BOND MARKET UPDATE

As of 9/30/20 | Volume 9, Issue 3 | FFTAM.com

In the 3rd Quarter of 2020, fixed income performance trended mostly sideways after a very nice rebound in the 2nd Quarter. Broadly, governments and credit generated positive returns. Total returns for both taxable investments and tax-free investments were positive. For taxable portfolios in the 3rd Quarter, the Barclays Aggregate generated a total return of 0.62%. For tax-free portfolios in the 3rd Quarter, the Barclays 1-10yr Muni generated a total return of 1.07%. YTD returns are 6.79% and 3.22%, respectively. The economy continued its reopening process, the Fed reconfirms its support, and the markets continue to do its best at looking through the short-term economic challenges of COVID.

Economy

GDP in the 2nd Quarter of 2020 came in with a final Q/Q reading of -31.4%. GDP Projections for the 3rd Quarter of 2020 are estimated at +25.3%, reflecting the reopening of businesses as the country somewhat learns how to deal with COVID. After peaking in the second quarter, US Unemployment and US Continuing Jobless Claims continue to decline. However, Continuing Claims, U3 and U6 Unemployment readings remain elevated. (see chart 1)

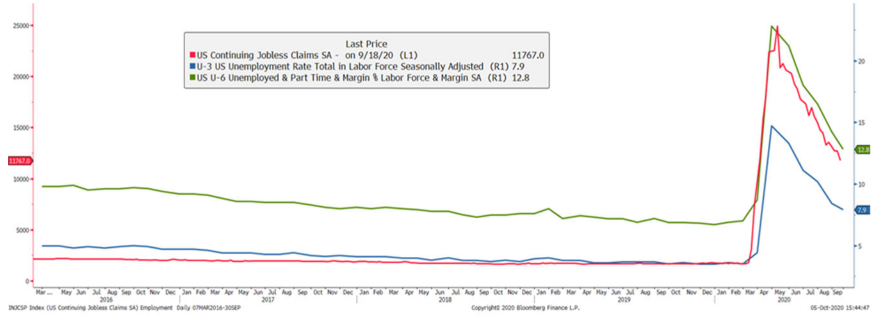

Chart 1

As we continue to reemerge from the COVID shutdowns, we are seeing nice bounce backs from historical low PMI's (see chart 2). In the 3rd Quarter of 2020, all major economies saw PMI's surpass 50. It should be noted, even though we are seeing prints above 50, it is from a much lower base and we really need to see prints in the 60's to show that a bounce is meaningful.

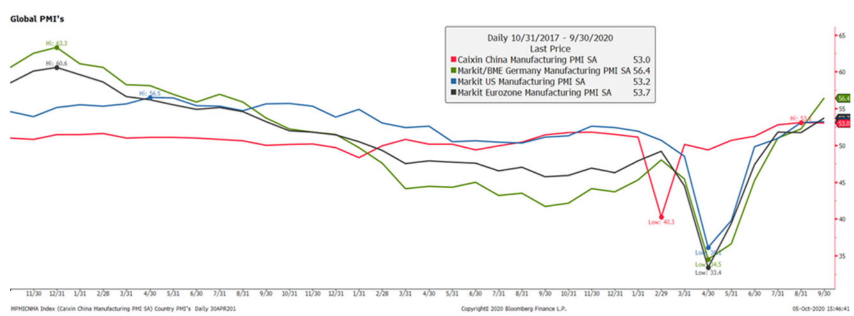

Chart 2

FFTAM OFFICE LOCATIONS

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400 Pine Street
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FORT WORTH
1000 Forest Park Blvd
Suite 200
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Odessa, TX 79765
432-367-8912

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3515 Dowlen Road
Beaumont, TX 77706
409-600-6460

HOUSTON
24080 Hwy 59 N
Kingwood, TX 77339
281-318-4625

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Rates

For the 3rd Quarter of 2020, U.S. risk free rates have trended sideways as the Fed has intervened in the markets (see chart 3). The Fed, at both the July and September FOMC meetings elected to keep the cash rate at the zero-lower bound. In addition, it was made clear that it is their intention to keep the cash rate at the zero lower bound though at least 2023. Historically, at this point in the economic cycle, the risk-free curve should start to steepen as the economy starts the recovery process. It will be interesting to see if the Fed will let this happen.

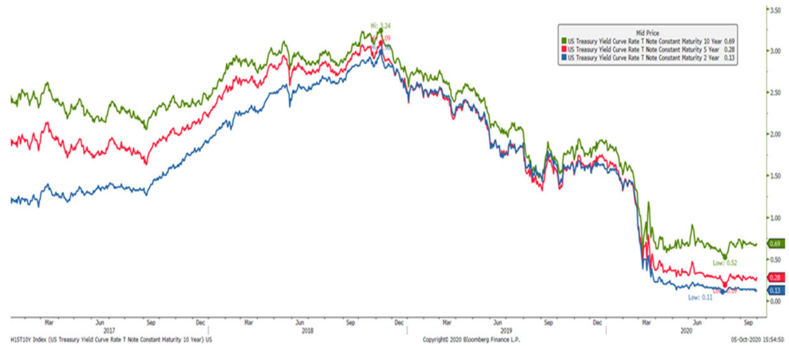

Chart 3

For the 3rd Quarter of 2020, global developed bond rates essentially mimicked what happened here in the USA. Global rates trended sideways. Not all countries have reached new lows, however, two countries still trade with negative 10yr interest rates (see chart 4).

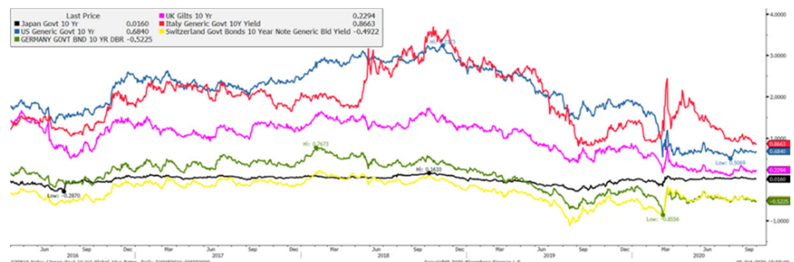

Chart 4

Credit

Credit performed well versus risk free in the 3rd Quarter of 2020. Spreads tightened for both investment grade and high yield as risk appetite prevailed with the backing of the Fed. Investment grade spreads tightened by roughly 14bps. High yield spreads tightened by roughly 109bps. As you can see in Chart 5, we have not recouped all that was lost, but the tightening that we have seen is very beneficial to corporate balance sheets.

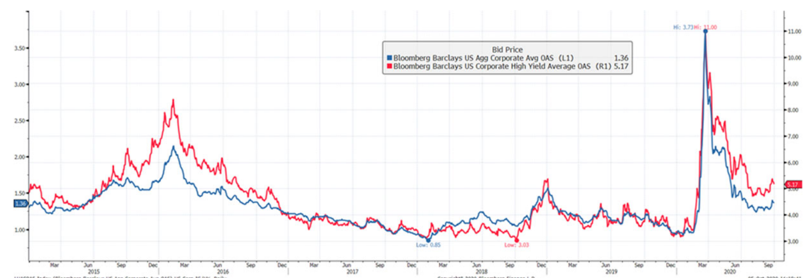

Chart 5

Looking Forward

Looking forward, markets have improved substantially and will most likely trend sideways until it becomes clearer how this pandemic will play out. Additional stimulus, depending on the size, can steepen the curve. For credit, I don't see risk premiums increasing too much as the Fed is acting as a backstop, but there could be further pressure on balance sheets if a fall/winter round of COVID proves to be potent. As always, we run a high-quality portfolio that looks to take advantage of opportunities as they present themselves. We have been active in seeking those opportunities and feel good about the changes that have been made. This doesn't mean we won't have another hiccup in this market, but the hiccup should be smaller. In addition, we do not believe the economy will reach pre-COVID levels for some time. This will be a long drawn out process with a weaker economic footing that should persist for several years to come. However, stimulus by Congress does have the ability to shorten that time frame.

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