Short Maturity Muni and Low Duration 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

Many market participants were less focused on the Federal Reserve's economic and interest rate forecasts in the months leading up to the CV-19 related downturn, but the committee's June meeting was highly anticipated. Investors were anxious to learn how long the central bank would keep short-term interest rates near Zero. Some participants thought that a form of yield curve control, similar to Japan, might be unveiled, but Chair Powell and his colleagues instead opted for nearly unanimous forward guidance on Fed Funds. Currently, the FOMC does not see the overnight lending rate rising through 2022. While this may be subject to change if there is a faster economic recovery, our outlook is for short-term interest rates to remain subdued at least for the remainder of 2020 and well into 2021.

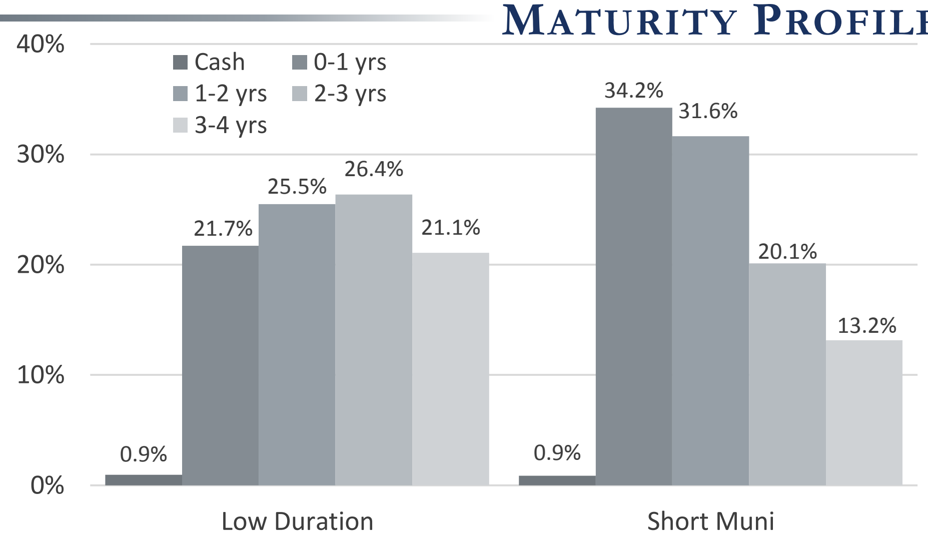
Low Duration

Duration: 1.95 yrs
Yield-to-Worst: 0.46 %
Yield-to-Maturity: 0.52 %
Maturity: 2.06 yrs

Short Muni

Duration: 1.43 yrs
Yield-to-Worst: 0.92 %
Yield-to-Maturity: 0.94 %
Maturity: 1.52 yrs

Maturity Profile



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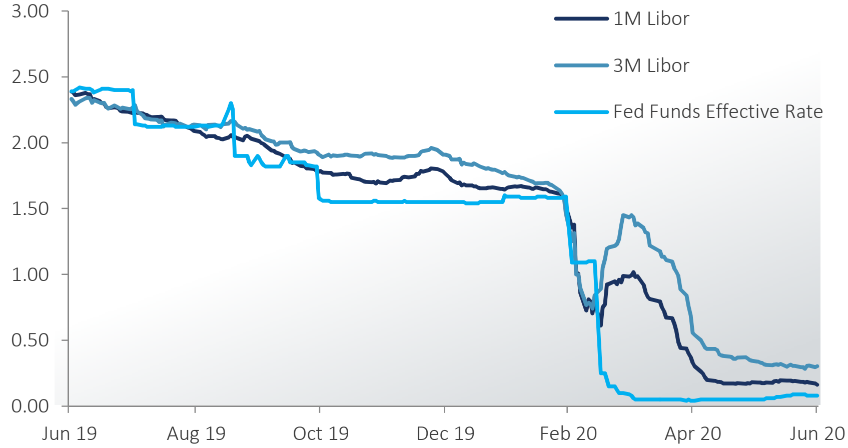
Performance Notes

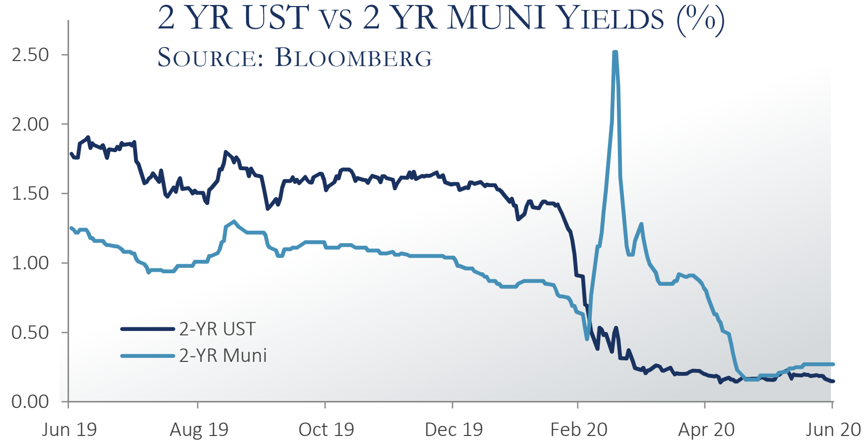
Short-term yields in the municipal market and investment grade corporate spreads both fell meaningfully over the quarter pushing total returns for these strategies notably positive. Within the Short Maturity Muni strategy, the allocation to 3-4 year bonds improved returns versus the benchmark as demand for tax-exempts returned. The swift retracement of credit spreads and Low Duration Taxable's overweight to corporate debt drove meaningful outperformance versus government bond positions. Looking forward, although short-term rates are likely to remain low, we still see opportunities to add incremental yield versus cash alternatives and CDs in both the municipal and high-grade corporate sectors. Broad access to both the primary and secondary markets is essential to the search for suitable credits at fair value.

1M / 3M LIBOR Rates (%)
Source: Bloomberg



"We still see opportunities to add incremental yield versus cash alternatives and CDs in both the municipal and high-grade corporate sectors, and this requires broad access to both the primary and secondary markets."

2 YR UST vs 2 YR MUNI Yields (%)
Source: Bloomberg



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