Intermediate Maturity Taxable

Commentary – Second Quarter 2020

Macro Overview

The U.S. economy has begun to slowly reopen from a prolonged shutdown, and it appears the 'depression' scenario may have been avoided thanks in large part to aggressive economic stimulus. The Federal Reserve cut its benchmark rate to Zero and committed to unlimited asset purchases while Congress delivered a multi-trillion dollar fiscal package to support individuals and businesses. Bulls will argue the stimulus worked, pointing to US equities having their strongest quarter ever after the drastic Q1 declines. However, the stimulus comes at a very high cost, leaving the country with a record high 'Debt to GDP' of 121%. Additionally, CV-19 has not been fully contained, and recent spikes are causing concern that shutdown scenarios and stay at home mandates will return.

- Despite a rebound in equity markets, economic, labor market, and earnings recoveries will likely take much longer.
- Front-end UST yields tied to Fed Funds will be anchored near Zero with the Fed signaling no interest rate increases in 2021 and most likely not in 2022 either.
- Low intermediate to longer-term UST yields likely in place with low inflation, the need for an economic recovery, and a strong global bid for high quality liquid assets.
- Q1 GDP was revised down to -5% and some estimates are -35% for Q2. We expect a rebound in Q3 and Q4 but still anticipate negative GDP of approximately -6% for full year 2020.

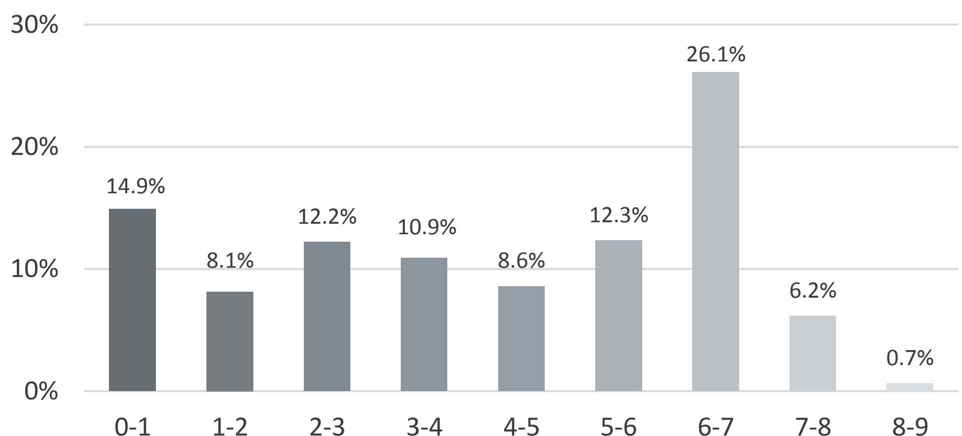
Market Dynamics

As equity markets roared higher in the second quarter, corporate credit spreads contracted as a constructive sentiment took hold of the market. The first quarter's significant volatility pushed credit spreads to levels not seen since 2009, but there was a quick rebound as the Federal Reserve implemented buying programs to support investment grade corporate bond and ETF markets. The Bloomberg Barclays US Aggregate Credit Index that reached nearly +350bps in mid-March, finished the period at approximately +140bps, only about 40bps higher than at the first of the year. Our near term view still sees a domestic corporate landscape that has many large firms carrying strong balance sheets, stable revenue streams, and sound credit fundamentals, but we remain cautious and deliberate when selecting names during this environment.

Composite Characteristics

Duration: 4.11 yrs
Yield-to-Worst: 1.11 %
Yield-to-Maturity: 1.17 %
Maturity: 5.79 yrs

Duration Profile



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Performance Notes

Our consistent approach to selecting higher quality corporate issuers helped buffer volatility versus weaker credits in the first quarter, but the overweight to credit detracted from returns. As risk markets swiftly improved and credit spreads retraced during the second quarter, the strategy's overweight to corporate debt was once again additive and produced meaningful outperformance versus the benchmark. Looking ahead, we see the potential for continued volatility in risk assets as full economic activity will be slow to return. With that said, the Federal Reserve's unprecedented involvement in the sector will continue to support markets and, for the foreseeable future, will likely limit significant spread widening in investment grade corporates.

10-YR US Treasury Yield (%)

Source: Bloomberg

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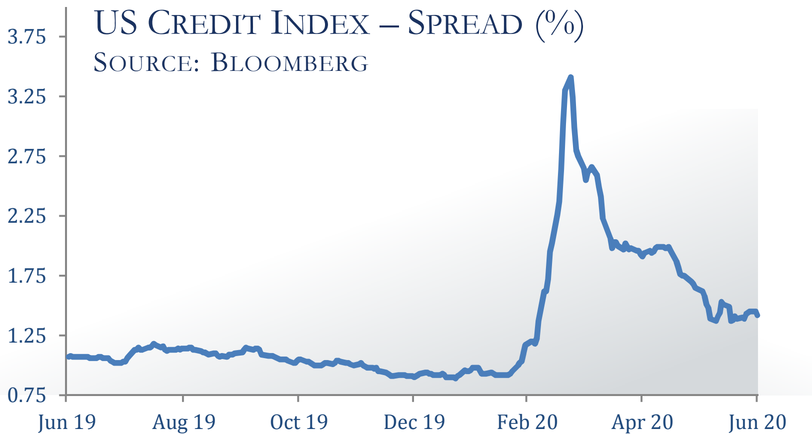
US Credit Index – Spread (%)

Source: Bloomberg



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