Intermediate Maturity Muni

Commentary – Third Quarter 2020

Macro Overview

In a pivotal move, the Federal Reserve made its most significant inflation policy change in decades when it announced that the committee will now target average inflation, implying that it will allow price pressures to run above the 2% target “for some time” before considering monetary tightening. After a 5% decline in Q1, GDP contracted at an astonishing 31.7% rate during Q2. Despite still-stubbornly high unemployment (8%) and slowing jobs numbers, US equities posted strong gains during the quarter, remaining optimistic that a recovery was already underway. Treasury yields were effectively flat during Q3 with front-end yields dropping approximately 2 bps while the 30-yr UST rose 5 bps. Looking ahead, uncertainties still loom, with the outcome of November’s election at the forefront for many investors.

- Front-end UST yields will remain near zero, tied to the Fed Funds rate. Fed forecasts are signaling no interest rate increases expected through 2023.
- Fed balance sheet has ballooned to $7 trillion over the course of the past 6 months and could increase to $10 trillion or more should additional stimulus materialize.
- Prospects for additional U.S. fiscal stimulus have diminished over the past several weeks perhaps pushing any new programs into 2021 when the new Congress arrives.
- Jobless Claims hit nearly 7 million in late March with cumulative claims now approximately 54 million. Monthly prints appear to be slowing, but still a ways to go before bottoming out.
- Covid-19 infection rates have been increasing in spots and causing concern over a second wave as we enter the fall and winter months.

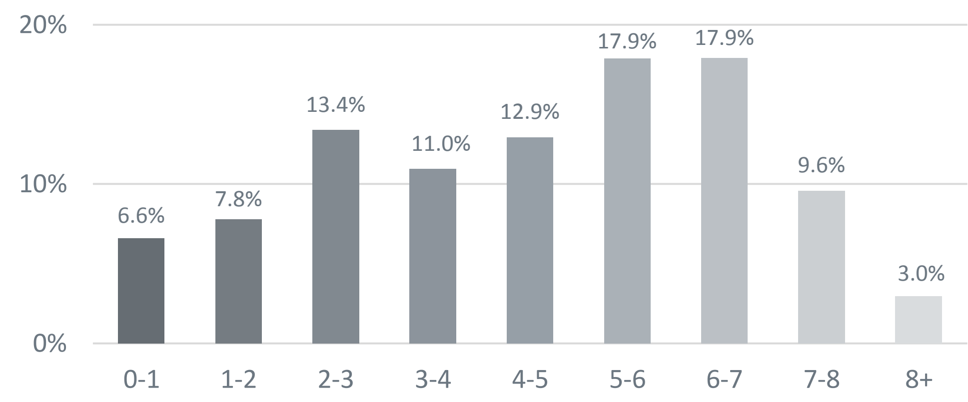
Market Dynamics

As the U.S. emerges from Covid-related shutdowns, municipal issuers continue to grapple with the fallout from declines in revenues. States are appealing for additional stimulus measures; however, it’s looking more likely additional aid will have to wait until Congress convenes in ’21. Despite elevated credit risk, market volatility was at record lows during Q3. Demand remained steady while supply was mostly subdued, painting a positive technical picture. In addition, taxable municipal issuance is up 349% year-over-year, reducing traditional tax-exempt supply. Issuers are adopting the taxable approach as it gives them the ability to advance refund prior debt, provides more flexibility with regard to spending bond proceeds, and it expands the investor base as an ever-growing number of overseas buyers welcome the name diversity and yield pickup over similarly-rated corporate and GSE credits.

Composite Characteristics

Duration: 4.56 yrs
Yield-to-Worst: 0.96 %
Yield-to-Maturity: 1.40 %
Maturity: 7.16 yrs

Duration Profile



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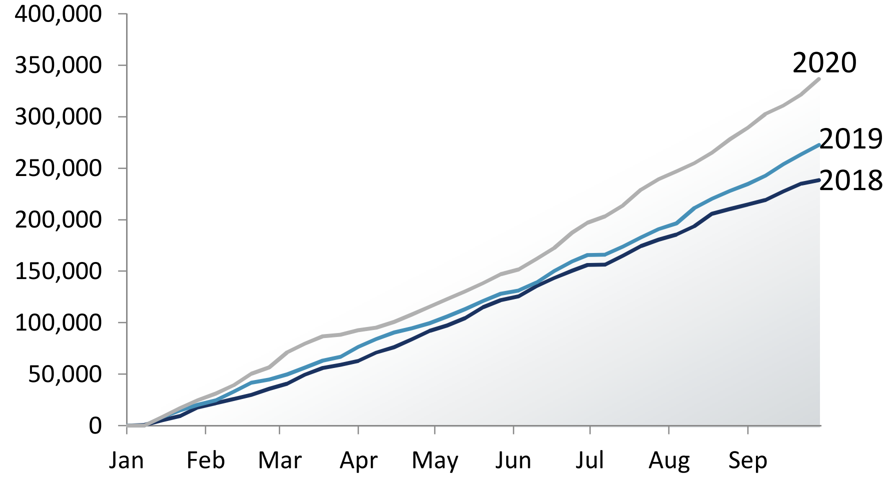
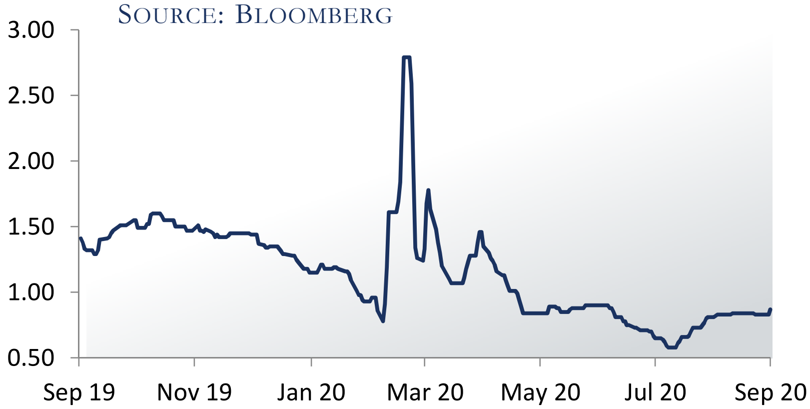
Performance Notes

On the strength of July and September results, the 1-15 Year Municipal Index posted positive returns for the quarter at 1.15% overcoming modest weakness in August. The Intermediate Maturity Municipal strategy modestly trailed the benchmark for the quarter. Our overweight to higher quality credits, which was particularly additive in Q1 & Q2, was the primary detractor as credit spreads on lower-rated bonds compressed in July. In our view, taxes are likely to increase in some form moving forward, whether it is the result of new policies from Washington or from increases at the state/local level, or both. As a result, the value of the municipal tax-exemption will likewise increase. Even at low absolute rates, demand should remain steady as investors seek out tax-exempt income.

Total Municipal Issuance YoY ($Bln)
Source: Bloomberg



10 YR MMD Yield (%)
Source: Bloomberg



"Visible supply is currently at its highest reading of the year as issuers are rushing to the market to front-run uncertainty surrounding the election.

We believe any cheapening from the elevated supply presents a buying opportunity

as Munis are likely to perform well post-election. "

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