Short Maturity Muni and Low Duration 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

The September meeting of the Federal Reserve proved to be a significant event for investors and strategies focused on shorter maturity debt. While some participants thought a form of yield curve control might still be unveiled, the FOMC again opted for nearly unanimous forward guidance on Fed Funds. Currently, the committee does not see the overnight lending rate rising through 2023. Additionally, the committee updated the way that it would target inflation, now allowing prices to move above its historical 2% threshold before taking action in the form of a rate hike. While neither investors nor the Fed themselves know what the economy or inflation will truly look like in three years, our outlook is for short-term interest rates to remain subdued through 2021, and likely into 2022.

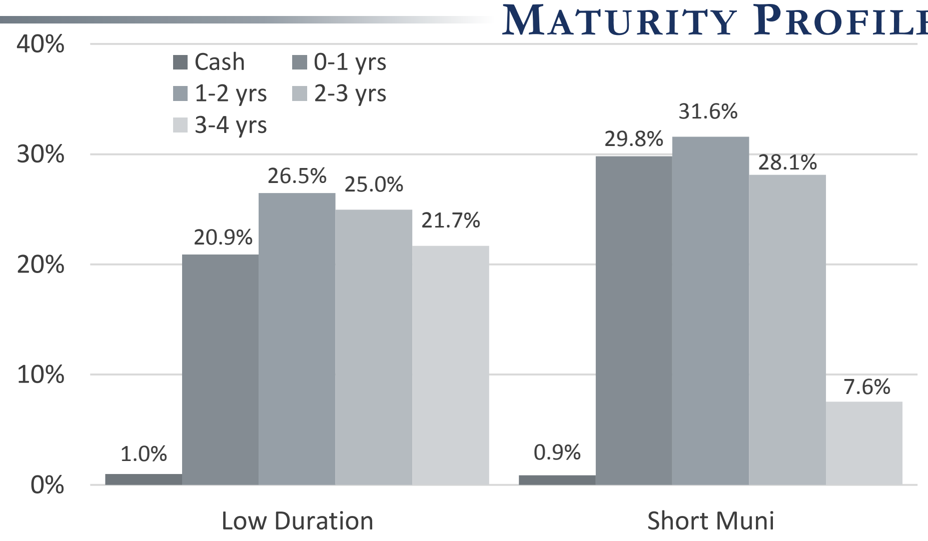
Low Duration

Duration: 1.94 yrs
Yield-to-Worst: 0.36 %
Yield-to-Maturity: 0.47 %
Maturity: 2.08 yrs

Short Muni

Duration: 1.52 yrs
Yield-to-Worst: 0.58 %
Yield-to-Maturity: 0.60 %
Maturity: 1.61 yrs

Maturity Profile



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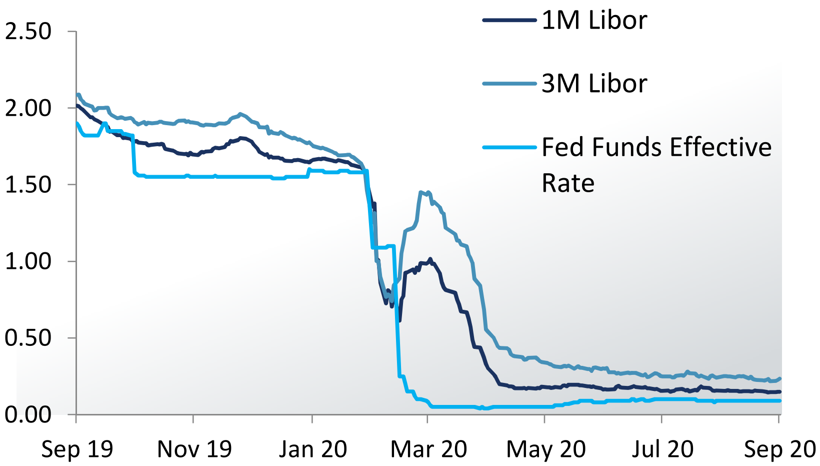
Performance Notes

Short-term yields in the municipal market and investment grade corporate spreads both traded within a particularly tight range over the quarter as little changed in the outlook for very accommodative rates from the Federal Reserve. With a target reinvestment between 3-4 years, short maturity municipal has been able to take advantage of a still positively sloped tax-exempt yield curve and incremental spread found within select sectors and issuers. Low Duration Taxable's overweight to IG corporate debt continues to provide incremental yield to the portfolios while maintaining our selection discipline focused on higher quality corporate issuers with sound balance sheets. Looking forward, we still see opportunities to add incremental yield versus money markets and other cash alternatives that have approached a 0% yield.

1M / 3M LIBOR Rates (%)

Source: Bloomberg



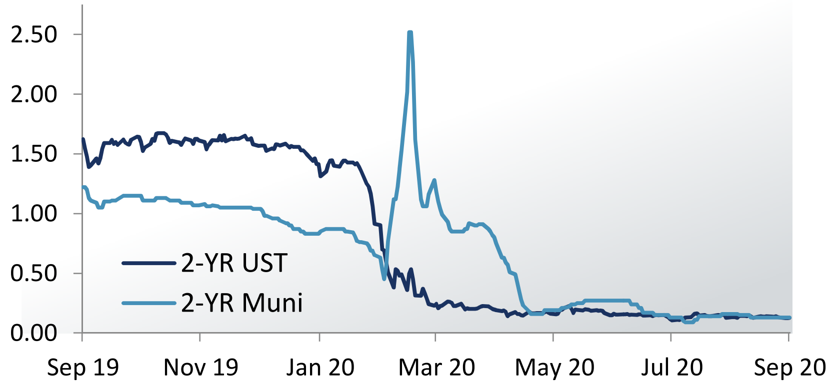
"Within the Short Maturity Muni and Low Duration Taxable strategies

we still see opportunities to add incremental yield

versus money markets and other cash alternatives that have approached a 0% yield."

2 YR UST vs 2 YR Muni Yields (%)

Source: Bloomberg



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