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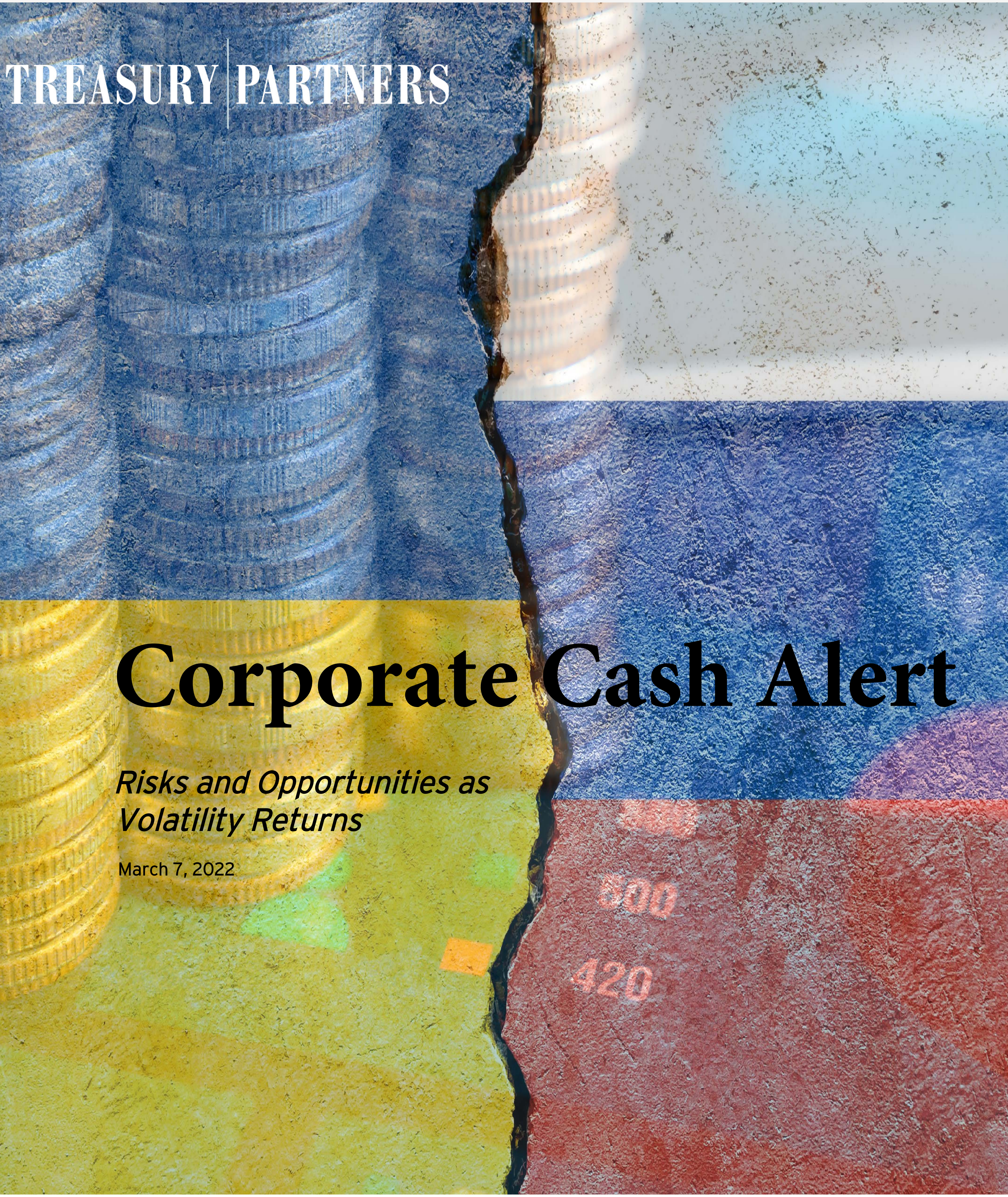


Corporate Cash Alert

Risks and Opportunities as Volatility Returns

March 7, 2022

Introduction

The past several months have been marked by a sudden return of market volatility. From rising short-term rates and shifting Fed policy expectations to heightened concerns about international credit exposures, there have been plenty of new developments. Read on for how Treasury Partners is positioning portfolios in today's market.

A Brief Word on Russia/Ukraine

Headlines across the globe are rightfully dominated by news of the ongoing Russian invasion of Ukraine. This war has created new uncertainties for companies with material linkages to either countries' economies, particularly those with joint ventures or investments impacted by harsh international sanctions against Russia.

We've always prioritized the safety of client assets, which includes actively seeking to minimize exposure to potential geopolitical and accounting transparency risks. As a result, we have no direct holdings backed by Russian or Ukrainian issuers. Some of the issuers currently held in client portfolios have indirect exposure; for example, large international-facing banks hold loans linked to or backed by Russian/Ukrainian companies or assets, and some companies in the energy industry have joint ventures or operating agreements with Russian energy firms. For example, Apple recently suspended product sales in Russia and Toyota has suspended auto production in St. Petersburg. For a more complete rundown of such multinational corporate actions, please see Strategas Research Partners' running list included as an appendix to this Alert.

Although the situation is still evolving and we expect further knock-on effects to unfold, at this time we remain comfortable that the magnitude of any related exposure and losses will be manageable and would not lead to material credit degradation. Clearly the situation is tragic and changing daily. Given the material devastation within Ukraine and global impacts of the Russian sanctions, a deteriorating global macroeconomic backdrop may be the most important consequence affecting our investment landscape. We will of course continue to diligently monitor the situation.

Sea-Change in Rates

The change in market rates since the beginning of Q4 2021 has been nothing short of astounding. The front-end of the Treasury curve has ratcheted higher from near-zero levels, with 1 and 2-year yields in particular rising in a parabolic fashion.

2-5 Year Treasury Yields

Source: Bloomberg

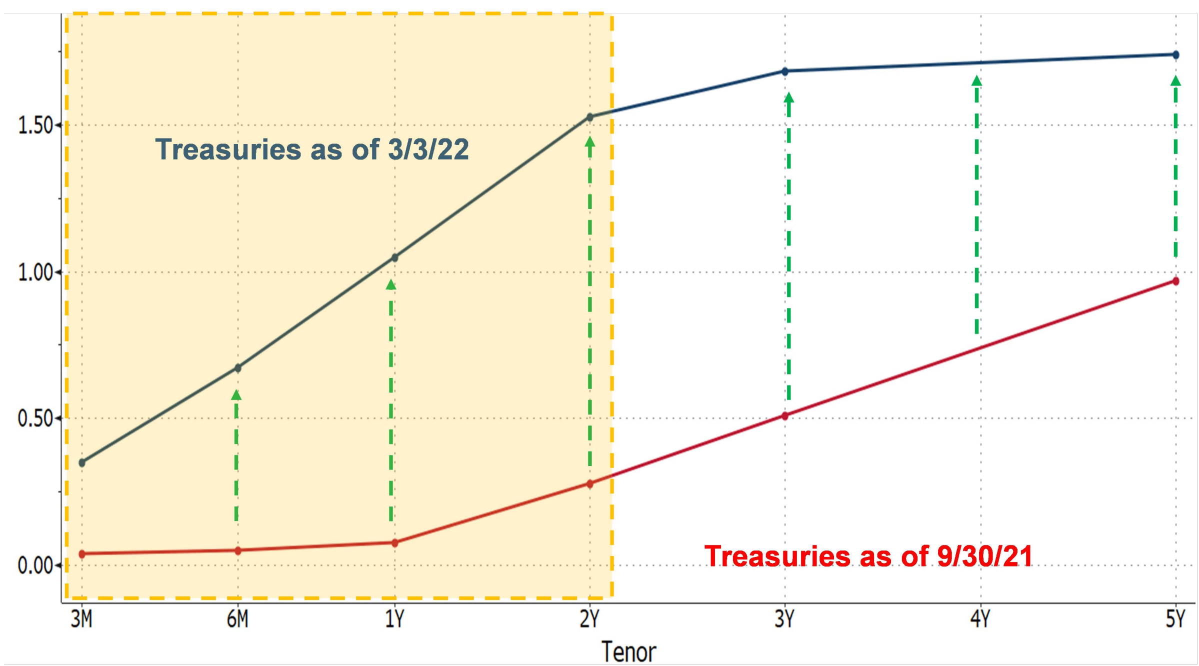
As always, it all traces back to the Fed. Elevated inflation has compelled the Fed to rapidly pivot to a more hawkish stance that dramatically shifted market perceptions of future policy decisions. In the span of five months, the consensus has gone from debating whether liftoff would commence in 2022 to now penciling in upwards of *5-7 hikes this year alone*. Investors are also grappling with how to assess the potential contours and impact of "Quantitative Tightening" or allowing bonds to roll off from the Fed's balance sheet. The Fed's balance sheet has ballooned to a staggering $8.9 trillion, the equivalent of nearly 40% of US annual GDP. With little historical record on the collateral impact of balance sheet runoff (and no prior instances of active selling), what happens with QT represents the greatest "known unknown" overhanging markets.

Federal Reserve Balance Sheet as a Percentage of US GDP

Source: Bloomberg

This confluence of changes has significantly altered the front-end of the curve, which now features a much steeper slope up to two years and a much flatter tone from two to five years.

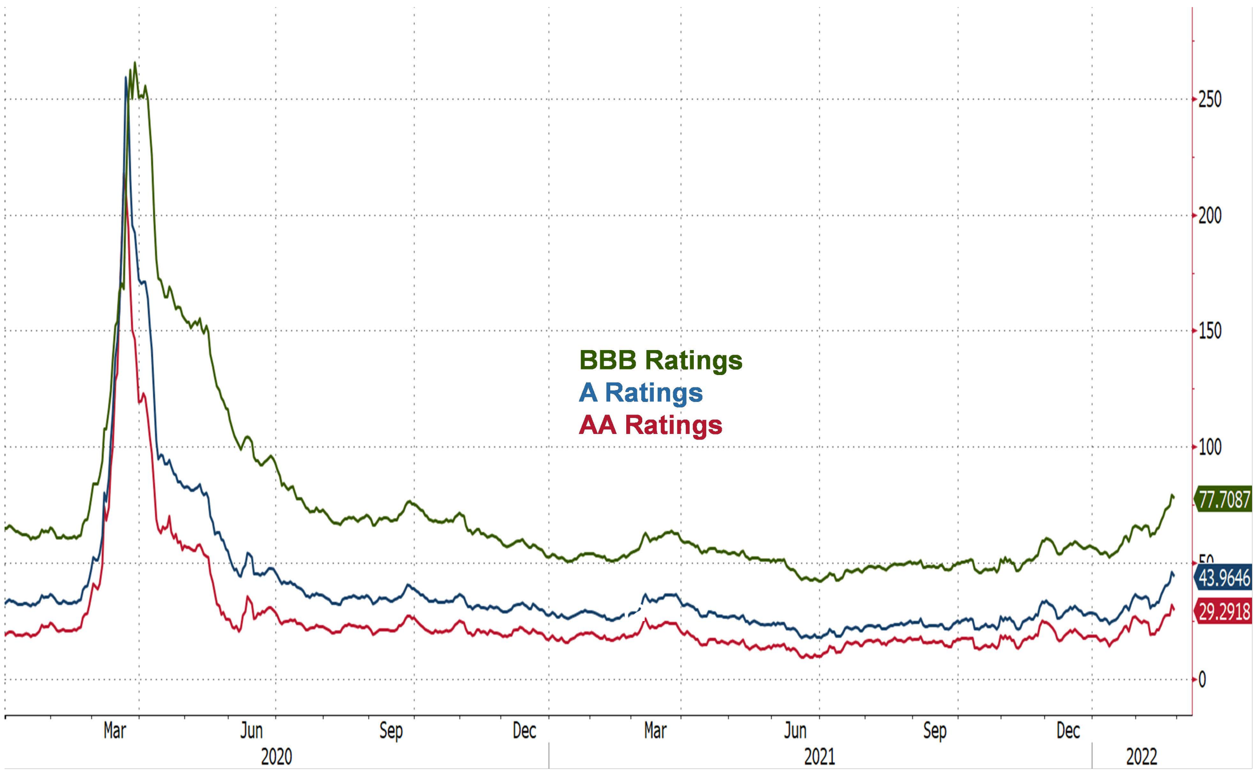
Treasury Yield Curve



Source: Bloomberg

These massive adjustments have nevertheless been orderly, with no signs of undue credit stress. Although they have lately ticked higher, credit spreads are still trading consistent with established multi-year ranges. This benign credit environment makes sense given: (a) the underlying strength of the American economy; (b) the post-Covid expansion continues apace with strong jobs growth; (c) still-healthy consumer spending; and (d) resilient corporate cashflows and earnings growth.

3 Year Corporate Bond Credit Spreads



Source: Bloomberg

Treasury Partners View

We'll be blunt: we consider it ***highly unlikely*** that the Fed implements 6-7 hikes this year. Such a pace would be more reminiscent of the tightening cycles of yesteryear (and the decision-making of a long-gone generation of Fed officials). Everything we've observed about the temperament of current central bankers since 2008's Great Financial Crisis argues against their willingness to take such Volcker-like actions.

Remember: despite inflation measures running well >5% YoY since early summer 2021, the Fed was still engaging in Quantitative Easing until a few days ago. Importantly, at this point they own 25% of all tradeable Treasury debt and haven't so much as outlined a plan to reduce the size of their balance sheet.

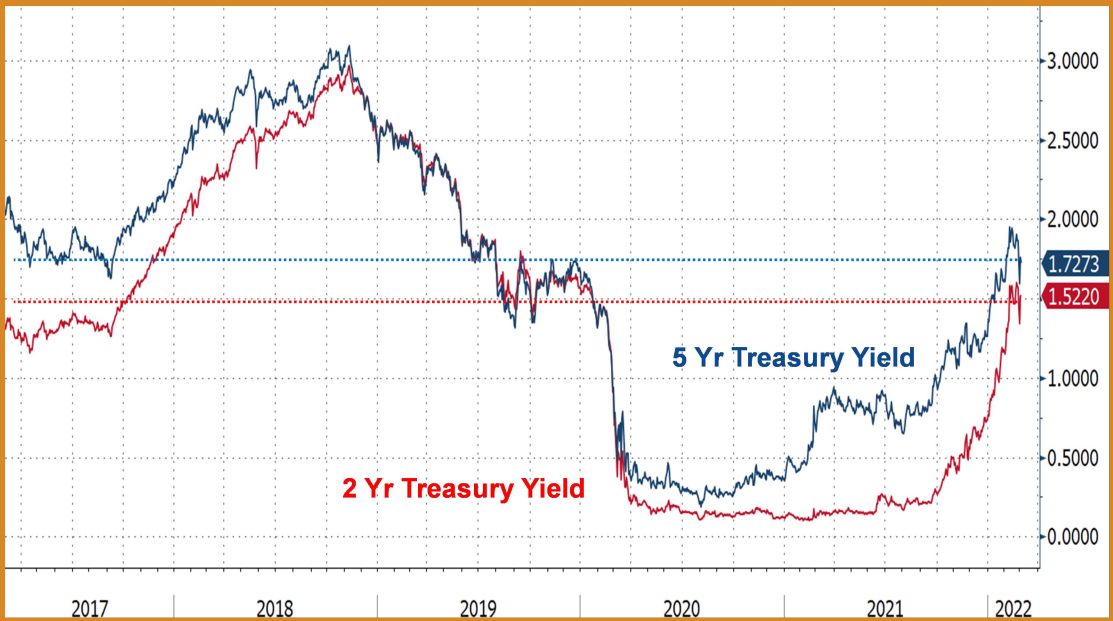
Maturities	Total Outstanding Treasury Securities	Total Federal Reserve Treasury Holdings	Fed Holdings as % of Total Outstanding
<1 Year	$6,624,902	$1,143,157	17.3%
1-5 Years	$8,606,628	$2,203,397	25.6%
5-10 Years	$4,046,733	$1,011,998	25.0%
10-30 Years	$3,580,885	$1,369,557	38.2%
Total	$22,859,148	$5,728,109	25.1%

Source: Bloomberg, St. Louis Federal Reserve - Federal Reserve Economic Data (FRED) database, and Treasury Partners calculations as of 2/2/2022. All figures in millions.

Pivoting to a more modest 3-4 hikes in 2022 with some balance sheet runoff commencing in H2 is our base case. Our view is informed by the seemingly little-acknowledged reality that traditional rate hikes aren't the only way to tighten financial conditions. Other direct Fed actions, such as adjusting the timing and pace of balance sheet runoff, can act as 'substitutes.' Additionally, indirect actions outside the Fed's control can also help do some of the heavy lifting – skyrocketing energy prices serve as a "tax" on consumer spending and cool down economic activity.

Given the disconnect between our base case and the market's expectations for Fed tightening, we think current short-term rates present corporate cash investors with an excellent opportunity to extend maturities. In fact, today's Treasury yields have basically round-tripped over the past 5 years, the last time we were in the early stages of a tightening cycle.

2-5 Year Treasury Yields, Past 5 Years



Source: Bloomberg

As our clients know, we suspended extending maturities starting in July 2020. Since rates spiked, we've shifted our strategy and are aggressively extending maturities to increase portfolio yields. In addition, surging 3- to 12-month rates have resulted in a wide gap between the yields on money market funds (MMFs) vs. short-term Treasuries. We've been taking advantage of this gap by reducing MMF balances and building liquidity ladders using 3-month Treasury bills. With MMFs currently returning approximately 3 basis points, utilizing such near-term Treasury ladders generates a substantial 40 basis point pickup.

As always, we thank our valued clients for your continued trust and confidence in our stewardship of your cash management needs.

Appendix: Multinational Corporate Actions

MULTINATIONALS ARE DESERTING RUSSIA

- **Mastercard** has blocked certain Russian activity from its payment network.
- **Visa** has blocked certain Russian activity from its payment network.
- **American Express** announced it would halt relationships with Russian bank partners.
- **BlackRock** stopped new share creation for the iShares MSCI Russia ETF.
- **HSBC** is reportedly ending its relationships with Russian banks.
- **NYSE** temporarily suspended trading for Russia-based companies on the exchange.
- **Nasdaq** temporarily suspended trading for Russia-based companies on the exchange.
- **DirecTV** has removed Russia's RT network from its line-up.
- **Netflix** announced it would not air Russian state TV Channels.
- **Roku** banned RT worldwide.
- **Google** banned Russia state media advertising & content monetization, removed apps for RT and Sputnik from Play Store. YouTube blocked Russian state media, including RT.
- **Disney** suspended movie released in Russia.
- **Spotify** announced it would indefinitely close its Russian office.
- **Sony** suspended movie released in Russia.
- **Warner Brothers** suspended movie released in Russia.
- **Apple** has paused all product sales in Russia.
- **Dell** has suspended all product sales in Russia and Ukraine.
- **Snap Inc** has stopped advertising sales to Russian and Belarusian entities.
- **Meta** has stopped advertising sales from Russian state media.
- **Twitter** has temporarily paused advertisements in Ukraine and Russia.
- **H&M Group** has temporarily stopped sales in Russia.
- **Nike** has indicated it no longer guarantees delivery of goods to Russia.
- **Adidas** severed its partnership with the Russian Football Union.
- **Canada Goose** has suspended e-commerce and wholesale sales to Russia.
- **Diageo** suspended sales in Russia.
- **Ikea** announced it was halting operations in Russia.
- **Toyota** has suspended car production in Russia.
- **General Motors** announced a temporary suspending of vehicle exports to Russia.
- **Harley Davidson** has paused business relationships in Russia.
- **Volkswagen** announced suspension of production in two Russian cities and an export pause.
- **Mercedes-Benz** suspended exports of passenger cars and vans to Russia, paused local manufacturing.
- **BMW** said it would suspend local production and export for the Russian market.
- **Honda** suspended exports of motorcycles and vehicles to Russia.
- **Renault** has paused local manufacturing in Russia.
- **FedEx** suspended shipments to Russia.
- **UPS** suspended shipments to Russia.
- **Maersk** suspended cargo bookings with Russia.
- **MSC Mediterranean Shipping Company** suspended cargo booking with Russia.
- **Boeing** closed Kyiv office, halted operations at Moscow campus, and suspended support for Russian airlines.
- **Airbus** suspended support services to Russian airlines and supply of spare parts to Russia.
- **Delta** has suspended its alliance with Aeroflot.
- **Sabre Corp** terminated its distribution agreement with Aeroflot.
- **Airbnb** has suspended services in Russia and Belarus.
- **Shell** announced it would exit all Russian operations.
- **BP** announced it would divest its 20% stake in Rosneft.
- **Equinor** announced it would sever its joint ventures in Russia.
- **Exxon** announced it would not invest in new developments in Russia.
- **TotalEnergies** announced it would cease providing new capital for projects in Russia.
- **Intel** has suspended chip shipments to Russia.
- **AMD** has suspended chip shipments to Russia.
- **SAP** said it would stop business in Russia "aligned with sanctions".
- **Oracle** announced it had suspended all operations in Russia.

Source: Strategas as of 3/4/22

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