Short Maturity Muni and Low Duration Taxable

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

The last Federal Reserve meeting of 2020 did little to change our outlook that short-term interest rates will remain subdued. The FOMC again gave nearly unanimous forward guidance on Fed Funds, forecasting the overnight lending rate remaining near 0% until 2023. Those forecasts are now more closely tied to an inflation rate that would need to exceed 2% before momentary policy tightens. It is worth noting that market inflation gauges continued to push higher over the quarter, with the 10-yr breakeven rate closing the year at nearly 2%. While highly unlikely that the FOMC would consider raising rates in the coming year, a strong post-pandemic growth rebound could pressure prices later in the year and perhaps result in at least some consideration by the committee in 2022.

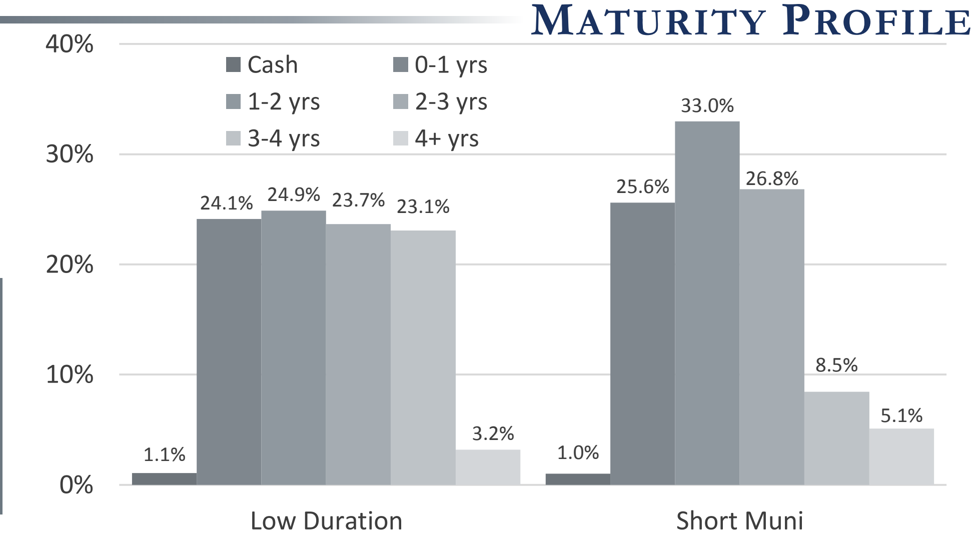
Low Duration

Duration: 1.82 yrs
Yield-to-Worst: 0.36 %
Yield-to-Maturity: 0.47 %
Maturity: 1.97 yrs

Short Muni

Duration: 1.73 yrs
Yield-to-Worst: 0.41 %
Yield-to-Maturity: 0.43 %
Maturity: 1.85 yrs

Maturity Profile



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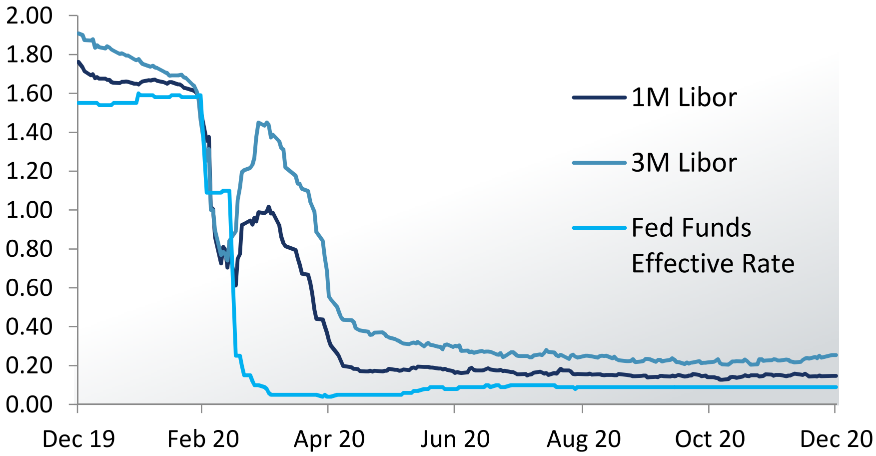
Performance Notes

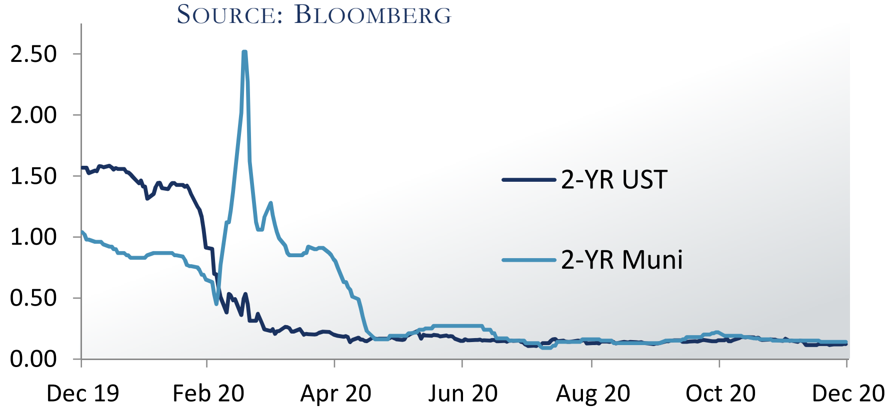
With the Federal Reserve steadfast in their intent to keep monetary policy accommodative during the pandemic, short-term yields for both municipals and investment grade corporates remained near historic lows over the quarter. Modest curve steepness was constructive for the Short Maturity Municipal strategy, as its targeted reinvestment between 4-5 years helped capture incremental yield not found further down the curve. Low Duration Taxable's overweight to IG corporate debt continued to provide incremental yield to portfolios, and benefited from a strong rally in spreads to close out the year. Looking forward, we continue to see opportunities to add incremental yield versus cash alternatives that remain near a 0% yield, but this requires robust market access and judicious security selection.

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



"The last Federal Reserve meeting of 2020 did little to change our outlook that short-term interest rates will remain subdued in the near-term."

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



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