BOND MARKET UPDATE

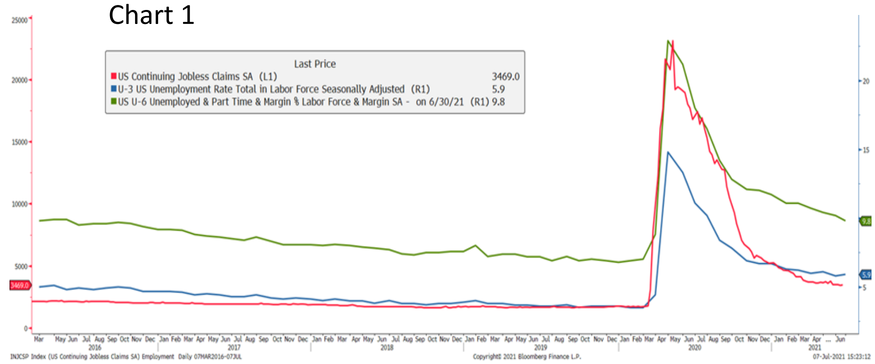
As of 06/30/21 | Volume 10, Issue 2 | FFTAM.com

In the 2nd Quarter of 2021, total returns for both taxable investments and tax-free investments were slightly positive. For taxable portfolios in the 2nd Quarter, the Barclays Aggregate generated a total return of 1.83%. For tax-free portfolios in the 2nd Quarter, the Barclays 1-10yr Muni generated a total return of 0.62%. YTD returns are -1.60% and 0.36%, respectively. The economy continued its reopening process, the Fed reconfirmed its support for the time being, yield curves flattened, and the markets are now firmly looking to when the Fed starts to reduce accommodation.

Economy

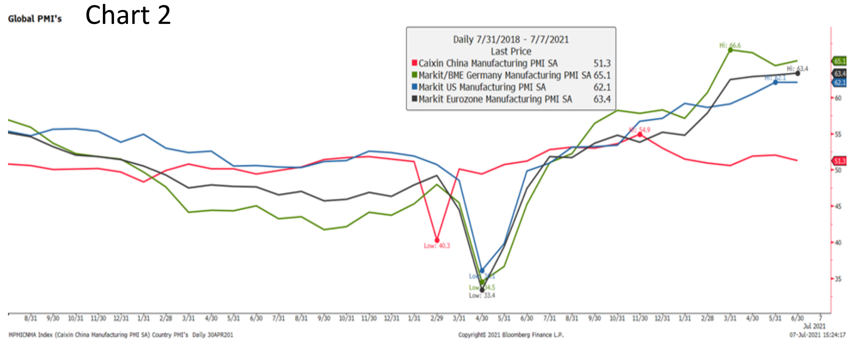
GDP in the 1st Quarter of 2021 came in with a final Q/Q reading of +6.4%. GDP Projections for the 2nd Quarter of 2021 are estimated at +10.0% Q/Q and current estimates for the year of 2021 are for a growth rate of 8.0%. US Unemployment and US Continuing Jobless Claims continue to decline. As the economy continues to reopen, these numbers should continue to improve as we progress throughout 2021. In addition, federal and state unemployment benefits are set to expire which should accelerate the growth of jobs in the coming quarters. (see chart 1)

Chart 1



Over the last quarter, we have started to see a leveling off of PMI's at elevated levels, signaling that 2nd Quarter may indeed be peak growth from a trough established in the 2nd Quarter of 2020 (see chart 2). Even though PMI's are peaking, it should be noted that they are leveling off at very attractive and elevated levels. If we maintain these levels, growth should be robust going forward.

Chart 2



FIRST FINANCIAL TRUST LOCATIONS

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400 Pine Street
Suite 300
Abilene, TX 79601
325-627-7100

BEAUMONT
3515 Dowlen Road
Beaumont, TX 77706
409-600-6460

BRYAN/COLLEGE STATION
1716 Briarcrest Dr
Suite 400
Bryan, TX 77802
979-260-2134

FORT WORTH
1000 Forest Park Blvd
Suite 200
Fort Worth, TX 76110
682-703-6404

HOUSTON
24080 Hwy 59 N
Kingwood, TX 77339
281-318-4625

ODESSA
3555 Billy Hext Rd
Odessa, TX 79765
432-367-8912

SAN ANGELO
222 S. Koenigheim St San Angelo, TX 76903 325-659-5987

SAN ANTONIO
9601 McAllister Fwy
Suite 1204
San Antonio, TX 78216
210-864-4774

STEPHENVILLE
2201 W. South Loop
Stephenville, TX 76401
254-918-6262

SWEETWATER
201 Elm Street
Sweetwater, TX 79556
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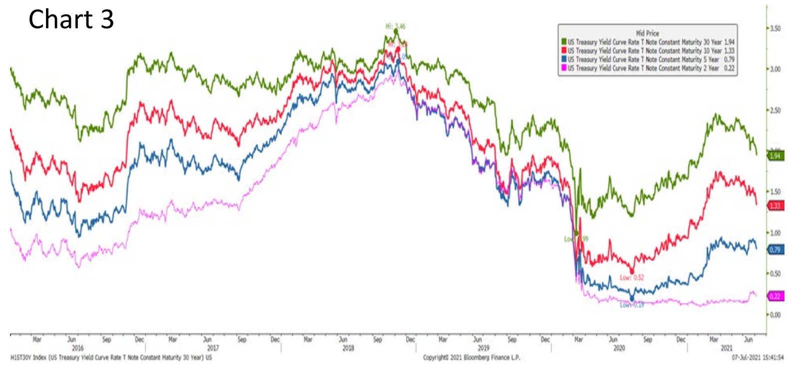
Rates

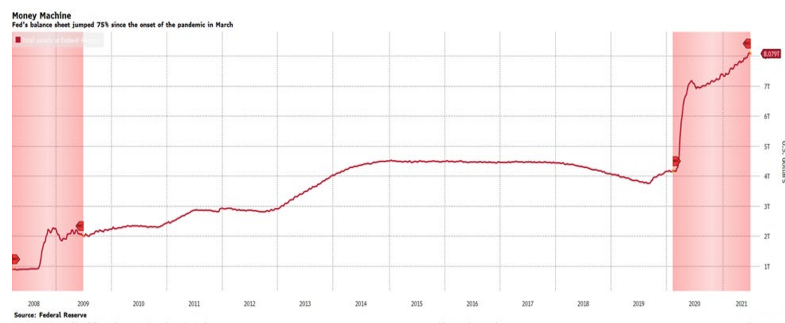
For the 2nd Quarter of 2021, U.S. risk free rates stopped steepening and flattened aggressively (see chart 3). The Fed, at both the April and June FOMC meetings elected to keep the cash rate at the zero-lower bound and reconfirmed their intention to keep the cash rate at the zero-lower bound for an extended period. However, at the June meeting, the communication by the Fed did change slightly. The Fed expressed interest, for the first time, in the need to start removing the excessive accommodation or tapering of the monthly $120B in bond purchases. Even though currently their objectives have not been met, they felt comfortable in signaling that their objectives of employment and inflation would most likely be met sooner than expected. Indications of a taper plan being communicated are centered around the end of the 3rd Quarter.

Chart 3



The Fed's balance sheet currently stands at $8.1T (see chart 4). By the end of the year, their balance sheet should grow to roughly $8.6T. If the Fed does start their tapering plan at the start of 2022, the balance sheet would still grow (at a slower monthly rate) until all monthly buying has ended. At that point, expectations are that they will maintain the current level, which is currently estimated at around $9T in size.

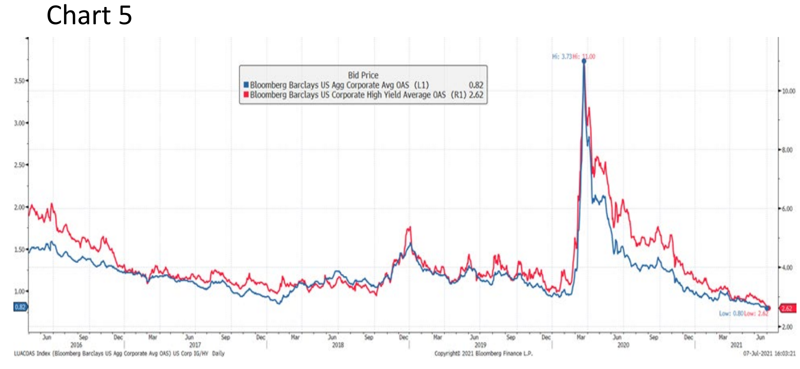
Chart 4



Credit

Credit performed well versus risk free in the 2nd Quarter of 2021. Spreads tightened for both investment grade and high yield as risk appetite prevailed with the backing of the Fed, an increase in vaccinations, and a massive $1.9T stimulus pushed through Congress in the 1st Quarter. Investment grade spreads tightened by roughly 11bps. High yield spreads tightened by roughly 42bps. As you can see, we are now pushing through previous credit risk premium lows prior to Covid (see chart 5).

Chart 5



Looking Forward

Looking forward, the risk-free curve should at some point revert to steepening. Historically, the average 10-2yr UST spread has been roughly 140bps. Currently, we are slightly below average at roughly 120bps. Since we are still in the early stages of this economic recovery, we would expect the 10-2yr UST spread to approach 200bps. This should take the 10yr UST to slightly over 2%. However, the most recent communication by the Fed did surprise markets. The release of the dot plots revealed a quicker stance by the Fed in raising rates than previously communicated. Many participants took the Fed at their word in previous communique' that they would like to see the economy run hot, inferring letting inflations expectations exceed previous thresholds to make up for the past 10 years of results below inflation targets. Inflation readings should continue to exceed the Fed's goal. How much above that goal will dictate whether the Fed can hold the cash rate steady at the zero-lower bound. For credit, we still don't see risk premiums increasing too much as the Fed is still extremely accommodative, vaccination rates are up, although increasing at a much slower rate and stimulus is in full swing. We will continue to look to reduce credit risk as we approach the Fed announcement on the end of QE4. As always, we run a high-quality portfolio that looks to take advantage of opportunities as they present themselves. We have been active in seeking those opportunities and feel good about the changes that have been made.