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Neuberger Berman Tax-Exempt Intermediate Maturity Fixed Income Portfolio

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Performance Highlights

The Tax-Exempt Intermediate Maturity Fixed Income Portfolio ("Portfolio") posted a positive return in the first quarter of 2025 but underperformed the benchmark.

Market Context

Fixed Income Performance

U.S. government yields were mixed across the curve in March. The 2-year yield decreased by 10 bps to 3.89%, while the 5-year yield dropped by 7 bps to 3.95%. The 10-year yield remained unchanged at 4.21%, and the 30-year yield increased by 8 bps to 4.57%. The 10-year TIPS yield declined slightly by 1 bp, closing at 1.85%. These movements reflect ongoing adjustments to expectations for inflation, economic growth and Fed rate decisions. Intermediate yields across other major developed countries showed varied movements during March.

Credit Markets and Spreads

Fixed income spread sectors generally widened in March, reflecting heightened market uncertainty and evolving risk sentiment, especially around tariffs.

- U.S. high yield corporate spreads widened sharply by 68 bps, reaching 355 bps.
- Senior floating rate loan spreads widened by 33 bps to 461 bps.
- U.S. investment grade corporate spreads were wider by 7 bps to 94 bps.
- Global investment grade corporate spreads were wider by 7 bps to 97 bps.

Despite widening spreads, investor demand for fixed income remained solid, supported by stable corporate fundamentals and attractive yields. U.S. Agency MBS saw less widening, demonstrating resilience as lower net MBS supply helped sustain performance in the face of broader market volatility.

U.S. Economy

- Non-Farm Payrolls: February payrolls rose by 151k, slightly below expectations but better than January's 143k, which saw a downward revision of -18k. December's payrolls were revised upward to +323k. The unemployment rate edged higher to 4.1% in February.
- Wages: Average hourly earnings increased 0.28% MoM in February, a deceleration from January's 0.48%, but YoY growth held steady at 4.0%.
- Inflation: February headline CPI rose 2.87% YoY (vs. January: 2.96%), while core CPI increased 3.1% YoY compared to January's 3.3%.
- Retail Sales: February retail sales showed a mixed picture, with total sales up 0.2% MoM but dragged by declines in motor vehicle sales and restaurants. Control group sales rose 1.0% MoM, suggesting modest consumer spending growth.

Economic activity has shown initial signs of softening, but GDP growth remains positive. Uncertainty around the magnitude and duration of tariffs, geopolitical risks and potential upward inflation pressures from Trump policies could continue to create pockets of volatility. On the monetary policy front, the Fed will likely focus on the data as inflation remains above the 2% target. Markets anticipate further rate cuts, and potentially more if there is a material slowing in real GDP growth. Consumer spending remains relatively resilient but could be challenged by tariffs, and corporate balance sheets are stable, though trade tensions, geopolitical risks and the potential for further moderation in economic growth pose risks.

Investment grade U.S. municipal bond performance, as measured by the ICE BofA Municipal Securities Index, delivered a return of -.50% during the first quarter. For the quarter, 1-3 year munis generated a return of 1.01% and the 3-7 year part of the curve returned .71%. Longer maturities, in the 22+ year range, underperformed shorter bonds with a return of -1.63%. The Bloomberg Taxable Municipal Index meaningfully outperformed tax-exempts with a return of 2.99%.[1] Per Bloomberg, total municipal issuance (tax-exempt only) for the quarter was $123.3 billion or 18% higher than it was for the same quarter a year earlier. With regard to credit, BBB rated securities slightly outperformed higher rated securities during the quarter. Revenue bonds and general obligations delivered comparable returns during the quarter and housing related credits outperformed.

Portfolio Review

The Portfolio posted a positive return in the first quarter of 2025 but underperformed the benchmark. Security selection was slightly beneficial, but its positioning across the curve was a headwind as the yield curve steepened. Rating allocation also detracted from returns.

Outlook

Returns in the municipal market started well in the first quarter but fizzled in March. Supply was heavy throughout the period but increasingly weighed on market sentiment, pushing yields higher. As a result, municipals generally trailed Treasuries during the quarter, leaving valuations at more attractive levels than at the start of 2025. That said, the biggest story of the year came after quarter-end—when the Trump administration announced on April 2 that it would be raising tariffs by far more than many had expected. This created extreme volatility in the equity market, but also hurt Treasuries, which did not perform as a "safe haven" asset class. Yields moved sharply higher as it appeared some investors were shunning U.S. dollar-denominated assets. During the week of April 7, the municipal market experienced wild price swings and a sharp move higher in yields. Multiple factors combined to cause the market to weaken, including Treasury market volatility, municipal fund outflows, a sharp rise in "bid-wanted" activity, and concerns about continued heavy supply. Importantly, the sell-off did not appear to be related to municipal credit quality. For the week of April 7, AAA municipal yields moved higher by roughly 65 basis points across the yield curve. Most of the scheduled new issue supply for the week was pulled to avoid generating additional market pressure.

While we expect volatility to stay elevated until tariff policy comes into clearer focus, we think today's valuations are pricing in a lot of market uncertainty. We also believe that higher degrees of volatility may make it harder to know what bonds are worth. In our view, that backdrop may be ideal for our approach to investing, which revolves around using a large broker-dealer network to locate mispriced securities. In effect, we find ourselves in a bond-pickers market. Finally, the rates backup should increase the opportunity set, where appropriate, to execute tax-loss swaps in client portfolios, which can be an important additional source of value.

We recognize that the recent market environment has been difficult, but yields are now much higher and we expect more deals and secondary market opportunities to offer price concessions. In our opinion, we are moving into a period where active management could really shine.

[1]Source: Bloomberg

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A bond's value may fluctuate based on interest rates, market conditions, credit quality and other factors. There may be a gain or loss if bonds are sold prior to maturity. Of course, bonds are subject to the credit risk of the issuer.

The municipal securities market could be significantly affected by adverse political and legislative changes, the financial health of a municipality or the financial condition of municipal securities market, as well as uncertainties related to taxation or the rights of municipal security holders.

Third-party economic or market estimates discussed herein may or may not be realized and no opinion or representation is being given regarding such estimates. Target yields are based on current market conditions. There is no guarantee, and investors should not assume, that any estimates or target yields will be realized.

Through December 31, 2023 the Index consists of 80% ICE BofA 3-7 Year US Municipal Securities Index and 20% ICE BofA 7-12 Year US Municipal Securities Index. From January 1, 2024 and onward, the Index consists of ICE BofA 2-12 Year US Municipal Securities Index.
ICE BofA 2-12 Year US Municipal Securities Index is a subset of ICE BofA US Municipal Securities Index including all securities with a remaining term to final maturity greater than or equal to 2 years and less than 12 years. ICE BofA US Municipal Securities Index tracks the performance of US dollar denominated investment grade tax-exempt debt publicly issued by US states and territories, and their political subdivisions, in the US domestic market. Qualifying securities must have at least one year remaining term to final maturity, at least 18 months to final maturity at the time of issuance, a fixed coupon schedule and an investment grade rating (based on an average of Moody's, S&P and Fitch). Minimum size requirements vary based on the initial term to final maturity at time of issuance.The index is rebalanced on the last calendar day of the month, based on information available up to and including the third business day before the last business day of the month.

The benchmark is an unmanaged blend of indices. NBIA advises according to the Portfolio characteristics which may differ from those of the benchmark. Additional disclosures for complete benchmark descriptions are available upon request.

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