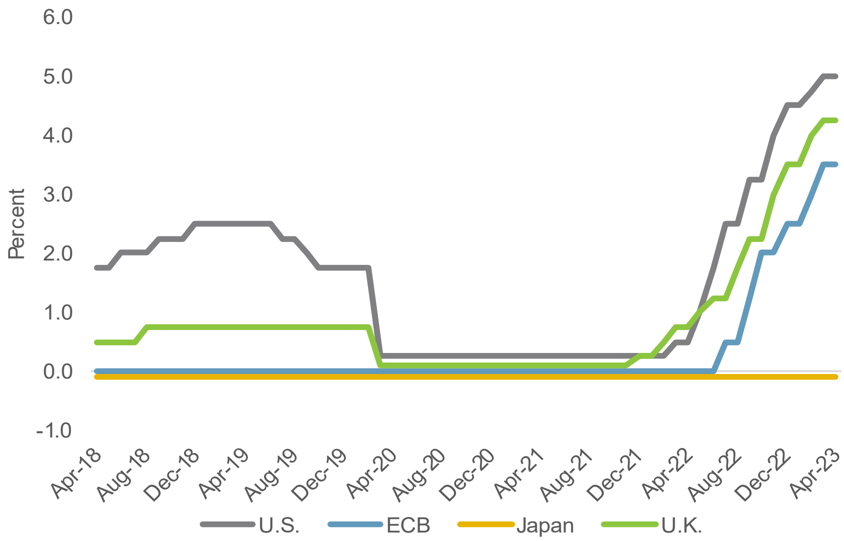
- The FOMC increased the federal funds rate by 0.25%, to a range of 4.75%-5.00%, at its March meeting. We expect an additional 0.25% rate hike at the FOMC's next meeting (May 3) which will increase the target range to 5.00%-5.25%.
- The FOMC's median federal funds forecast for year end 2023 is 5.125%. Market expectations are for a peak rate of 5.1% in June and two rate cuts in the second half of 2023. The FOMC also expects slow growth and above-target inflation during 2023 and 2024.
- The Fed, after the failures of Silicon Valley Bank and Signature Bank, implemented the Bank Term Funding Program (BTFP) which boosts a bank's liquidity by allowing it to exchange assets such as U.S. Treasuries for cash at their full-face amount, regardless of the current market value.

Source: TD Economics & Bloomberg Financial L.P.; April 30, 2023

Our Long-Term Views:

- The Fed funds effective rate will move higher over the next two months before stabilizing near 5.0% as the FOMC continues its fight against inflation. The peak range on federal funds may reach 5.00%-5.25% in 2023. The market expects the beginning of an easing cycle in the second half of 2023.
- The FOMC is committed to its monetary policy framework and market facilities to support price stability, labor markets, and financial market liquidity.

Central Bank Policy Rates



Source: Bloomberg Financial L.P.; April 30, 2023

Central Banks are trying to keep inflation expectations well anchored by raising their respective policy rates (becoming more restrictive) in order to slow growth and dampen demand as inflation remains well above target.

Central Banks are near the end of their respective tightening cycles and are more data dependent currently.

The Bank of Japan (BoJ) is the only major developed market central bank not to have increased its policy rate during the post-COVID economic recovery.

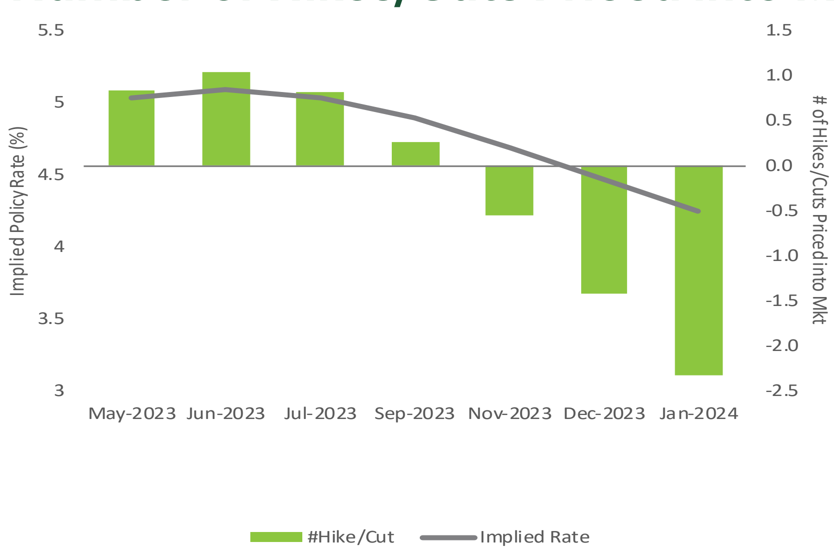
Cash/Short-term Market Update

- Short-term Treasury yields are increasing along with the federal funds rate; however, Fed funds futures are indicating interest rate cuts during the second half of 2023.
- Short-term credit spreads tightened 9 bps during the month as bank spreads recovered some of last month's widening (19 basis points (bps) tighter during April) as investors became selective buyers of the sector.
- Prime money fund assets increased $52.4 billion during the 3-month period ending April 2023. Total assets are $772 billion up 87% Year-over-Year (YoY). Asset growth should continue as rates on these funds greatly exceed bank deposit interest rates.

Source: Bloomberg Financial L.P.; April 30, 2023

- **Current Positioning:**
  - Short and Short/Intermediate Government/ Credit models remain overweight corporate bonds and have a similar duration relative to their respective benchmarks.

Number of Hikes/Cuts Priced into Market



Source: Bloomberg Financial L.P.; April 30, 2023

The FOMC increased interest rates by 0.25% at its March meeting. This is the ninth consecutive meeting in which the FOMC hiked rates. An implied peak policy rate of just over 5.00% is expected by June 2023.

The Fed funds futures market expects two interest rate cuts in 2023, with additional policy rate cuts in 2024.

1-3 Year Corporate Option-Adjusted Spread (OAS)

Source: Bloomberg Financial L.P.; April 30, 2023

At 92 bps, the index OAS is 9 bps tighter from last month end. YoY, the index OAS is wider by 17 bps as recent regional bank failures, high inflation, slower GDP growth, a hawkish FOMC, and geopolitical events negatively impacted valuations.

Corporate fundamentals are expected to weaken as we enter an economic slowdown. Financial conditions are in restrictive territory which is a negative development for corporate sector financing and valuations.

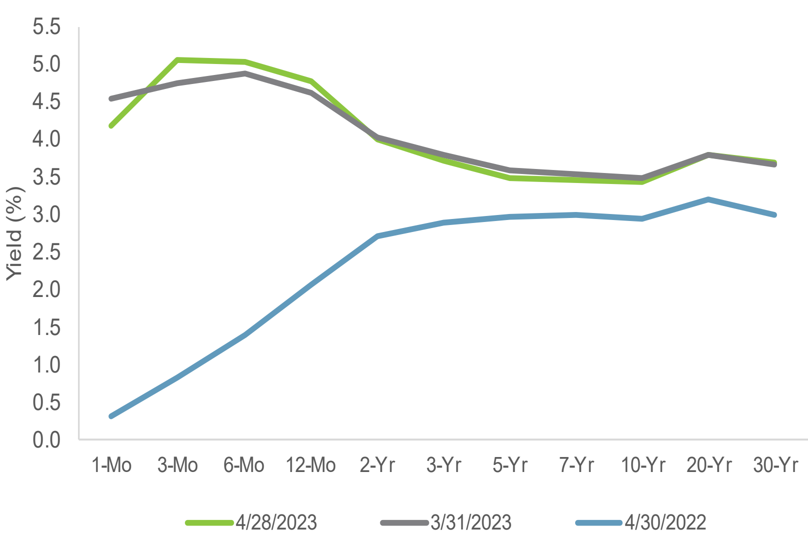
U.S. Treasury Market Update

- During April, U.S. Treasury yields were mixed as investor focus partly shifted from regional banks failures and fears of contagion in the banking system back to U.S. economic data. FOMC members reiterated their commitment toward fighting inflation and maintaining higher rates for a longer period. Declining economic growth and lower inflation in 2023 are the consensus forecast.
- The FOMC noted that its balance sheet reduction program will continue. The monthly cap in the Treasury portfolio is $60 billion.

Source: Bloomberg Financial L.P.; April 30, 2023

- **Current Positioning:**
  - Government models remain overweight the agency sector and have a similar duration relative to their respective benchmarks.

Treasury Yields

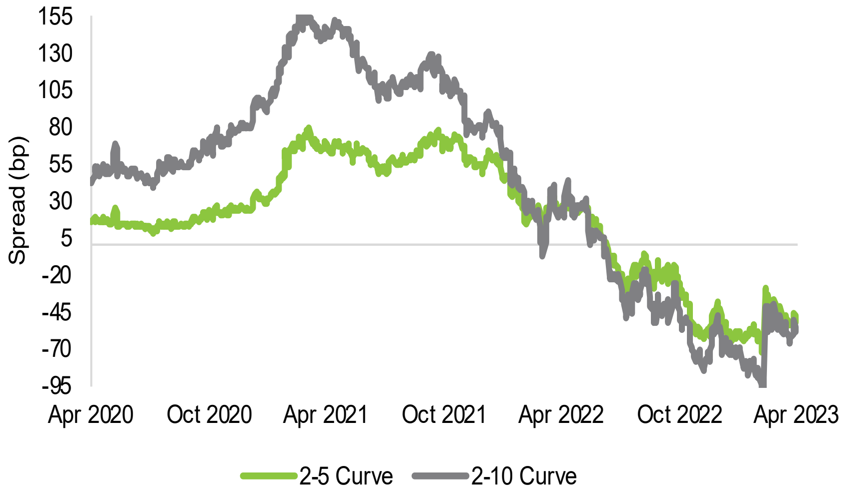


Source: Bloomberg Financial L.P.; April 30, 2023

During the month, Treasury yields were mixed, and the yield curve steepened. The yield spread between 2- and 30-year Treasury securities increased 4 bps, to -34 bps. The yield gap between the 3-month and the 10-year Treasury is -163 bps, an additional inversion of 36 bps from last month end.

We expect front-end yields to move higher from current levels.

Treasury Curves



Source: Bloomberg Financial L.P.; April 30, 2023

The inversion within the intermediate segment of the Treasury curve increased during the month as longer-term yields decreased more than the shorter-end of the curve. In April, the 2s5s curve, at -53 bps, flattened 7 bps while the 2s10s curve inverted 2 bps, to -59 bps.

Investment Grade Credit Market Update

- Looking forward, corporate fundamentals should remain positive but will moderate from very strong levels as the economy enters a period of below-trend growth. Financial conditions should reside mostly in restrictive territory which will negatively impact the corporate sector.
- Many companies took advantage of historically low interest rates to refinance short-term debt and/or increase cash positions to enhance financial flexibility.
- Corporate bond spreads, at 136 bps, tightened 2 bps during April as investors became selective buyers of the banking sector which drove spreads tighter. Regional bank failures, high inflation, slower GDP growth, a hawkish FOMC, and geopolitical events are impacting valuations.

Source: Bloomberg Financial L.P.; April 30, 2023

- **Current Positioning:**
  - Government/Credit models remain overweight the corporate sector, mostly in the banking industry, and have a similar duration relative to their respective benchmarks.

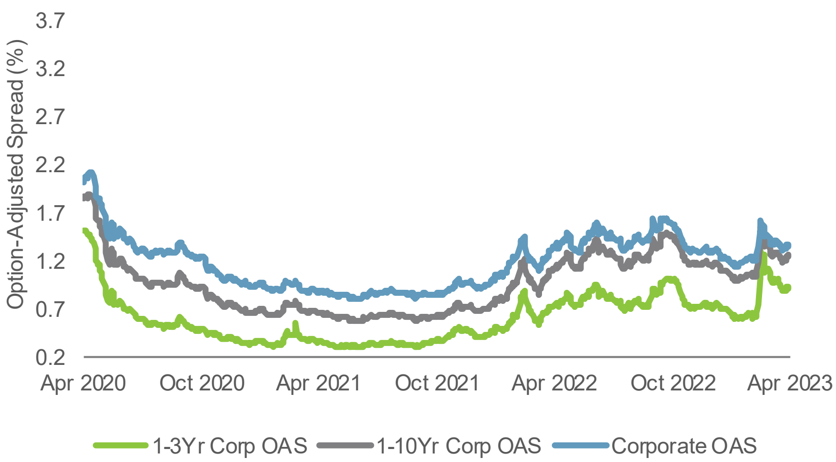
Corporate Spread & Issuance

Source: Bloomberg Financial L.P.; April 30, 2023

For the month, primary market issuance was $66.2 billion, a month over month decrease of $38 billion and a 39% decrease from the same period last year. The spread on the corporate bond index tightened 2 bps, to 136 bps, during the month.

We expect 2023 issuance to grow slightly relative to 2022 so the cumulative YoY change in corporate issuance should move toward, then above 0%, assuming stable financing conditions.

Corporate Spreads by Maturity



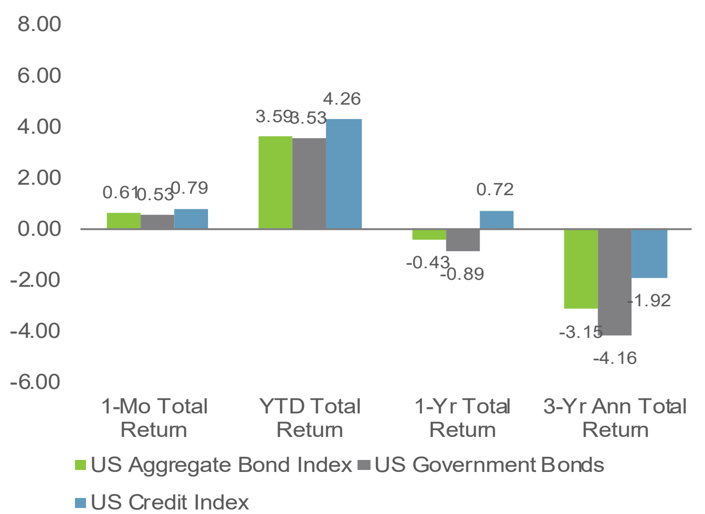
Source: Bloomberg Financial L.P.; April 30, 2023

Corporate bond spreads are wider by 1 bp YoY reflecting heightened financial market volatility due to recent regional bank failures, higher inflation, tighter monetary policy, geopolitical events, and emerging signs of a slowing economy.

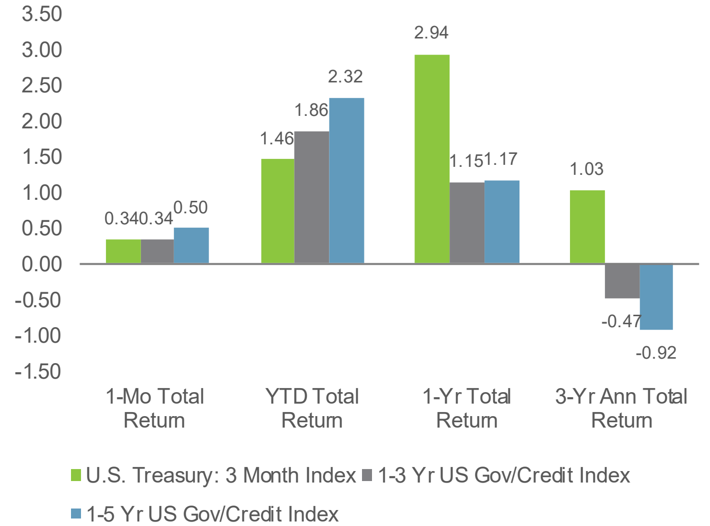
The corporate index OAS, at 136 bps, is 2 bps tighter relative to the last month end.

Charts & Tables

Fixed Income Bond Indices



Total Return (%)



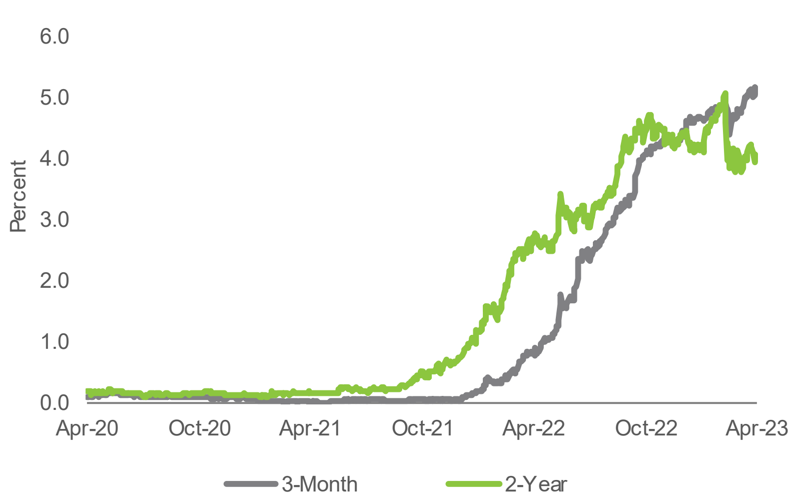
Economic Figures & Short-term Rates

Description	Current	3-mo Ago	1-yr Ago	Next Release
Fed Funds (%)	5.00	4.50	0.50	5/3/2023
CPI (YoY %)	5.00	6.50	8.50	5/10/2023
PCE (YoY %)	4.20	5.30	6.80	5/26/2023
Unemployment Rate (%)	3.50	3.50	3.60	5/5/2023
GDP (YoY %)	1.60	0.90	3.70	5/25/2023
Retail Sales (YoY %)	2.30	6.00	8.40	5/16/2023
Leading Indicators (YoY %)	-7.80	-6.00	6.00	5/18/2023
Housing Starts (000s)	1,420	1,348	1,716	5/17/2023

Description	Current	3-mo Ago	1-yr Ago
Fed Funds (%)	5.00	4.50	0.50
3-Mo U.S. Treasury Bill	5.06	4.67	0.83
6-Mo U.S. Treasury Bill	5.02	4.83	1.41
USD O/N Govt. Repo	4.84	4.32	0.27
U.S. 30-Day Comm Paper*	4.96	4.52	0.67
U.S. 90-Day Comm Paper*	5.15	4.71	1.21

*A1/P1/F1 rated U.S. Commercial Paper

Treasury Market



Change in Yield Curve (basis points)				
Maturity	**Yield Curve (%)**	**1-Mo Ago**	**3-Mo Ago**	**1-Yr Ago**
1-Mo	4.18	-35	-34	385
3-Mo	5.06	31	39	422
6-Mo	5.02	14	19	362
12-Mo	4.76	14	9	269
2-Yr	4.01	-2	-20	129
3-Yr	3.72	-7	-18	83
5-Yr	3.49	-9	-13	53
7-Yr	3.46	-7	-11	48
10-Yr	3.43	-5	-9	49
20-Yr	3.80	1	3	59
30-Yr	3.68	3	4	68

Source for all charts and tables: Bloomberg Financial L.P.; April 30, 2023

Talking Points

TD Asset Management:

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The information contained herein is current as of April 30, 2023.

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Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk, prepayment risk, and inflation risk. Corporate debt securities are subject to the risk of the issuer's inability to meet principal and interest payments on the obligation and may also be subject to price volatility due to factors such as interest rate sensitivity, market perception of the creditworthiness of the issuer and general market liquidity. High yield, lower-rated securities are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. Interest on municipal bonds is generally exempt from federal tax. However, some bonds may be subject to the alternative minimum tax and/or state or local taxes.