EquityCompass

Fixed Income Perspectives

A Monthly Strategy Review of Bond Market Trends And Economic Developments

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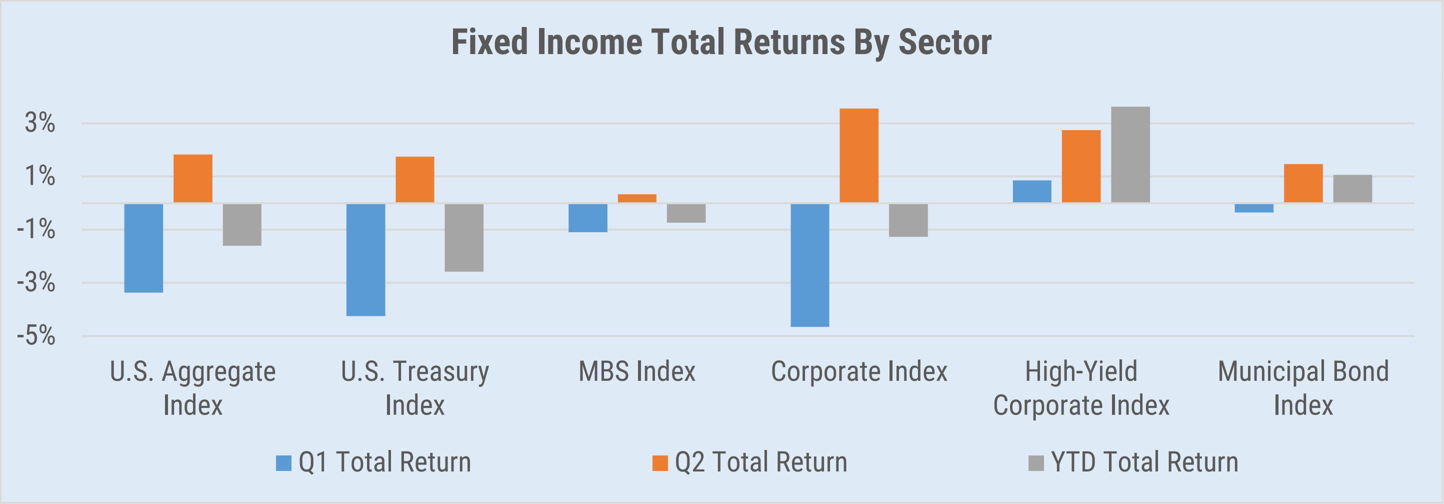
Fixed Income Sector Performance

Following the worst quarter for the bond market in 40 years, fixed income investors experienced a bit of a reprieve over the past three months. All major market sectors posted positive total returns for the second quarter, though most taxable, investment-grade indices remained in negative territory on a year-to-date basis. While the Bloomberg Barclays U.S. Aggregate Bond Index (AGG) recovered 54% of its previous decline, the year-to-date total return for the AGG was -1.60% through June 30. Investment-grade corporate bonds were the top performing sector for the quarter with a 3.55% total return.

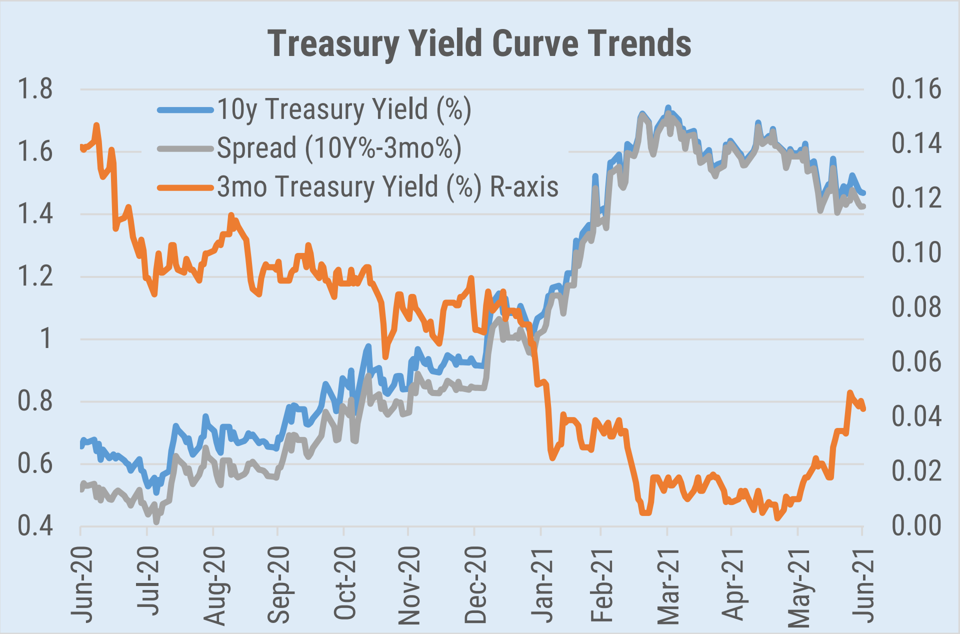
As economic fundamentals continue to improve, further normalization in bond yields should be expected. At the end of 2019 prior to the onset of the pandemic, the AGG yielded 2.3%, well above its 6/30/21 yield of 1.5%. **A return to a yield of 2.3% would imply additional market value depreciation for the AGG of around 500 basis points, while a reversion to its average yield level from the 2017–2019 time frame could result in a price reduction of nearly 900 basis points.**



YTD returns through June 30; Fixed income indices provided by Bloomberg Barclays; Source: Bloomberg Finance, LP

Treasury Yield Curve

After surging during the first quarter, Treasury yields retreated across the curve, as technical factors, uncertainty over COVID variants, and concerns over the future trajectory of the economic recovery put downward pressure on yields. The 10-year U.S. Treasury yield dropped by 27 basis points during the second quarter to 1.47% and fell to an intraday low of 1.25% on July 8. Counterintuitively, this decline in long-term rates coincided with some of the highest inflation readings seen over the past 30 years. **The recent reprieve from the steepening yield curve may prove to be temporary, with long-term rates poised to resume their ascent as inflation remains above the Fed's target and tapering looms.**

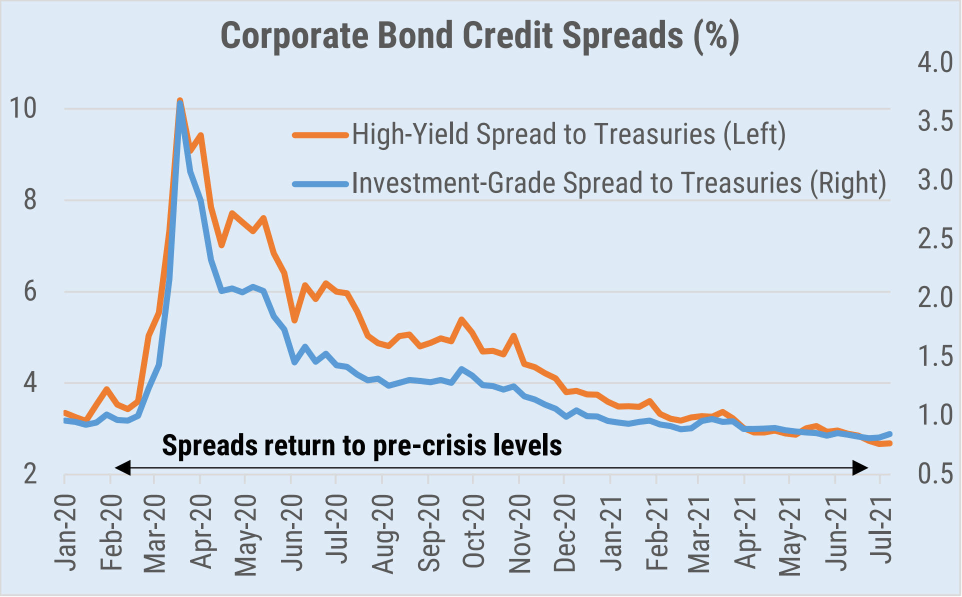


Source: Bloomberg Finance, LP

Credit Spreads

Despite a few periodic bouts of relatively short-lived volatility, credit spreads have completed their journey back to pre-pandemic levels. An important leading indicator for the economy, the sustained compression of credit spreads foreshadows continued strength in corporate hiring and capital expenditures over the coming months. The lack of spread widening in the face of falling Treasury yields suggests that bond market participants are not overly concerned about a sharp slowdown in economic activity.

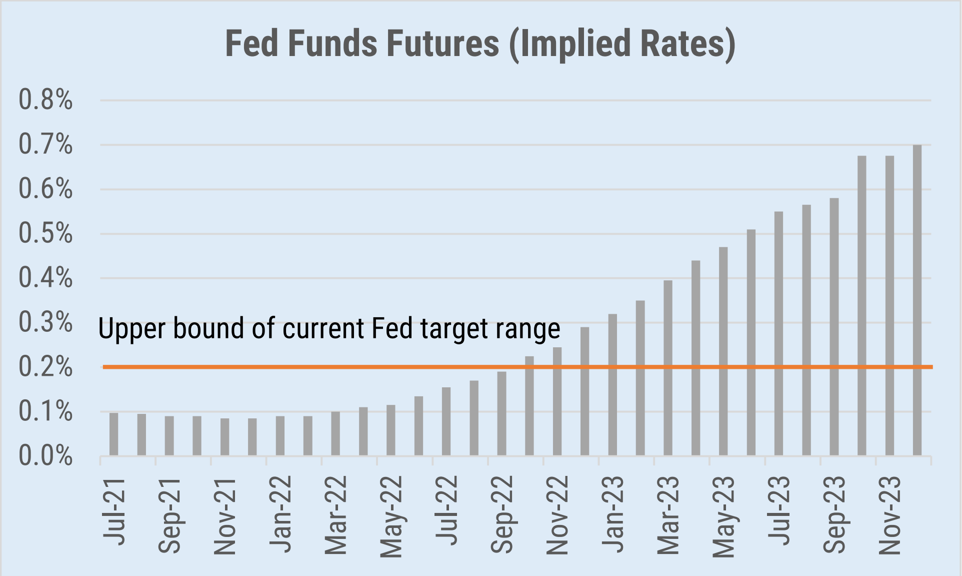
While low credit spreads are a sign of confidence in the economy, the lack of absolute yield available in the corporate bond market reduces the relative value of company debt compared to U.S. government-backed obligations. The average yield on Bloomberg Barclays U.S. Corporate High-Yield Bond Index dipped below 4.0% for the first time on record in February and stood at a paltry 3.75% as of June 30.



Source: Bloomberg Finance, LP

Federal Reserve Monetary Policy

While market participants have generally been receptive to the Federal Reserve's (Fed) forward guidance, fed fund futures imply a growing skepticism about the Fed's willingness to remain at the zero bound indefinitely in a reflationary environment. The Consumer Price Index (CPI) increased by 5.4% in June on a year-over-year basis and will likely remain elevated for at least several more months due to surging demand and lingering supply constraints, before settling back toward 2.0% as these transitory factors abate.

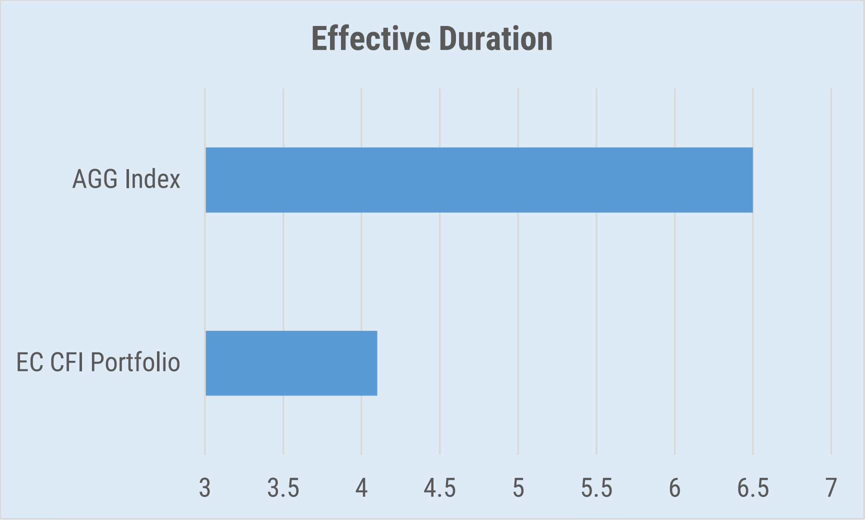


Source: Bloomberg Finance, LP

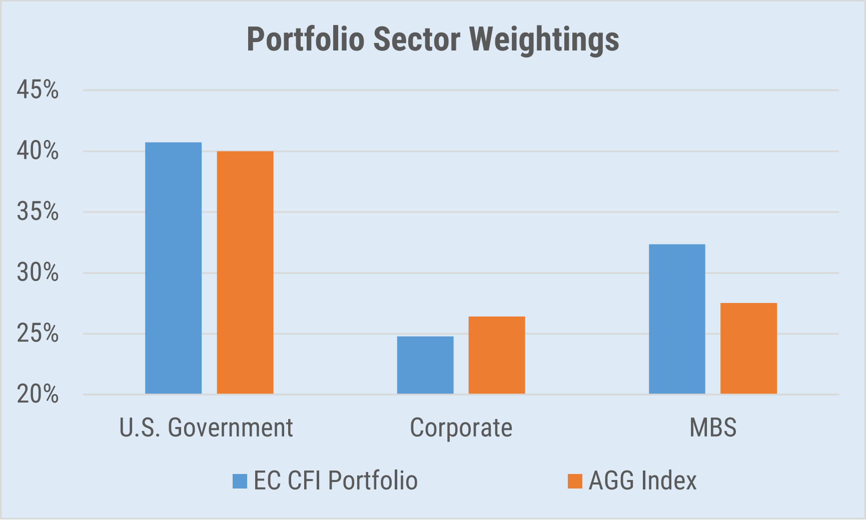
Fed funds futures are currently pricing in one 25 basis point rate hike by the end of 2022, while the latest dot plot suggests that policy makers will refrain from raising rates until 2023. Based on the latest communications from key Fed officials, a tapering announcement will likely be forthcoming later this year or early next year, as an initial step toward policy normalization.

Core Fixed Income Portfolio Statistics

The EquityCompass Core Fixed Income Portfolio (CFI) is now available as an SMA on Stifel's CAP and Opportunity platforms. **CFI is positioned to mitigate price depreciation if the economy continues to normalize, while providing risk diversification benefits if the recovery fails to meet consensus expectations.** Relative to the AGG, CFI's four-year average duration is about 40% shorter than the index. While nearly half of the AGG's interest rate risk exposure comes from bonds with durations of greater than 10 years, only 9% of our portfolio is tied to the long-end of the yield curve, predominately in the form of inflation-protected Treasuries.



Source: Bloomberg Finance, LP



Source: Bloomberg Finance, LP

Fixed Income Market Review

- Bonds staged a partial recovery in the second quarter, as technical factors, uncertainty over virus variants, and concerns over the future trajectory of the economic recovery put downward pressure on yields.
- The recent reprieve from the steepening yield curve may prove to be temporary, with long-term rates poised to resume their ascent as inflation remains above the Fed’s target and tapering looms.
- In contrast to the more cautious tone evident in the Treasury sector, corporate bond investors continue to express an optimistic outlook, as credit spreads hold fairly steady near their post-pandemic record lows.
- While the timeline for the Fed’s exit strategy remains uncertain, policy makers are gradually shifting toward more hawkish forward guidance in advance of a possible tapering announcement later this year.
- Loss mitigation, rather than yield maximization, amid considerable bond market volatility remains the primary focus of the EquityCompass Core Fixed Income (CFI) Portfolio.

High-Frequency Economic Monitor

Our weekly indicators have been picking up emerging strength in the labor market for the past several weeks, despite the somewhat disappointing monthly payroll numbers for April and May. **The overall trend in the weekly indicators, along with the stronger-than-expected June employment report, continue to point toward a sustained and robust recovery.**

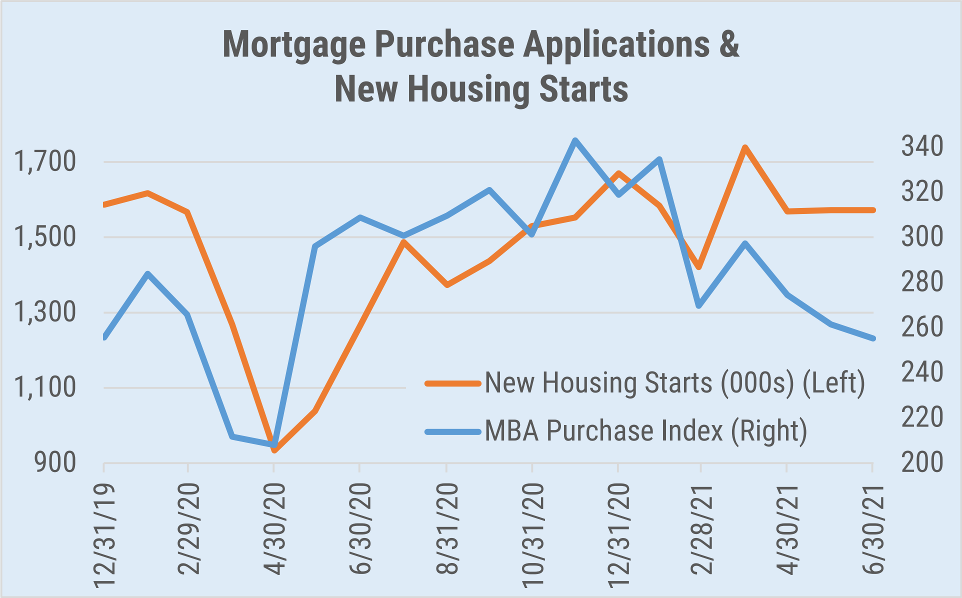
High-Frequency Indicators	Current Reading	-1 Week	-2 Weeks	-3 Weeks	1 Week Pct	2 Week Pct	3 Week Pct
U.S. Crude Rotary Rig Count	372	373	365	359	-0.3%	1.9%	3.6%
Raw Steel Production	1,835	1,839	1,834	1,840	-0.2%	0.1%	-0.3%
MBA U.S. Mortgage Purchase Index	255.2	268	266.3	262.1	-4.8%	-4.2%	-2.6%
JRI Same Store Sales Monthly	16.70%	16.20%	15.40%	14.50%	0.5%	1.3%	2.2%
Department Store YOY % Change (MTD)	-9.50%	-9.80%	-10.90%	-11.80%	0.3%	1.4%	2.3%
Initial Jobless Claims SA	371	416	418	374	-10.8%	-11.2%	-0.8%
Continuing Jobless Claims SA	3,339	3,412	3,528	3,517	-2.1%	-5.4%	-5.1%
Consumer Comfort Index	55.1	56.9	56.2	55.4	-3.2%	-2.0%	-0.5%
U.S. TSA Checkpoint Numbers	2,167,380	2,100,761	2,097,433	1,984,658	3.2%	3.3%	9.2%
Chicago Board Options Exchange (VIX)	15.1	15.6	20.7	15.7	-3.5%	-27.2%	-3.7%
IG Corp. Credit Default Spread	46.9	47.2	50.9	48.3	-0.7%	-7.9%	-2.9%

Data as of 7/2/2021. Green denotes positive trend; red denotes negative trend.

Source: Bloomberg Finance, LP

Mortgage Applications

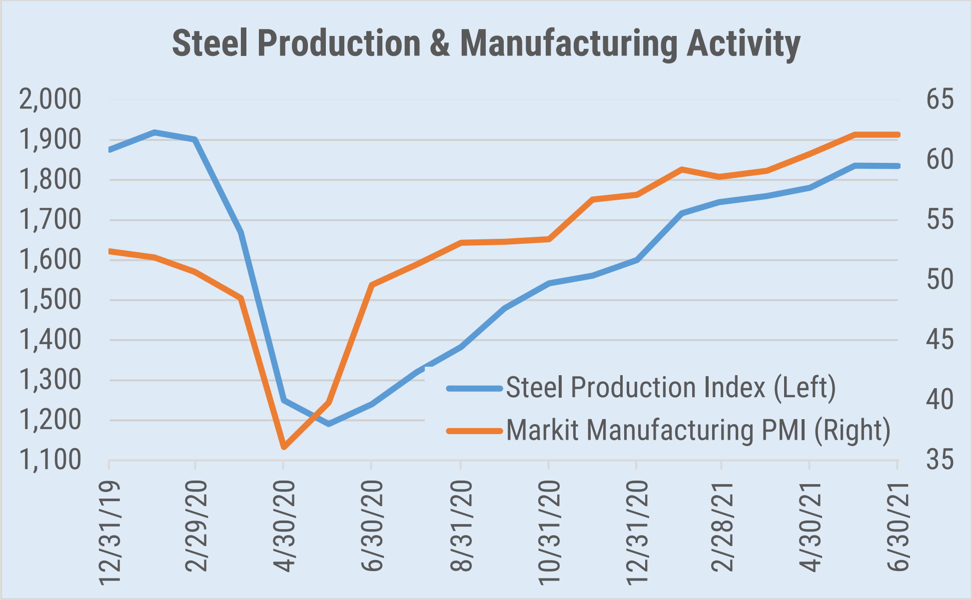
Turnover in the housing sector, which was a primary beneficiary of last year's historically low interest rate environment, now appears to be stabilizing around 2019's pre-pandemic levels. While residential real estate prices have risen significantly over the past year, applications for mortgages to fund home purchases have dropped well below the 12-year highs reached during the fourth quarter of 2020, due to reduced affordability and limited supply.



Source: Bloomberg Finance, LP

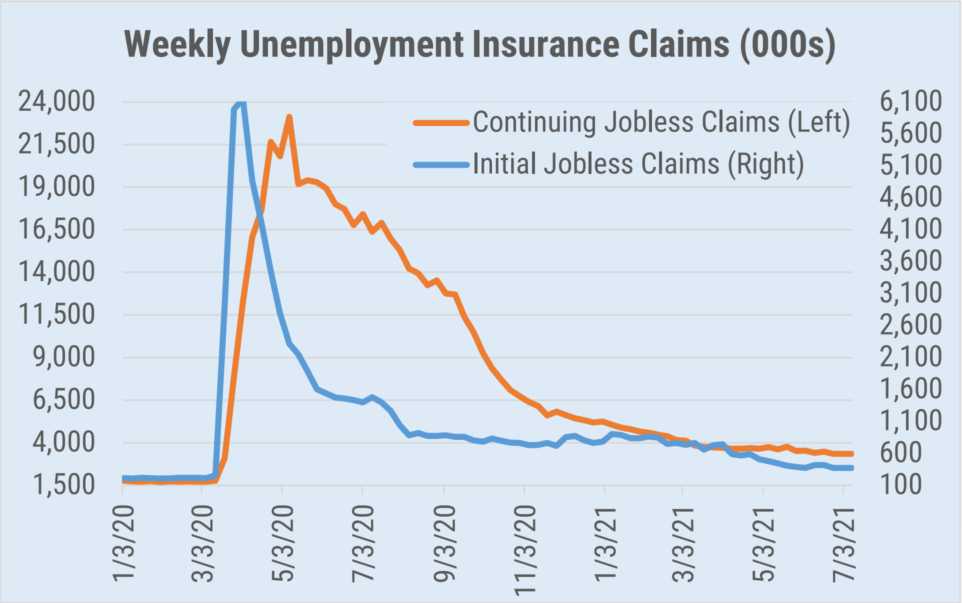
Steel Production

With solid demand for durable goods coming from both households and businesses, manufacturing activity continues to expand at a healthy pace. The ISM Manufacturing Index remained over 60 for the third consecutive month, and for the fourth time out of the past five months, with a reading of 60.7 in April. The last time that manufacturers were this consistently optimistic about future production was during the first half of 2004. The Raw Steel Production Index has climbed by 16% this year and set a new post-pandemic high of 1852 for the week of July 12.



Source: Bloomberg Finance, LP

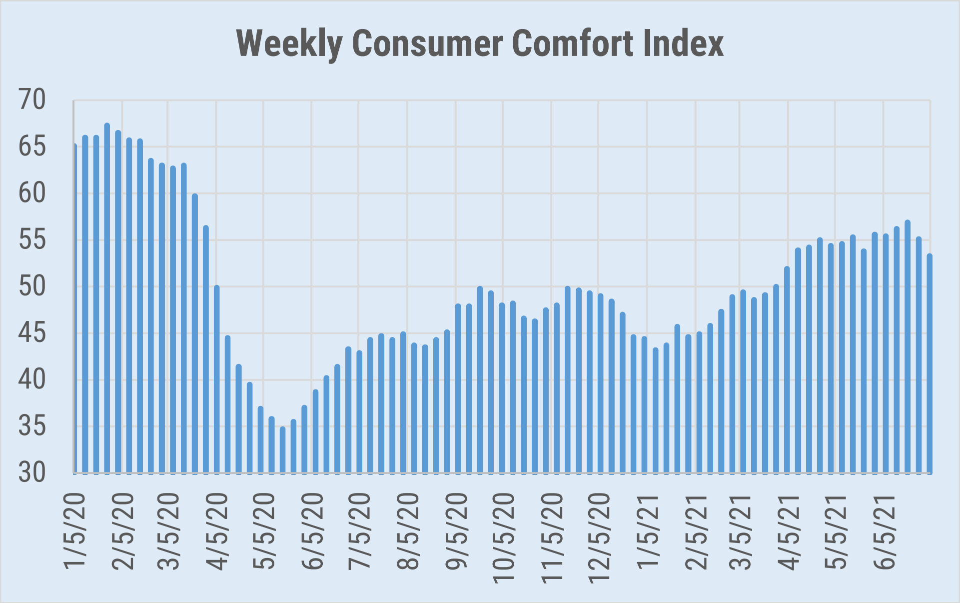
The continued downward trend in initial jobless claims suggests that nonfarm payroll gains could exceed 1million per month over the next several months. Initial jobless claims dropped by 12% to a post-pandemic low of 367,000 for the last week in June, marking the fifth consecutive month of notable improvement in first-time unemployment filings. After temporarily stalling near the 3.7 million level during April and May, continuing claims resumed their descent in June, as a number of states discontinued the enhanced federal unemployment benefits. Continuing claims have remained below 3.5 million for three consecutive weeks through June 25.



Source: Bloomberg Finance, LP

Consumer Confidence

Following a notable improvement in sentiment through the first four months of the year, measures of consumer confidence have stalled due to heightened concerns over inflation and a resurgence in virus cases. The weekly Consumer Comfort Index posted its lowest reading in three months for the week of July 4, dropping back to the 53 level. The monthly University of Michigan Consumer Sentiment Index also appears to have plateaued, coming in at 85.5 in June, down from its post-pandemic peak of 88.3 in April.



Source: Bloomberg Finance, LP

Economic Data Review

- A wide range of high-frequency economic indicators reflected broad-based favorable trends entering the third quarter.
- While housing prices have surged, activity levels have stabilized at 2019 levels due to reduced affordability and supply constraints.
- Sustained demand for manufactured goods from households and businesses continues to fuel a healthy expansion in the production side of the economy.
- The steady drop in weekly jobless claims points to a coming surge in employment growth, building on June’s 850,000 gain in nonfarm payrolls.
- Following a notable improvement in sentiment through the first four months of the year, measures of consumer confidence have recently stalled due to heightened concerns over rising inflation and an upturn in virus cases.

About the Author

James J. DeMasi, CFA
Senior Portfolio Manager

Jim joined EquityCompass in July 2019 as a Senior Portfolio Manager for the Core Fixed Income Portfolio and co-manager of the High-Dividend Portfolio. Prior to joining the portfolio management team, Jim served as the Chief Fixed Income Strategist at Stifel, Nicolaus & Company, Incorporated for 12 years. At Stifel, Jim created investment portfolio and risk management strategies for the firm's institutional fixed income clients. He also managed a $3 billion bond portfolio for Stifel Bank. Previously, he spent five years at Legg Mason as a fixed income strategist and 13 years at the Federal Deposit Insurance Corporation (FDIC) in bank supervision. His FDIC career focused on the credit analysis of bank balance sheets and the risk profile of innovative credit market instruments, including corporate bonds, mortgage-backed securities, and derivatives.

Jim has a B.S. in Finance from West Virginia University. He is also a CFA charter holder and member of the CFA Society Baltimore.

About EquityCompass

EquityCompass Investment Management, LLC ("EquityCompass") is a Baltimore-based equity investment management team that provides portfolio strategies with respect to assets of over $4.6 billion.[1]

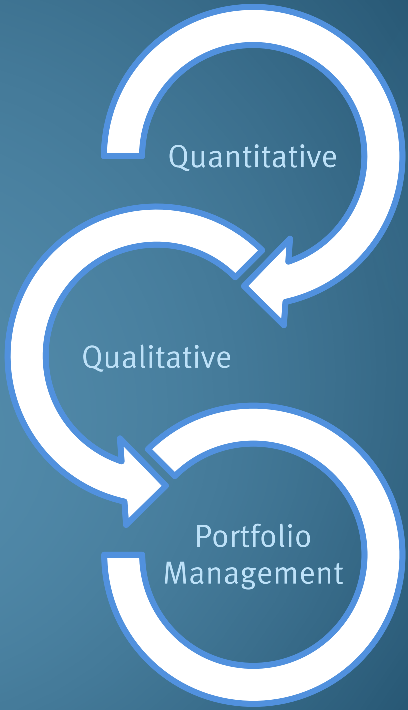
At EquityCompass, our mission as an asset management company is to provide investment solutions that address the needs of clients accumulating, mitigating risk to, and decumulating wealth. We aim to accomplish these goals with an organization culture that prizes intellectual honesty, open dialogue among colleagues, and a commitment to continually improve ourselves and the investment process.

Extensive Investment Experience

- Investment team led by Richard Cripps, CFA – former Managing Director of Portfolio Strategy at Stifel and former Chief Market Strategist and Co-Chairman of the investment committee at Legg Mason Wood Walker
- Senior members include Robert Hagstrom, CFA, as Chief Investment Officer and Chris Mutascio as Senior Managing Director – both with 20+ years of investment experience
- Publishing investment research since 2001
- Offering investment portfolios on the Stifel platform since 2006

Research-Driven, Risk-Managed Portfolio Strategies

- Incorporates fundamental, technical, and behavioral insights evolving from original research by EquityCompass professionals
- Portfolios are designed to maximize expected returns by focusing on stock selection while incorporating rigorous risk management strategies
- The investment team collaborates to leverage ideas, research, and expertise in making investment decisions on all strategies



Rigorous empirical testing to identify favorable risk-adjusted investment insights

Experienced qualitative analysis for final investment selection

Focused and disciplined portfolio decision-making

(1) Total assets combines both Assets Under Management and Assets Under Advisement as of June 30, 2021. Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non-fee paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

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Disclosures

Important Disclosures

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A minimum investment applies within the various investment advisory programs. There are costs associated with these programs, including but not limited to: execution costs for trades effected with other broker-dealers, exchange fees, transfer or other taxes, interest expense, any third-party account or administrative fees, wire transfer fees, any internal expenses charged by mutual funds or other investment companies, and the costs associated with products and services not described in the applicable Advisory Agreement. Ask a Stifel Financial Advisor for the Advisory Disclosure Brochure, which further outlines the fees, services, exclusions, and disclosures associated with these programs. You should consider all terms and conditions before deciding whether fee-based investing is appropriate for your needs.

Diversification and/or asset allocation does not ensure a profit or protect against loss. Any investment involves risks, including a possible loss of principal.

Description of Benchmark(s): The Bloomberg Barclays Consumer Comfort Index measures Americans' perceptions on three important variables: the state of the economy, personal finances and whether it's a good time to buy needed goods or services. A new index reading is generated every week, making it a timely sentiment gauge. The MBA Purchase Index is a weekly report of mortgage loan applications based on a sample of 75% of U.S. mortgage activity. Analysts consider the report to be a leading indicator of housing market activity. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). The Bloomberg Barclays U.S. Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting. The Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index tracks fixed-rate agency mortgage backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage. The Bloomberg Barclays U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. The Bloomberg Barclays U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded. The Bloomberg Barclays Municipal Bond Index is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year. The Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors. It consists of a diffusion index that summarizes whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting. The Chicago Board Options Exchange (CBOE) created the VIX (CBOE Volatility Index) to measure the 30-day expected volatility of the U.S. stock market, sometimes called the "fear index". The VIX is based on the prices of options on the S&P 500 Index and is calculated by aggregating weighted prices of the index's call and put options over a wide range of strike prices. Markit's North American Investment Grade CDX Index, or the CDX.NA.IG Index (the "IG Index"), is composed of one hundred twenty five (125) of the most liquid North American entities with investment grade credit ratings that trade in the CDS market. The Institute of Supply Management (ISM) Manufacturing Purchasing Managers Index (PMI) Report on Business is based on data compiled from monthly replies to questions asked of purchasing and supply executives in over 400 industrial companies. For each of the indicators measured, this report shows the percentage reporting each response, the net difference between the number of responses in the positive economic direction and the negative economic direction and the diffusion index. The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. The Langer U.S. Weekly Consumer Comfort Index is a rigorous, high-frequency measure of U.S. consumer attitudes. The unusually longstanding survey – conducted weekly since late 1985 – provides a unique, ahead-of-the-pack reality-check on consumer sentiment, a critical signal of economic activity. The Raw Steel Production index measures the real output of all relevant establishments located in the United States, regardless of their ownership, but not those located in U.S. territories. Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment. PAST PERFORMANCE CANNOT AND SHOULD NOT BE VIEWED AS AN INDICATOR OF FUTURE PERFORMANCE.