Intermediate Maturity Muni

Commentary – Fourth Quarter 2020

Macro Overview

With the Presidential election behind us and vaccine administration underway, we willingly bid farewell to 2020 and hope a return to "normal" and continued economic recovery are forthcoming. In Q4, US equities extended their rally off March lows with the S&P and DJIA returning 12% and 11%, respectively. Intermediate and longer-term US Treasury yields drifted marginally higher (10-yr +23bps and 30-yr +19bps) while front-end yields remained anchored near zero, driven by Federal Reserve policy. Markets have priced in generous progress on the vaccine front, however recent spikes in Covid-19 cases globally have reintroduced more stringent restrictions on social gatherings and business operations. Further, logistical challenges with administering the vaccine may hinder the economic recovery as more time will be needed before the virus is under control.

- Q3 GDP rebounded sharply, up 33% after a historic -31% decline in Q2. However, the anticipation is that full-year 2020 GDP will come in near -3%.
- Although inflation breakevens have increased over the last several months, there is still little tangible evidence that inflation will rise to the point where the Fed would need to alter policy in the near-term. US Personal Consumption Expenditure Index is currently at 1.3%, well below inflation targets.
- There was very little change in the December Fed statement. The Committee clarified that asset purchases will continue "until substantial further progress has been made towards the Committee's maximum employment and price stability goals".
- Front-end UST yields will remain near zero, tied to the Fed Funds rate. Fed language from its December meeting signaled no interest rate increases expected through 2023.

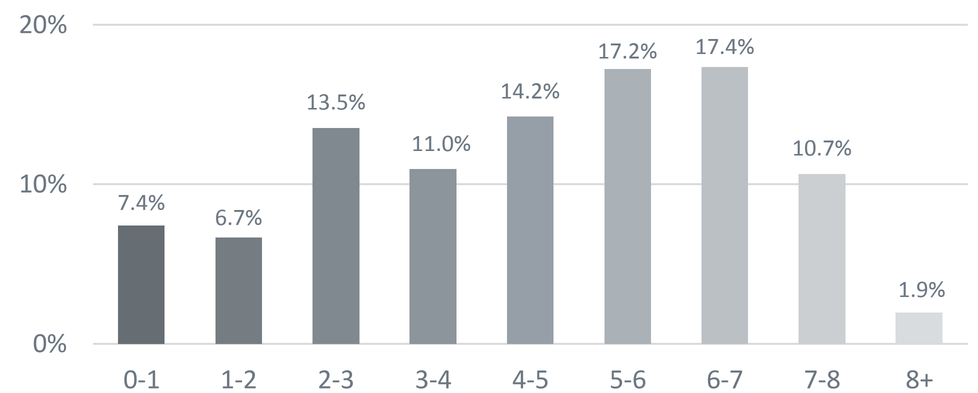
Market Dynamics

Covid-19 related repercussions on state and local government finances remain an unquantified risk. For most issuers, audited financials are still months away from being disseminated, and even those are likely to illustrate only a piece of the narrative. Anecdotal data suggests many issuers have fared more favorably than originally anticipated, however, there are credit pockets which still present uncertainty for bondholders. Supply/demand technicals drove the market during Q4 as investors continued to pour cash into the asset class anticipating both higher tax implications under the new administration and an economic recovery on the horizon. Credit spreads continued to compress during the quarter after widening substantially in March/April. Yields on intermediate and longer-term municipals were lower by 16bps and 23bps in the 10-yr and 30-yr portion of the curve, outperforming their UST counterparts during the quarter.

Composite Characteristics

Duration: 4.55 yrs
Yield-to-Worst: 0.85 %
Yield-to-Maturity: 1.32 %
Maturity: 7.23 yrs

Duration Profile



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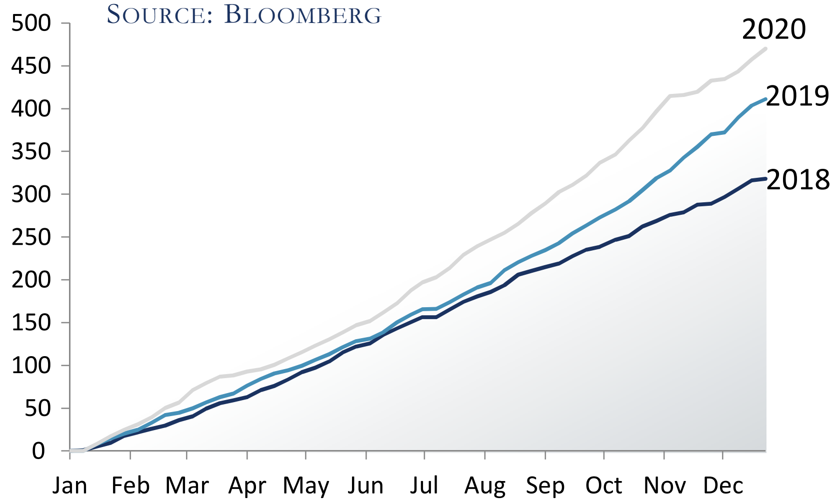
Performance Notes

The Bloomberg Barclays 1-15 Year Municipal Index posted positive returns in November and December after modest weakness in October, bringing total return for the quarter to 1.33%. The Intermediate Maturity Municipal strategy was generally in-line with the benchmark for the quarter. Our slightly longer duration versus the benchmark was additive and helped offset our overweight to higher quality credits, which lagged marginally on a performance basis over the quarter. With lower current absolute yields, traditional 5% coupon bonds command historically high premiums. As a result, 4% coupon bonds are becoming more common as investors avoid those high premiums. We now find value in 3% coupon bonds and in some instances, 2% coupon bonds, as there is meaningful yield pickup in these lower coupon structures.

Total Municipal Issuance YoY ($Bln)

Source: Bloomberg



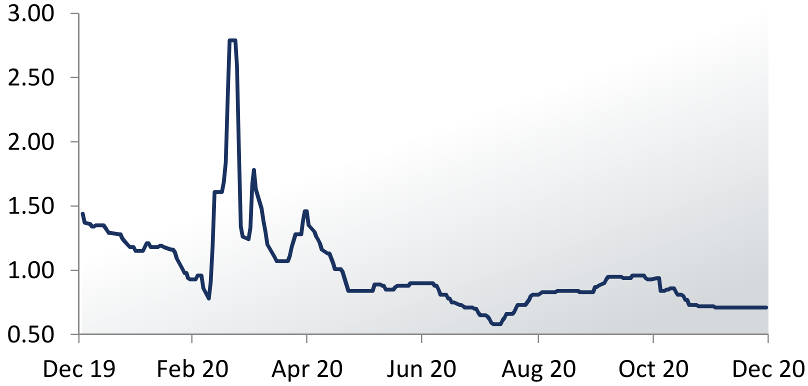
"We remain constructive on municipals as a whole as taxes are likely going up under the new administration,

resulting in a more-valuable tax exemption.

However, we remain particularly selective on credit."

10 YR MMD Yield (%)

Source: Bloomberg



Contact Us

804.648.3333

WWW.CAPRINBONDS.COM

Media Contact:
aplotkin@caprinbonds.com