STERLING CAPITAL

Bond Market Review | June 29, 2020

Summary

- Despite some volatility in equities, last week felt like the start of summer as vacation season began.
- Treasuries rallied and the curve flattened in risk-off fashion, with the 10-year Treasury yield declining to 65 basis points. Quarter-end rebalancing also contributed to volatility as fund managers repositioned portfolios ahead of the June 30 snapshot.
- The AAA-rated municipal market was largely unchanged for the week with light trading activity despite Treasury volatility. The lower-rated segment of the market continued to drive returns, led by Illinois, New Jersey and Connecticut.

Treasury Yields

Term	Treasury Yield	Δ MTD	Δ YTD
1 Year	0.15	-0.01	-1.41
2 Year	0.17	0.01	-1.40
5 Year	0.30	0.00	-1.39
10 Year	0.64	-0.01	-1.28
30 Year	1.37	-0.04	-1.02

Tax-Exempt

- The U.S. Senate is adjourned and the House is set to vote, and likely pass, its version of the next stimulus bill (concentrated toward local governments) in early July. Several stakeholders made public comments regarding the need for additional stimuli, perhaps in an effort to encourage passage in the Senate. In a survey of 1,100 cities by the National League of Cities, 65% have been forced to cancel or delay infrastructure projects. Metropolitan Transportation Authority (MTA) Chairman Patrick Foye announced that it would likely be forced to cut its workforce or reduce service levels if additional aid is not forthcoming. $13.5B in deferred maintenance plans previously approved for 2020 were reduced to $2.3B for only the most critical improvements. NYC Mayor Bill deBlasio announced he will need labor concessions, otherwise 22,000 city job cuts may be needed. Failure to pass a budget by the end of June may reactivate the city's fiscal control board, an oversight agency created out of the city's fiscal crisis of the mid-1970s. In a report released this week, Moody's stated that state and local governments will need at least $500B in aid over the next two fiscal years.
- California lawmakers agreed on a FY21 budget largely in line with the bill passed by the legislature last week. The budget largely assumes the federal government will supply additional funds to the state. The governor's budget outlined large spending cuts which were opposed by many state legislators. The compromise point lies with an October 1 deadline. If additional federal funds are not received by that date, the governor will have the ability to cut spending, significantly if necessary, in order to balance the budget for FY21.
- Texas Governor Greg Abbott halted plans to reopen the state's economy following a surge in COVID-19 cases, particularly around Houston. Governors in Louisiana, Kansas and North Carolina also delayed the next phase of reopening plans. Illinois is charging ahead and will move to phase four of its preset five phase reopening process. Beginning last Friday, movie theaters, zoos, museums, childcare centers and health and fitness centers in Illinois will be permitted to reopen or expand services. Indoor dining in restaurants and bars will resume under department of health guidelines, with certain capacity limitations.
- Bond insurance is making a comeback. New tax-exempt deals with insurance hit 10% over the last two months. This is the first time the 10% threshold has been reached for two consecutive months since July-August 2009. According to a manager at Build America Mutual, the driver behind growth in business is not necessarily a fear of defaults in the muni space, but rather a fear of downgrades.

Municipal Yields

Term	Municipal Yield	Δ MTD	Δ YTD	Tax-Equivalent Yield	Municipal/Treasury Ratio (%)	Δ MTD	Δ YTD
1 Year	0.25	0.14	-0.79	0.38	164.15	94.22	97.74
2 Year	0.27	0.11	-0.77	0.42	162.55	62.74	96.27
5 Year	0.41	0.03	-0.68	0.63	135.76	10.60	71.30
10 Year	0.90	0.06	-0.54	1.38	140.34	11.62	65.24
30 Year	1.63	-0.02	-0.46	2.51	118.97	1.65	31.51

Taxable

- Rising COVID-19 cases in a number of states drove negative risk sentiment this week, pushing spreads wider. Investment-grade credit spreads ended the week 7 basis points (bps) wider to 153bps, and high yield spreads moved 37bps wider to 615bps. The most COVID-19-affected sectors fared worse, while some sectors were unchanged, widening by no more than a few basis points. Despite some ugly days in the equity markets, credit investors did not seem to get too worked up.
- The Fed has been a big driver of investor calm, buying another $1.7B in corporate bonds last week. At the current pace, the Fed would hit about $32B in purchases by the scheduled end date of the Secondary Market Corporate Credit Facility (SMCCF) program. This leaves plenty of room to increase purchases substantially if the market tanks, or to extend the program if the market still needs support beyond September.
- Last week was the lightest week of supply in over three months, with only a handful of issuers hitting the market. Headline issuers included Intuit, Total, Svenska Handelsbanken, Athene and ING. The holiday-shortened week this week should make it one of the quietest weeks of 2020 thus far, and that trend could continue into July. Dealer estimates are in the $90-100B range for the month, which would be below the five year average.
- Secondary market volume continued its recent downward trend, down about 30% from the peak a few weeks ago. The summer slowdown is definitely real and this should be a very quiet week. Dealer inventories declined by about $1.6B last week, with nearly all of it coming out of the front end. It does not seem like a coincidence that this is almost the exact same amount that the Fed bought last week. Overseas flows were very quiet this week, with several holidays in effect.

As of 06.26.2020. Sources: Bloomberg, Barclays Capital, Bank of America Merrill Lynch. Please see page 3 for important disclosures and definitions.

Sectors[1]

	Duration	Spread	Δ MTD	Δ YTD	52- Week High	52-Week Low
Investment Grade Corporate	8.53	153	-21	60	373	93
-Financial	6.51	142	-32	62	378	80
-Industrial	9.21	159	-17	60	383	99
-Utility	11.11	150	-11	53	298	95
High Yield	3.87	615	-22	279	1100	315
Securitized	2.34	77	-3	35	135	38
-Commercial Mortgage-Backed Securities	5.32	135	-23	63	260	60
-Asset-Backed Securities	2.12	69	-42	25	325	27
-Mortgage-Backed Securities	2.10	72	-1	33	132	28

International Yields

	Germany	Japan	U.K.	France	Italy	Spain	Greece
2 Year	-0.70	-0.12	-0.07	-0.59	0.12	-0.43	--
5 Year	-0.71	0.10	-0.04	-0.53	0.62	-0.16	0.72
10 Year	-0.48	0.02	0.17	-0.13	1.29	0.46	1.27
30 Year	-0.04	0.59	0.63	0.59	2.25	1.25	--

Equity

	Current	Δ MTD	Δ YTD
Dow Jones	25,015.55	-367.56	-3,522.89
S&P 500	3,009.05	-35.26	-221.73
Nasdaq	9,757.22	267.35	784.62

Volatility

	Current	Δ MTD	Δ YTD
VIX	34.73	7.22	20.95
MOVE	51.21	-0.34	-7.07

Commodities

	Current	Δ MTD	Δ YTD
CRB	134.41	2.17	-51.37
Gold	1,780.30	28.60	257.20
Oil	38.49	3.00	-22.57
Gas	115.33	7.48	-53.72

Central Bank Rates

	Current	Δ MTD	Δ YTD
United States	0.25	0.00	-1.50
Europe	0.00	0.00	0.00
United Kingdom	0.10	0.00	-0.65
Japan	0.10	0.00	0.00
Canada	0.25	0.00	-1.50
TED Spread	17.1	-4.84	-19.38

Currency

	Current	Δ MTD	Δ YTD
US Dollar	97.433	-0.911	0.988
Euro	1.122	0.012	0.001
Pound	1.234	-0.001	-0.092
Yen	107.220	-0.610	-1.540
Canadian Dollar	1.369	-0.009	0.070
Franc	0.948	-0.014	-0.019

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[1]Sectors are represented by the following indices: Investment Grade Corporate – Bloomberg Barclays U.S. Corporate Bond; Financial – Bloomberg Barclays U.S. Aggregate Investment Grade Finance; Industrial – Bloomberg Barclays U.S. Aggregate Investment Grade Industrial; Utility – Bloomberg Barclays U.S. Investment Grade Utility; High Yield – Bloomberg Barclays U.S. Corporate High Yield; Securitized – Bloomberg Barclays U.S. Securitized; Commercial Mortgage-Backed Securities – Bloomberg Barclays U.S. Aggregate CMBS; Asset-Backed Securities – Bloomberg Barclays U.S. Aggregate ABS; Mortgage-Backed Securities – Bloomberg Barclays U.S. Aggregate MBS.

Technical Terms

Duration: a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates
Municipal/Treasury Ratio: a comparison of the current yield of municipal bonds to U.S. Treasuries
Tax-Equivalent Yield: the return that is required on a taxable investment to make it equal to the return on a tax-exempt investment
TED Spread: the difference between the three-month Treasury bill and the three-month LIBOR based in US dollars
Yield: the earnings generated and realized on an investment over a particular period of time
Yield Spread: the difference between the quoted rates of return between two different investment vehicles; also called the credit spread

Index Definitions

The volatility of an index varies greatly; all indices are unmanaged and investments cannot be made directly in an index.

Bloomberg Barclays US Aggregate ABS Index: A component of the Bloomberg Barclays US Aggregate Index, the Bloomberg Barclays US Aggregate ABS Index includes pass-through, bullet and controlled amortization structures. The Index includes only the senior class of each ABS issue and the ERISA-eligible B and C tranche.

Bloomberg Barclays US Aggregate CMBS Index: A component of the Bloomberg Barclays US Aggregate Index, the Bloomberg Barclays US Aggregate CMBS Index includes investment grade securities that are ERISA-eligible under the underwriter's exemption.

Bloomberg Barclays US Aggregate MBS Index: A component of the Bloomberg Barclays US Aggregate Index, the Bloomberg Barclays US Aggregate MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). The Index is formed by grouping the universe of over 600,000 individual fixed rate MBS pools into approximately 3,500 generic aggregates.

Bloomberg Barclays US Aggregate Investment Grade Finance Index: A component of the Bloomberg Barclays US Corporate Bond Index, the Bloomberg Barclays US Aggregate Investment Grade Finance Index measures publicly issued investment grade US corporate bonds in the Finance sector.

Bloomberg Barclays US Aggregate Investment Grade Industrial Index: A component of the Bloomberg Barclays US Corporate Bond Index, the Bloomberg Barclays US Aggregate Investment Grade Finance Index measures publicly issued investment grade US corporate bonds in the Industrial sector.

Bloomberg Barclays US Aggregate Investment Grade Utility Index: A component of the Bloomberg Barclays US Corporate Bond Index, the Bloomberg Barclays US Aggregate Investment Grade Finance Index measures publicly issued investment grade US corporate bonds in the Utility sector.

Bloomberg Barclays US Corporate Bond Index: The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

Bloomberg Barclays US Corporate High Yield Bond Index: The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Bloomberg Barclays US Securitized Index: Bloomberg Barclays US Securitized Index is comprised of predominantly MBS Agency securities, but also includes ABS, CMBS and covered securities. Bloomberg Barclays US Treasury Strips 20+ Year Index tracks the performance of zero coupon US Treasuries with a duration of 20 years or more.

CRB: The Commodity Research Bureau (CRB) Index acts as a representative indicator of today's global commodity markets. It measures the aggregated price direction of various commodity sectors.

Dow Jones: The Dow Jones Industrial Average (DJIA) is an index that tracks 30 large, publicly-owned blue chip companies trading on the New York Stock Exchange (NYSE) and the NASDAQ.

ICE BofAML 1-10 Year Municipal Securities Index: The ICE BofAML 1-10 Year Municipal Securities Index is a subset of the ICE BofAML U.S. Municipal Securities Index including all securities with a remaining term to final maturity less than 10 years.

MOVE: The MOVE Index is a well-recognized measure of U.S. interest rate volatility that tracks the movement in U.S. Treasury yield volatility implied by current prices of one-month over-the-counter options on 2-year, 5-year, 10-year and 30-year Treasuries.

Nasdaq: The Nasdaq Composite Index is the market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq-listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debenture securities.

S&P 500: The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The S&P 500 Index focuses on the large-cap segment of the market; however, since it includes a significant portion of the total value of the market, it also represents the market.

VIX: The CBOE Volatility Index, or VIX, is a real-time market index representing the market's expectations for volatility over the coming 30 days.

West Texas Intermediate: West Texas Intermediate (WTI) is a crude oil that serves as one of the main global oil benchmarks. It is sourced primarily from Texas and is one of the highest quality oils in the world, which is easy to refine. WTI is the underlying commodity for the NYMEX's oil futures contract.