4Q21 Bond Market Review & Outlook

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Let’s Start with The Bond Basics

The 10-Year US Treasury Rate

The 10-year US Treasury Rate is viewed as the "Risk-free" rate, meaning zero default risk.

Most debt is priced off the US 10-year treasury rate such as mortgages rates and auto loans.

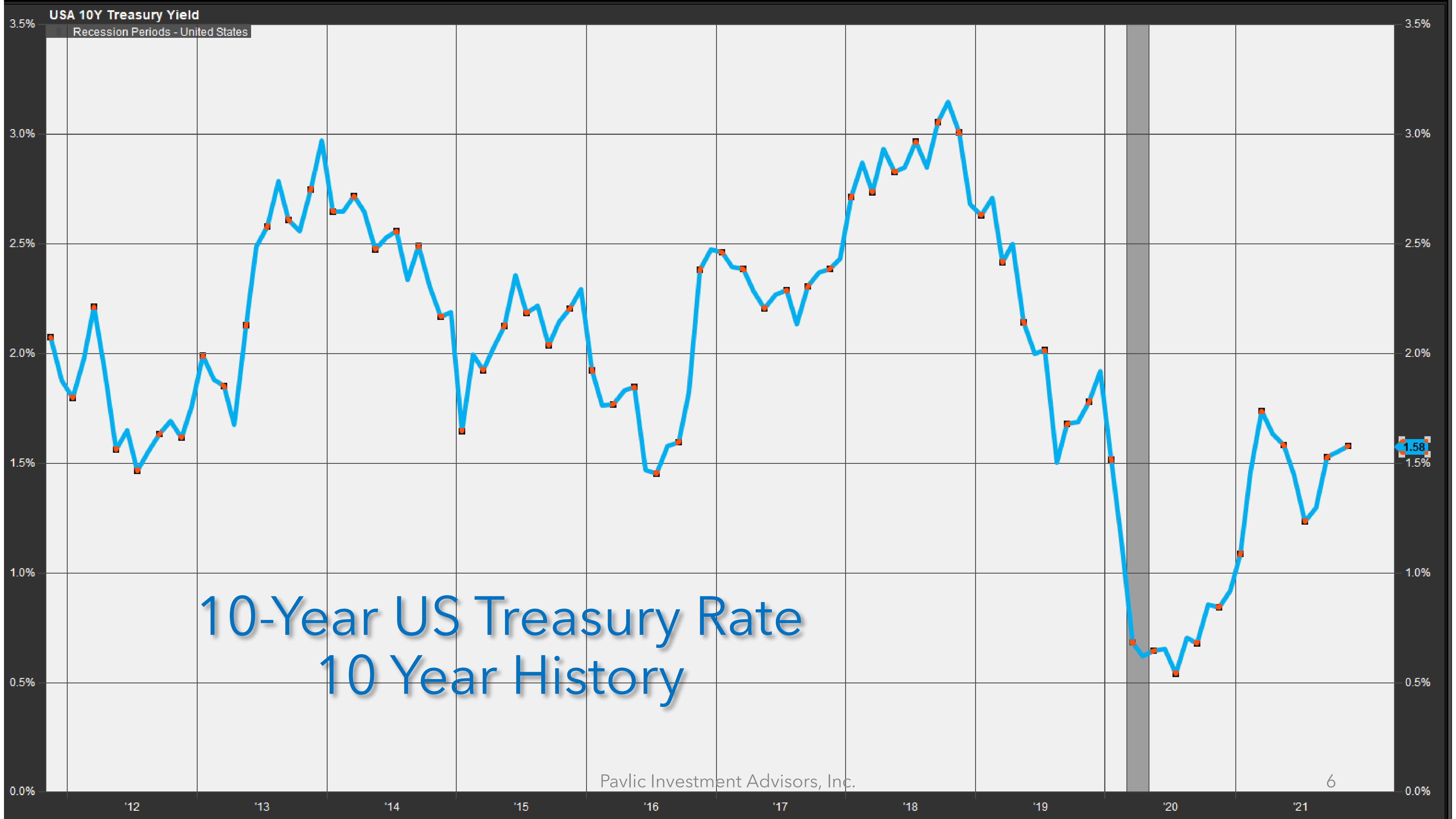
Banks can borrow at the US Treasury rate and make loans at a higher rate–the credit spread.

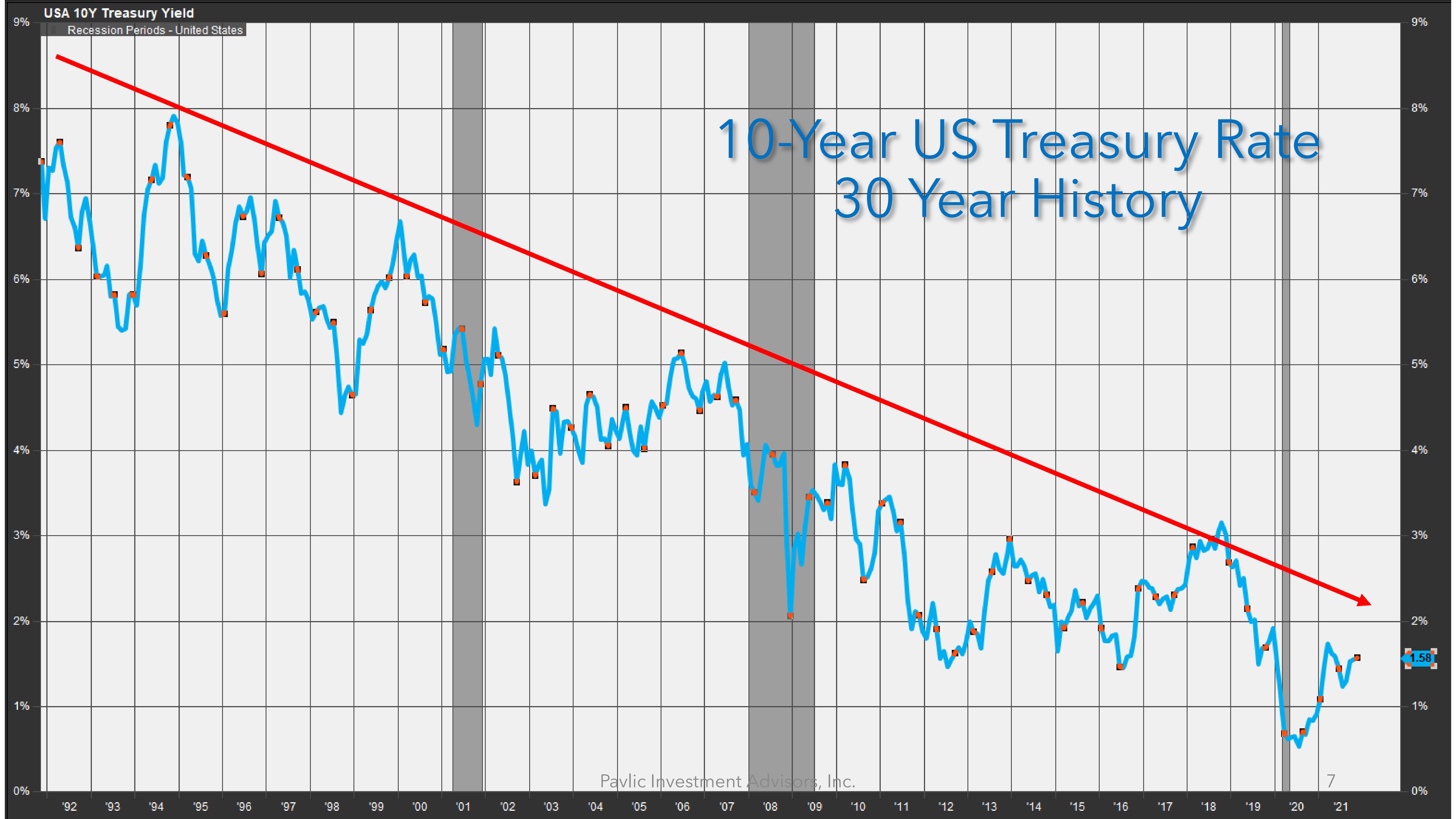
Yields on corporate bonds =

10-year treasury rate + default credit spread


USA 10Y Treasury Yield
Recession Periods - United States
1.8%
1.6%
1.4%
1.2%
1.0%
0.8%
0.6%
1.58
Nov
Dec
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
10-Year US Treasury Rate
1 Year History

10-Year US Treasury Rate 3 Year History


USA 10Y Treasury Yield
Recession Periods - United States
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
1.58
'12
'13
'14
'15
'16
'17
'18
'19
'20
'21
10-Year US Treasury Rate
10 Year History


USA 10Y Treasury Yield
Recession Periods - United States
10-Year US Treasury Rate
30 Year History
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
1.58
'92
'93
'94
'95
'96
'97
'98
'99
'00
'01
'02
'03
'04
'05
'06
'07
'08
'09
'10
'11
'12
'13
'14
'15
'16
'17
'18
'19
'20
'21
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Let's Add the Spread

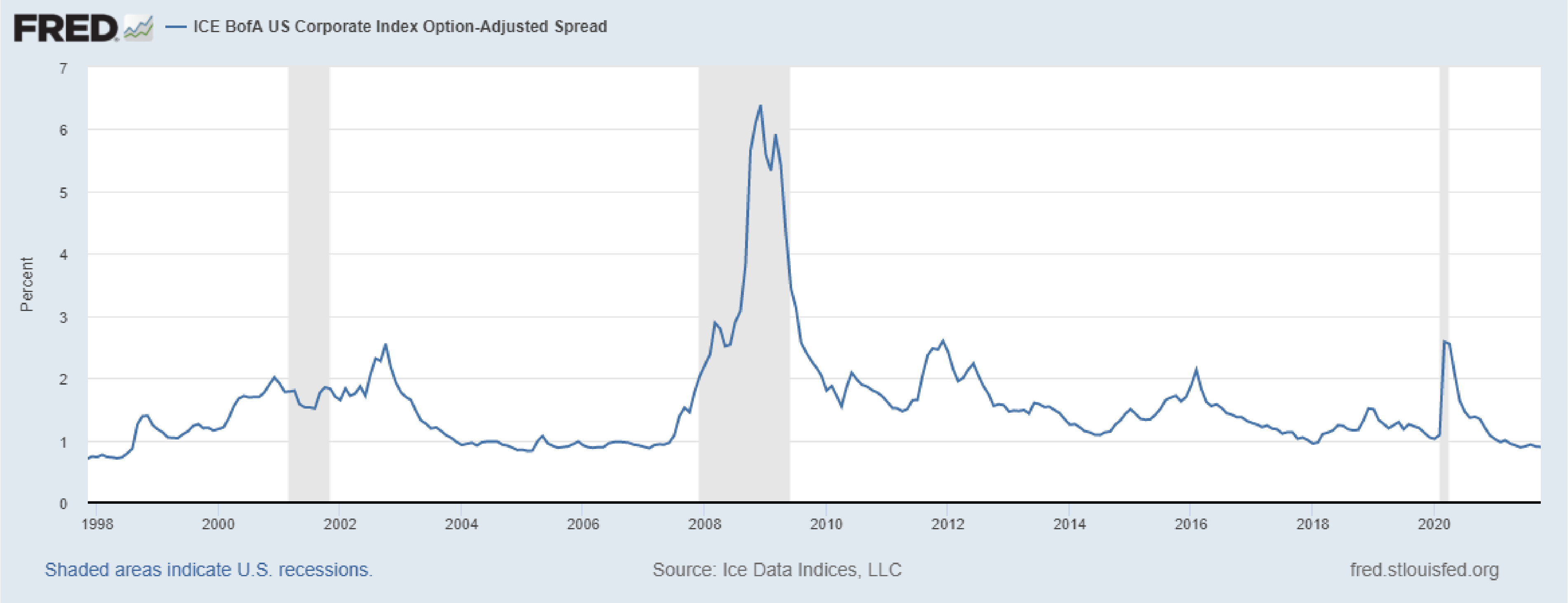
US Treasury Rate

+ Corporate Credit Spread

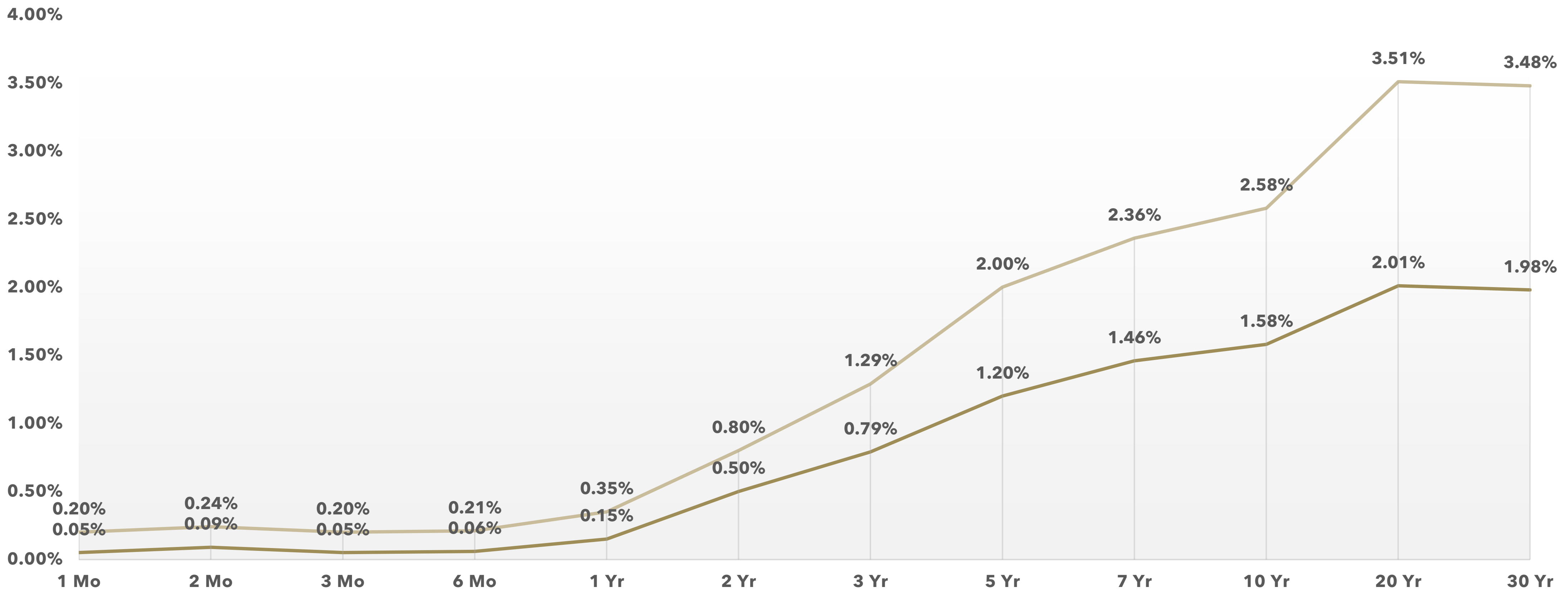
= Bond expected yield

(+) The Corporate Credit Spread

- Corporate Credit Spreads have reached all time lows at ~1.0%.
  - COVID corporate credit spread peaked at 2.5%
  - GFC Corporate Credit Spread peaked at 6.2%



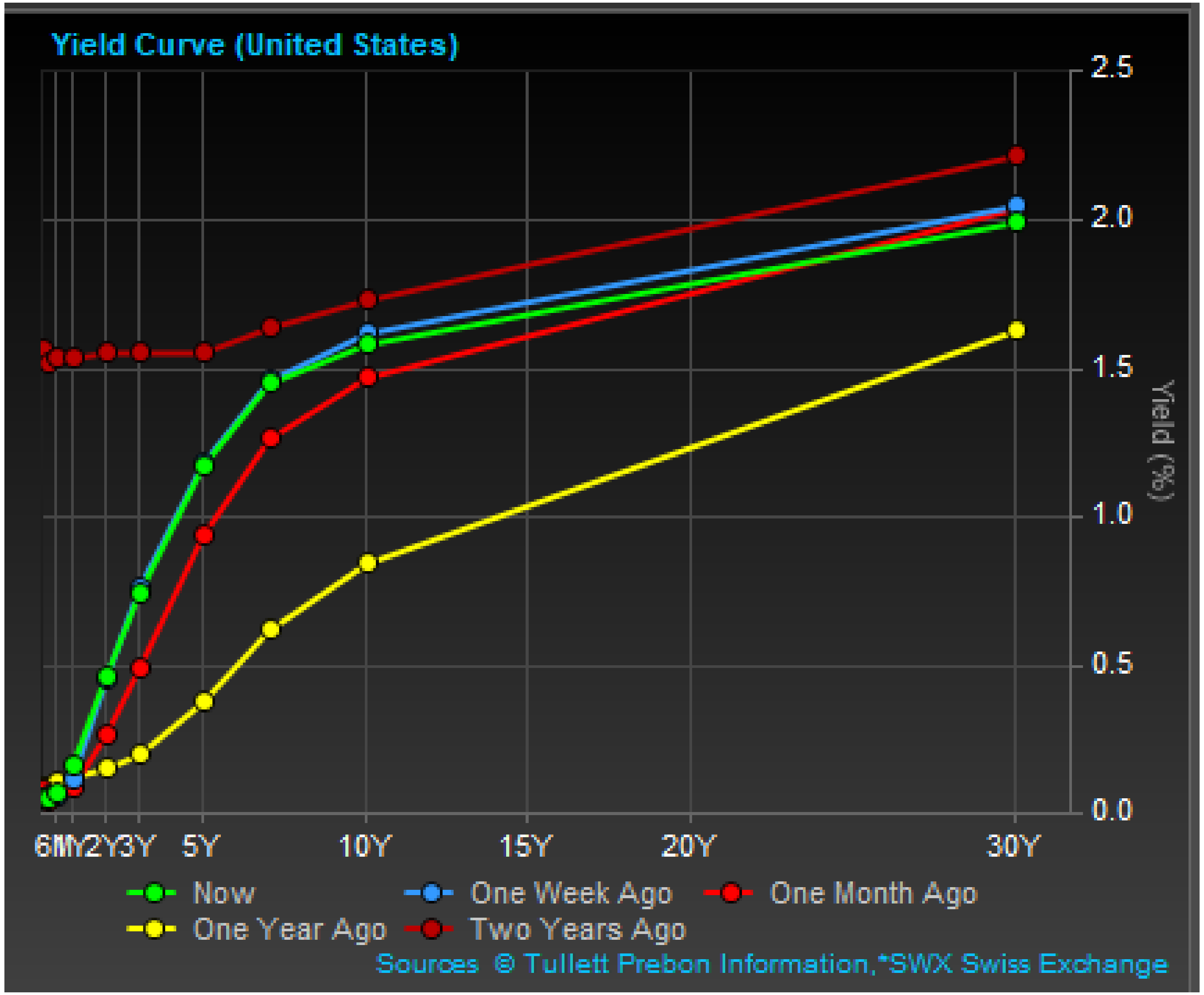
Putting the Rates Together = US Corporate Bond Curve



The Yield Curve Shows Steepening

- Suggestive of Continued **Higher Expected Growth**
- Suggestive of Continued **Higher Expected Inflation**
    - “How High?”
    - “How Long?”

- **<u>Higher Yields = Reinvest 2021 & 2022 Maturities at Higher Rates of Return.</u>**



Why is the Fed Funds Rate So Important?

- ***The Fed Controls the Short end of the curve*** *– The Fed Funds Rate—currently set at 0.00-0.25%. This rate is the rate banks charge each other to borrow/lend excess reserves overnight.*

- *Jerome Powell, Chair of the Federal Reserve, recently reiterated he is comfortable having inflation "run moderately hot" to continue to reach maximum employment which he views as far off.*

- *We expect the Fed to keep interest rates near 0% until the second half of 2022 when they will be forced to raise interest rates.*

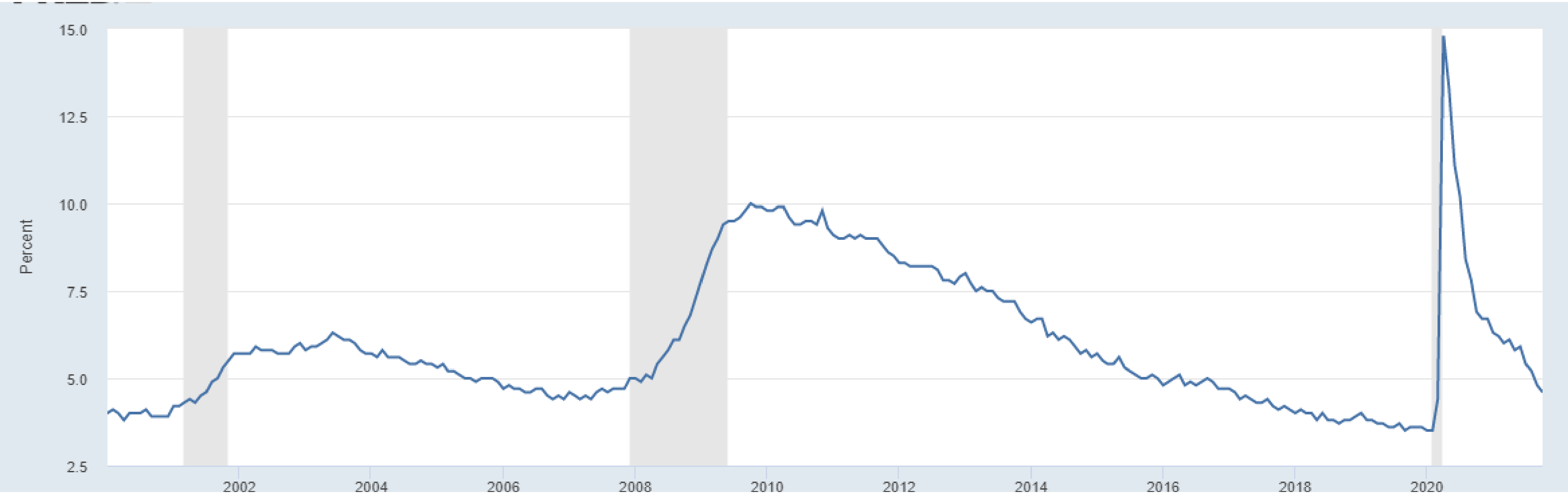
The Federal Reserve Mandate:

Maximize Employment

Stable Prices

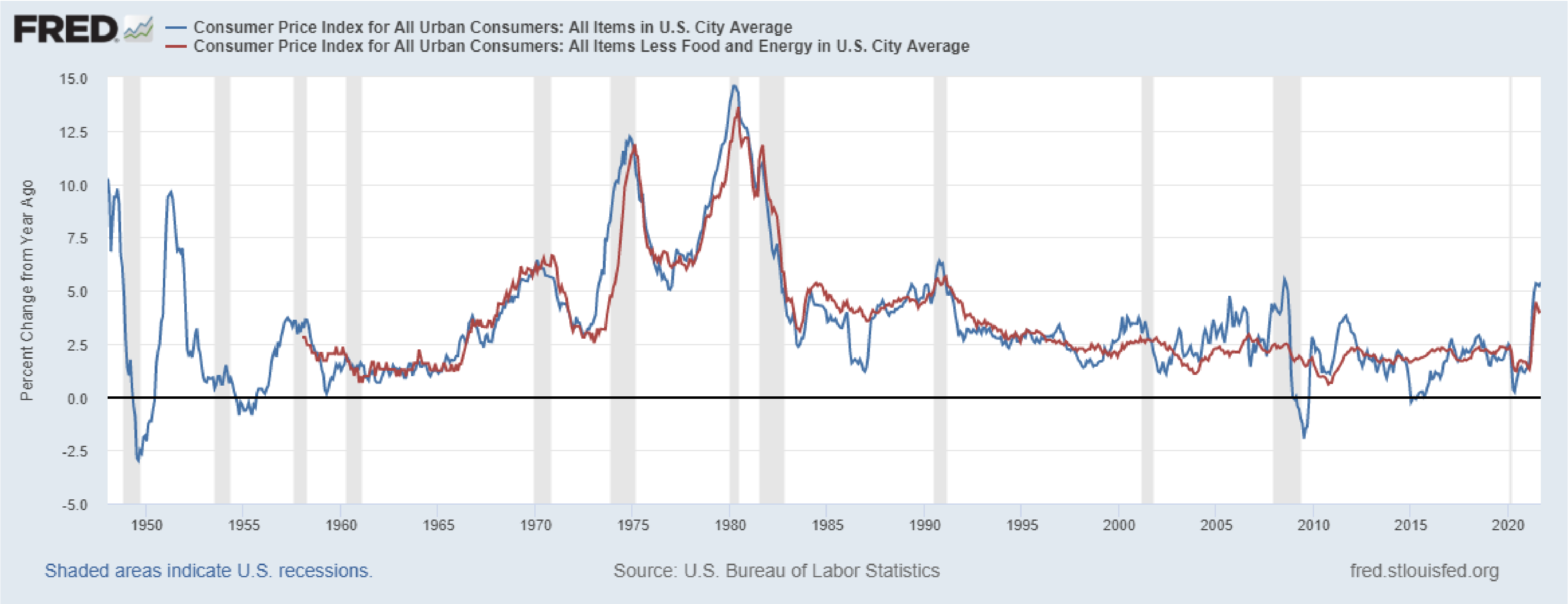
Employment Closing in on "Full"

- 4.6% Unemployment Rate the Latest Reading
- Despite "Progress to go", we could hit "full" employment very soon at the pace we are going



Inflation

- Comparisons to the 1970's and 1980's are far from where we are today, despite the steepness of inflation's climb since this summer

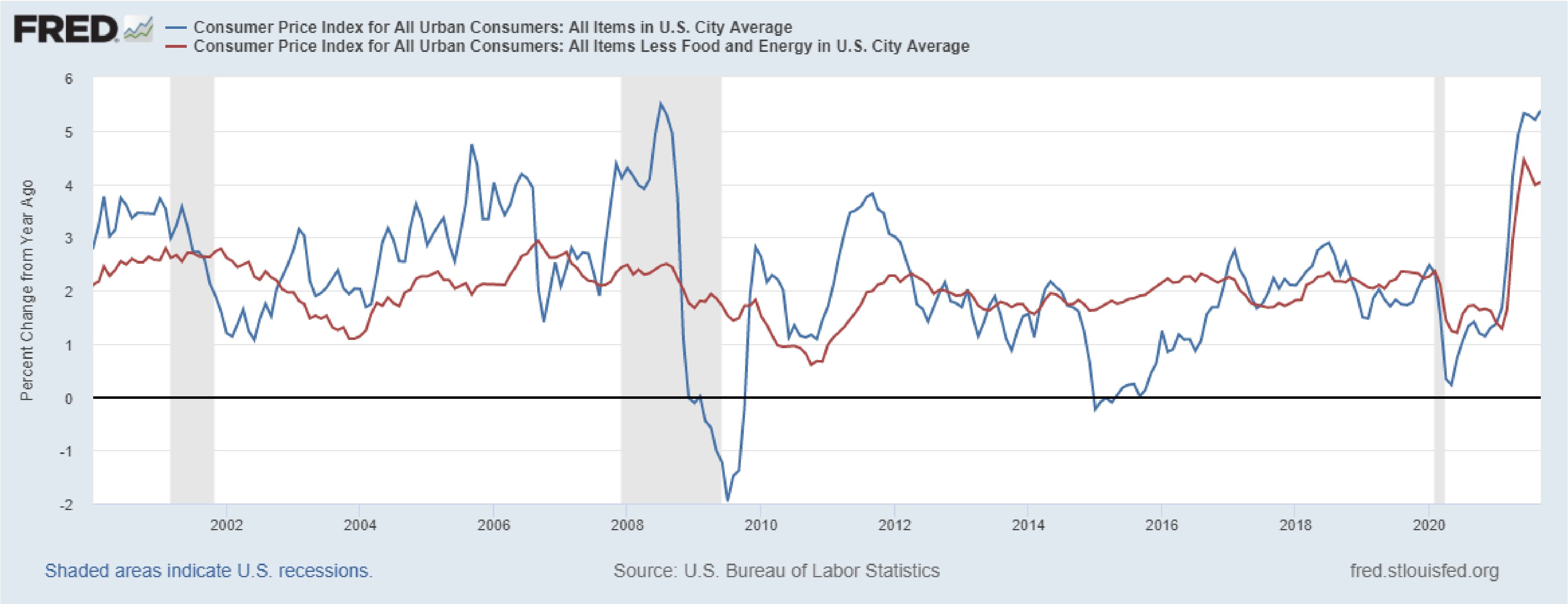


What has kept a lid on inflation for 40+ years?

- Competition Went Global
- Technological Innovations
- Aging Demographics
- Higher Debt = Lower Growth

Inflation

- "It's Transitory" line is getting stale…
  - COVID Supply Chain Disruptions
  - Worker Shortages
  - Labor Cost Increases
  - Food & Energy not the sole driver of cost increases



Inflation: The Latest Reading

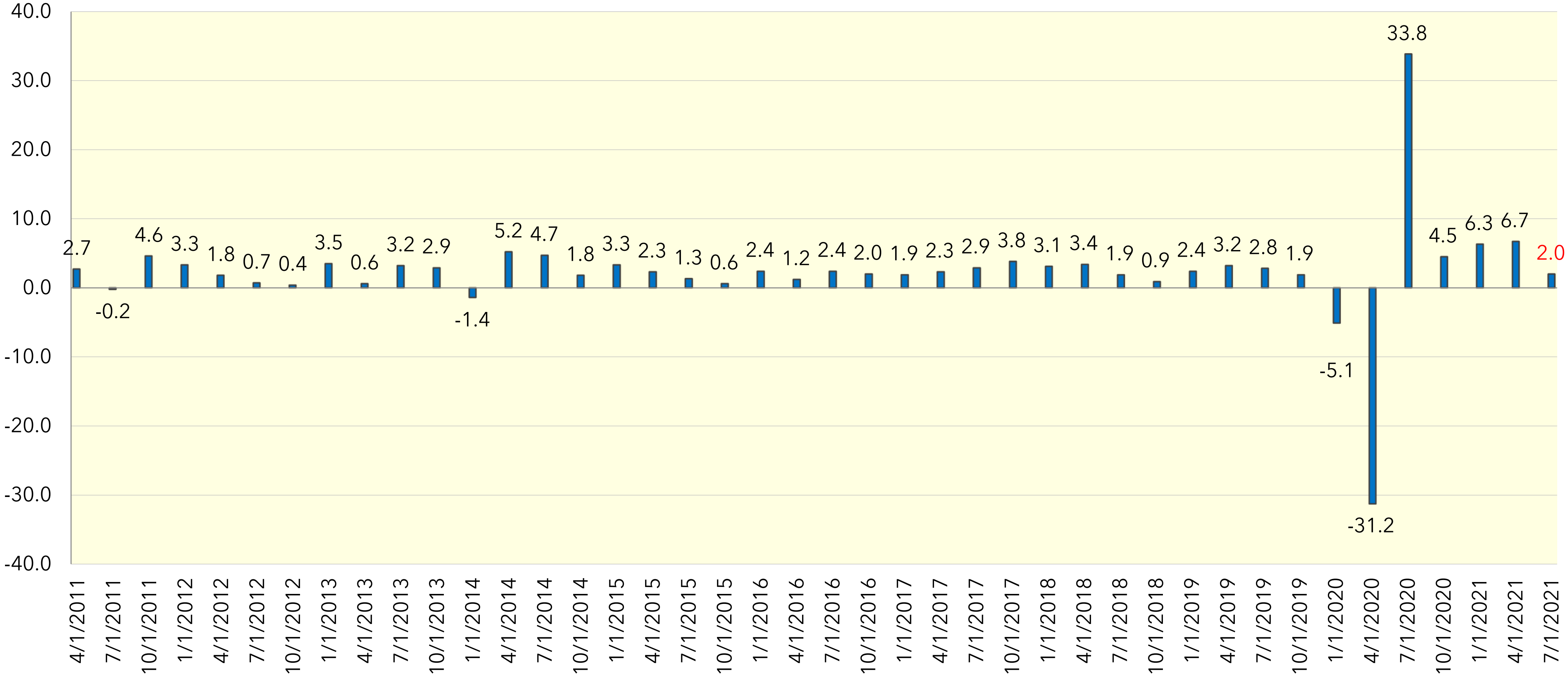
Headline and Core highest levels since 1991:

- Headline PCE inflation up +4.4% YoY
- Core Inflation (Ex-food and energy) up +3.6% YoY

Breaking down the numbers:

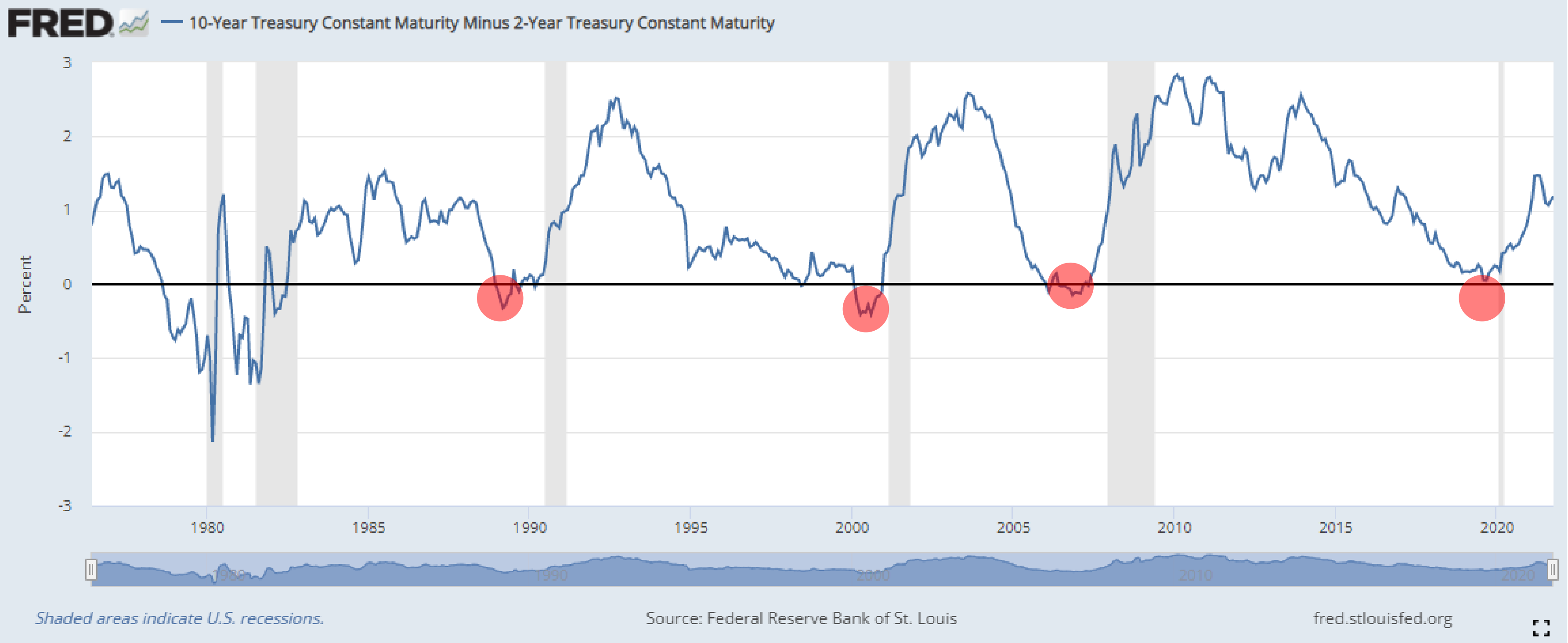
- Energy costs are up +24.9% YoY, but consumer saving & spending still above pre-COVID levels.
- Wages and salary increases averaged +4.6% YoY.

The Third Invisible Mandate??
US GDP Growth YoY % Change

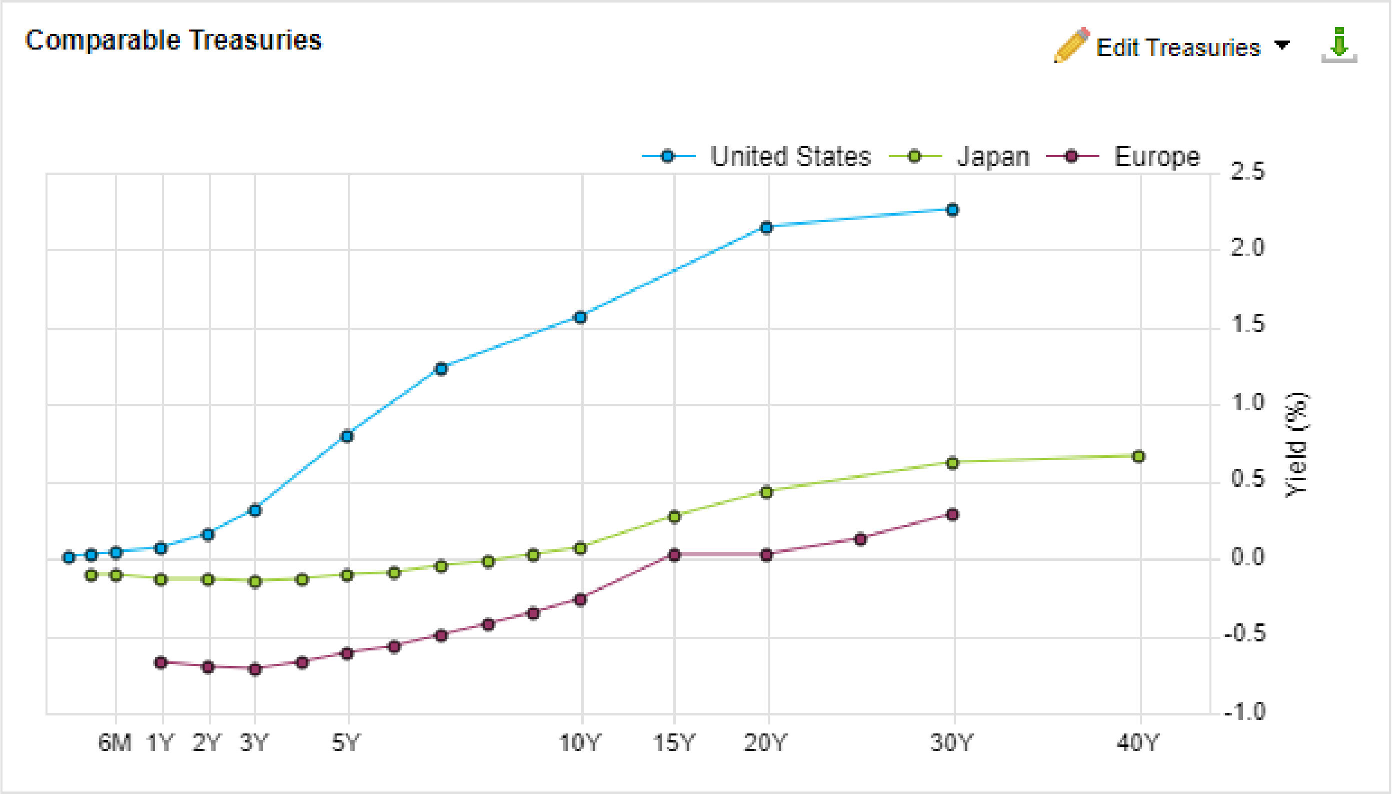


2yr vs. 10yr Yield Spread

- Traditionally a very good indicator of recessions
- We are far from anywhere close to an inverted curve



US Rates a "Bargain" Compared to Overseas



- If you think risk-free rates are low in the US, just look overseas
- This naturally keeps demand for US Treasuries and debt high, thereby keeping bond yields low

How Do We APPLY The Complex Bond Environment

- Bonds will benefit from improved economic environment
- Demand for bonds will remain strong relative to US Treasuries and ex-US sovereign debt
- Inflation will kill cash and US Treasury Returns–bonds give us a chance at keeping up with inflation

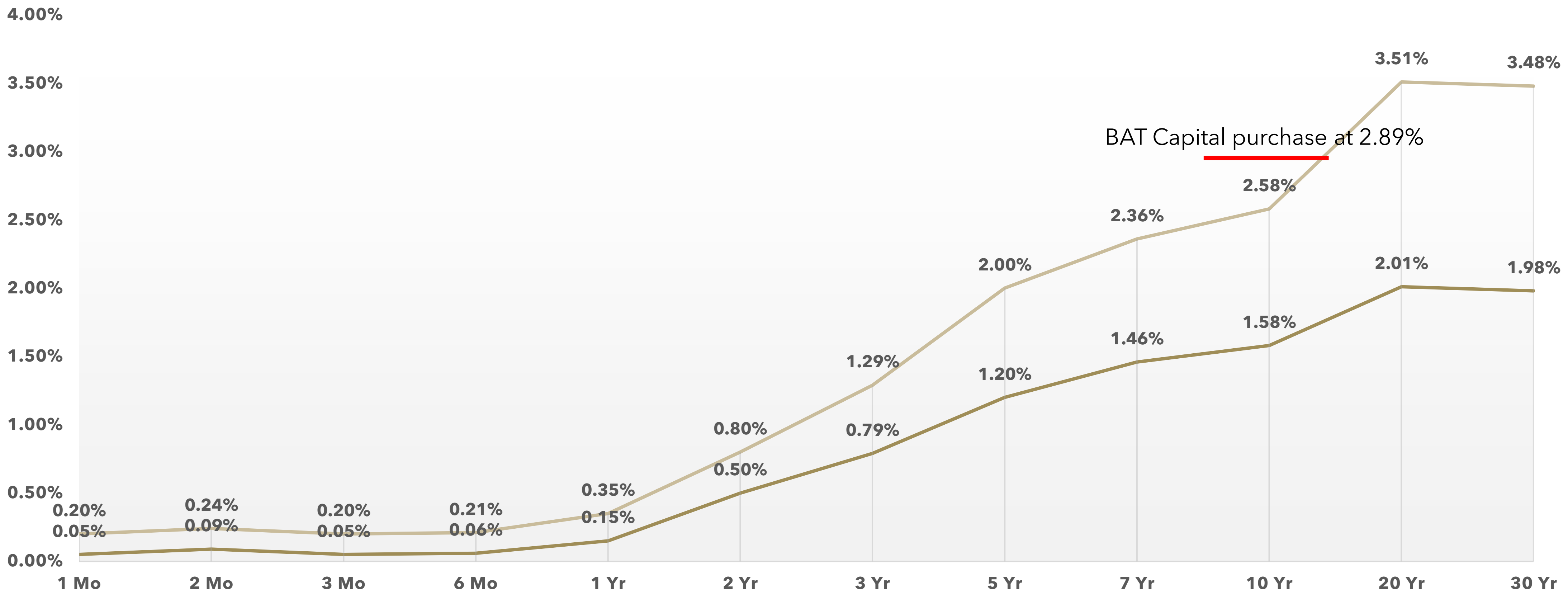
What is our Bond Strategy at EIG?

- Corporate Investment Grade Bonds (BBB-/Baa3) or Higher
- 10-year Maturity Ladder – ~10% market value in each year
- Industry Diversification across maturity ladder
- Minimize trading costs by holding bonds until maturity
- Maximize Return (YTM/YTC) for Very Conservative Risk

$300k Hypothetical EIG Bond Portfolio

Maturity	Fixed/Var	Description	Industry	CUSIP	Price	Quantity	Coupon	YTM	YTW	Rating	Market Value	%
Cash		Cash					0.00%	0.00%	0.00%		$3,125	1.0%
2022	Fixed	Endurance Specialty Hldgs	Financial	614810AB5	$ 103.91	25,000	4.70%	0.48%	0.48%	A-	$25,978	8.7%
2023	Fixed	Time Warner	Media	887317AR6	$ 106.86	28,000	4.05%	0.75%	0.75%	BBB	$29,922	10.0%
2024	Fixed	Monsanto	Agriculture	61166WAU5	$ 105.09	28,000	3.38%	1.43%	1.24%	BBB	$29,425	9.8%
2025	Fixed	Citigroup	Financial	172967JT9	$ 109.83	27,000	4.40%	1.57%	1.57%	Baa2/BBB	$29,654	9.9%
2026	Fixed	Potash Corp	Agriculture	73755LAN7	$ 109.59	28,000	4.00%	2.01%	1.92%	BBB	$30,685	10.2%
2027	Fixed	Air Lease Corp	Industrial	00912XAY0	$ 107.28	28,000	3.63%	2.28%	2.33%	BBB	$30,038	10.0%
2028	Fixed	Block Financial	Financial	093662AJ3	$ 100.73	30,000	2.50%	2.38%	2.38%	BBB	$30,218	10.1%
2029	Fixed	National Oilwell Varco	Oil & Gas	637071AM3	$ 106.34	28,000	3.60%	2.70%	2.72%	Baa1/BBB+	$29,774	9.9%
2030	Fixed	Altria Group	Industrial	02209SBJ1	$ 105.61	30,000	3.40%	2.64%	2.66%	A3/BBB	$31,683	10.6%
2031	Fixed	BAT Capital	Financial	05526DBS3	$ 98.33	30,000	2.73%	2.89%	2.89%	Baa2/BBB+	$29,499	9.8%
				WA Yields:		282,000	3.59%	1.92%	1.90%		$300,000	100.0%

Remember the Corporate Bond Yield Curve?



“Why Did I Lose Money Right Away?!”

Direct Corporate Bonds are illiquid and therefore have sometimes a 1.0 -2.0% spread between the Bid and Ask

On Day 1, The market Value will be midpoint of this spread

Holding bonds until maturity limits transactions costs

Matrix Pricing

The Good: You will always see a "Market Price"

The Bad: The Market Price sometimes doesn't reflect reality

The Ugly: Matrix Pricing can be sometimes far from reality.

The Remedy: At maturity, we get $100/bond back

Strategic vs. Tactical Asset Allocation

Bonds are your "SWAN" = Sleep Well At Night portion of your portfolio

Although yields remain low, bonds offer the best way to lower overall portfolio volatility

Q&A

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