

BOND MARKET UPDATE

As of 03/31/21 | Volume 10, Issue 1 | FFTAM.com

In the 1st Quarter of 2021, total returns for both taxable investments and tax-free investments were slightly negative. For taxable portfolios in the 1st Quarter, the Barclays Aggregate generated a total return of -3.37%. For tax-free portfolios in the 1st Quarter, the Barclays 1-10yr Muni generated a total return of -0.26%. The economy continued its reopening process, the Fed reconfirms its support, vaccine distribution increased substantially, yield curves steepened, and the markets are now firmly looking to the other side of Covid.

Economy

GDP in the 4th Quarter of 2020 came in with a final Q/Q reading of +4.3%. For the year, 2020 had a final growth rate of -3.5%. GDP Projections for the 1st Quarter of 2021 are estimated at +4.7% Q/Q and current estimates for the year of 2021 are for a growth rate of 5.8%. After peaking in the second quarter of 2020, US Unemployment and US Continuing Jobless Claims continue to decline. As the economy continues to reopen, these numbers should continue to improve as we progress through 2021. (see chart 1)

As we continue to see economies reopen, we are seeing nice bounce backs from historical low PMI's (see chart 2). In the 1st Quarter of 2021, all major economies saw PMI's remain above 50, and some that are spiking into the 60's.

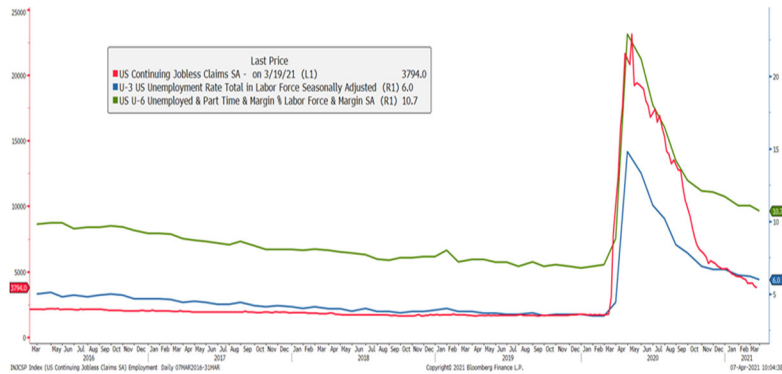


Chart 1

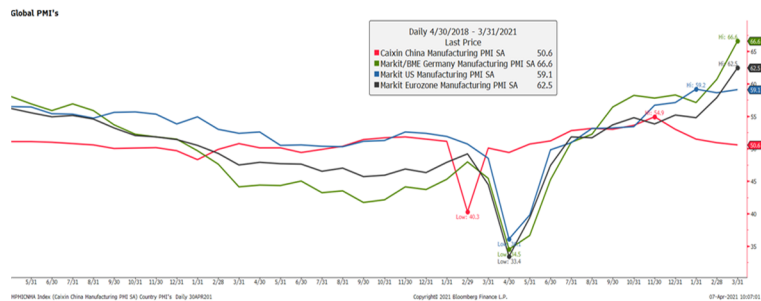


Chart 2

ABILENE

400 Pine Street
Suite 300
Abilene, TX 79601
325-627-7100

BEAUMONT

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

BRYAN/COLLEGE STATION

1716 Briarcrest Dr
Suite 400
Bryan, TX 77802
979-260-2134



ODESSA

3555 Billy Hext Rd
Odessa, TX 79765
432-367-8912

SAN ANGELO

222 S. Koenigheim St
San Angelo, TX 76903 325-659-5987

SAN ANTONIO

9601 McAllister Fwy
Suite 1204
San Antonio, TX 78216
210-864-4774

FORT WORTH

1000 Forest Park Blvd
Suite 200
Fort Worth, TX 76110
682-703-6404

HOUSTON

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

Not FDIC Insured | May Lose Value | No Bank Guarantee

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254-918-6262

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Rates

For the 1st Quarter of 2021, U.S. risk free rates continued to steepen as long rates have marched higher at a brisk pace (see chart 3). The Fed, at both the January and March FOMC meetings elected to keep the cash rate at the zero lower bound and reconfirmed their intention to keep the cash rate at the zero lower bound though at least 2023. In addition, at the March meeting, Powell communicated that the Fed will continue with its \$120B/month buy program until the Fed has meet their objectives of full employment and a rate of inflation comfortably above 2%.

The Fed's balance sheet currently stands at \$7.7T. By the end of the year their balance sheet should grow to roughly \$8.6T (see chart 4). Expectations are starting to build that the Fed will reach certain economic milestones in the 4th Quarter of 2021. At that time, the Fed will start to communicate an end to QE4 starting in 2022. This does not entail selling of securities but rather purchasing of securities to stop.

Credit

Credit performed well versus risk free in the 1st Quarter of 2021. Spreads tightened for both investment grade and high yield as risk appetite prevailed with the backing of the Fed, an increase in vaccinations, and a massive \$1.9T stimulus pushed through Congress. Investment grade spreads tightened by roughly 5bps. High yield spreads tightened by roughly 50bps. As you can see in chart 5, we have fully recovered from the Covid sell off.

Looking Forward

Looking forward, the risk-free curve should continue to steepen. Historically, the average 10-2yr UST spread has been roughly 140bps. Currently, we are slight above average at roughly 160bps. Since we are still in the early stages of this economic recovery, we expect the 10-2yr UST spread to approach 200bps. This should take the 10yr UST to slightly over 2%. The big story will be in the 4th Quarter of this year. This is when we expect the Fed to start the communication process with the market about the end of its \$120B/month purchasing program (QE4). This will create some minor ripples. For credit, we still don't see risk premiums increasing too much as the Fed is still in the market, a vaccine is now being widely distributed and stimulus is in full swing. However, we will look to reduce credit risk as we approach the Fed announcement on the end of QE4. 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.



Chart 3

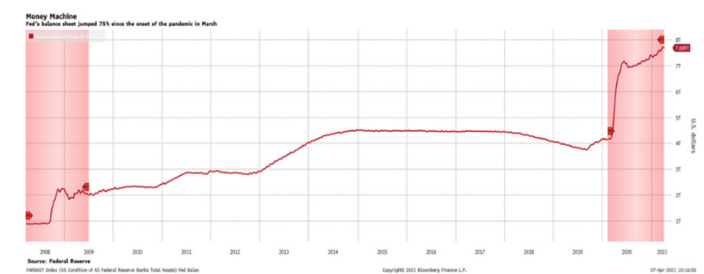


Chart 4

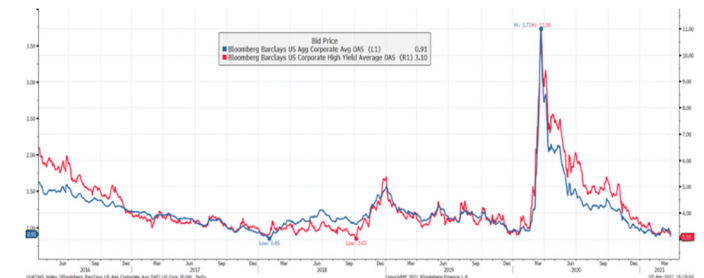


Chart 5

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