Intermediate Maturity Taxable

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.

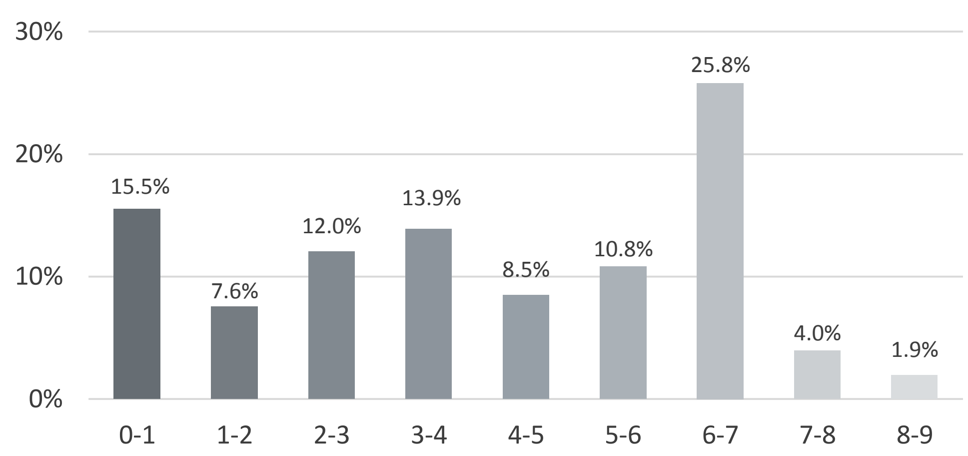
Market Dynamics

After a notable rally from late March through June, Investment Grade spreads spent much of the past quarter trading in a particularly tight range. While the Federal Reserve's unprecedented actions to support risk markets was the initial driver of the quick rebound, we currently see an environment where investor demand will be the key factor moving forward. Funds flows turned sharply positive in April and have remained constructive through the summer despite heavy new issuance. Helping spur buyers is not only the expectation of a rebound in growth, but the fact that a large portion of global sovereign debt now trades close to or below 0%. With the interest rate landscape unlikely to change in the near to medium-term, we see strong technical support for the sector from both our central bank and yield starved investors.

Composite Characteristics

Duration: 4.08 yrs
Yield-to-Worst: 0.95 %
Yield-to-Maturity: 1.03 %
Maturity: 5.77 yrs

Duration Profile



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Performance Notes

Although US Treasury yields touched record lows in early August (10YR UST reaching 0.50%), rates rebounded somewhat to close the quarter mostly unchanged. The intermediate taxable strategy has been well positioned to benefit from the corporate credit spread tightening over the last two quarters, and has maintained a neutral-to-slightly longer duration and maturity position. The strategy's overweight to IG corporate debt also continues to provide incremental yield to portfolios, while maintaining our selection discipline focused on higher quality corporate issuers with sound balance sheets as a way to buffer potential volatility. Looking ahead we do see some potential longer-term election implications for certain corporate sectors, like energy, but would not anticipate any immediate or material impact to the corporate market following November's outcome.

10-YR US Treasury Yield (%)

Source: Bloomberg

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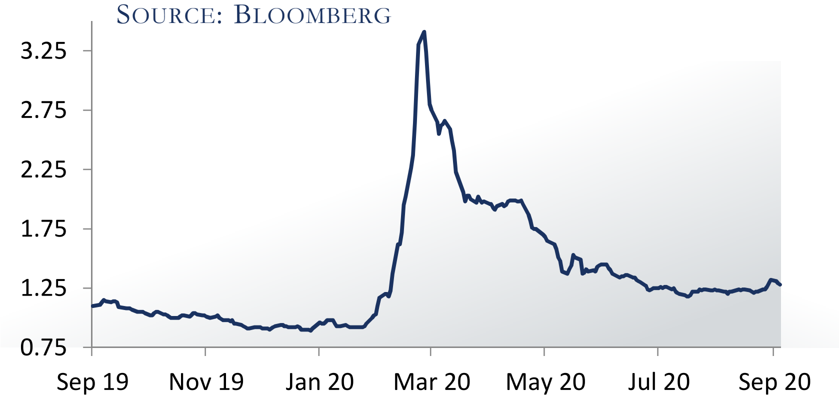
we see strong technical support for the corporate sector

from both our central bank and yield starved investors."

US Credit Index – Spread (%)

Source: Bloomberg



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