

Fourth Quarter 2019 Bond Market Commentary

Another strong year for investment returns across the fixed income markets. A year ago, expectations for several rate increases in 2020 were universally predicted, following four 25 basis point increases in 2018. Political pressure and decisive stock market weakness framed the famous “pivot” by the Fed in January. No longer was the Fed projected to raise rates in 2019. Both the bond market and equity markets were off to the races following the news. In summer of 2019, the Fed lowered rates three times. The rest of 2019 is history.

Interest rates across the yield curve plummeted in 2019. Short-term rates fell approximately 100 basis points while longer-term rates dropped 60 to 75 basis points. This resulted in longer-term maturities outperforming shorter-term maturities. Specifically, the annual return on 5 Year U.S. Treasuries was 5.8%, while 30 Year U.S. Treasuries produced returns of 16.2%. A year ago, we did not expect that.

As has been the case during previous Fed easing cycles, credit sectors benefited. Returns throughout the corporate segments outpaced the strong Treasury market results. Lower quality credits also performed very well. The BAA credit component led the way with a return of 16.46%.

Adjusting for the tax differential, Municipal bond returns shadowed the taxable market returns. During the year there were times when municipal rates were quite expensive relative to taxable rates. However, increased supply later in the year returned them to more normal levels.

A golden rule in investing is to not fight the Fed. Witnessing the Fed caving into political and equity market dynamics early last year only reinforces this proposition. Once the Fed reversed the commentary, risk was back on. As a result, both bonds and stocks produced notable returns in 2019.

Where do we go from here? With interest rates near historic lows and credit spreads following suit at historic lows, we are carefully selecting the securities being adding to the portfolios. Overall, we are managing the interest rate risk in the portfolio to remain neutral to our targets. Likewise, we are managing sector and quality risks conservatively, keeping our exposures very close to slightly above neutral.

We believe this strategy should keep our portfolios and their relative performance in-line with the market.

Index Returns As of 12/31/19	Performance Period		
	3 Month	6 Month	1 Year
Bloomberg Barclays US Treasury Intermediate	0.01%	1.19%	5.22%
Bloomberg Barclays Govt/Credit Intermediate	0.37%	1.75%	6.80%
Bloomberg Barclays Intermediate Aggregate	0.47%	1.85%	6.67%
Bloomberg Barclays US Treasury	-0.79%	1.59%	6.86%
Bloomberg Barclays Govt/Credit	-0.01%	2.63%	9.71%
Bloomberg Barclays Aggregate	0.18%	2.45%	8.72%
Bloomberg Barclays US Treasury 20+ Year	-4.24%	3.57%	15.11%
Bloomberg Barclays Corporate	1.18%	4.27%	14.54%
Bloomberg Barclays Corporate Intermediate	1.10%	2.86%	10.14%
Bloomberg Barclays Corporate High Yield	2.61%	3.98%	14.32%
Bloomberg Barclays Credit AAA	0.04%	1.81%	6.92%
Bloomberg Barclays Credit AA	-0.04%	2.80%	10.28%
Bloomberg Barclays Credit A	0.74%	3.69%	13.01%
Bloomberg Barclays Credit BAA	1.69%	5.01%	16.46%
Bloomberg Barclays MBS	0.71%	2.09%	6.35%
Bloomberg Barclays TIPS	1.35%	7.58%	7.13%
Bloomberg Barclays Inter-Short Muni	0.88%	1.56%	5.23%

Source: Bloomberg Barclays

Daily Generic Municipal Bond Yields as of 12/31/19

Term	Maturity	AAA	AA	A	BAA1
1 Yr	2021	1.03	1.11	1.21	1.64
2 Yr	2022	1.04	1.13	1.23	1.66
3 Yr	2023	1.05	1.16	1.28	1.71
4 Yr	2024	1.07	1.19	1.33	1.77
5 Yr	2025	1.11	1.25	1.41	1.85
7 Yr	2027	1.24	1.38	1.57	2.01
9 Yr	2029	1.39	1.55	1.76	2.19
10 Yr	2030	1.47	1.64	1.85	2.28
12 Yr	2032	1.58	1.77	1.98	2.41
14 Yr	2034	1.68	1.91	2.12	2.54
15 Yr	2035	1.72	1.97	2.17	2.59
17 Yr	2037	1.8	2.05	2.24	2.65
19 Yr	2039	1.86	2.11	2.3	2.71
20 Yr	2040	1.88	2.14	2.33	2.73
25 Yr	2045	2.03	2.29	2.47	2.87
30 Yr	2050	2.1	2.39	2.53	2.93

Source: Bloomberg

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Index Descriptions:

Bloomberg Barclays US Intermediate Treasury Index Unmanaged index includes all publicly issued, US Treasury securities that have a remaining maturity of greater than or equal to 1 year and less than 10 years, are rated investment grade, and have \$250 million or more of outstanding face value.

Bloomberg Barclays Intermediate Government/Credit Index: Is an unmanaged index based on all publicly issued intermediate government and corporate debt securities with maturities of 1-10 years. This index represents asset types which are subject to risk, including loss of principal.

Bloomberg Barclays U.S. Treasury Bond Index: Is part of Bloomberg Barclays global family of government bonds indices. The index measures the performance of the U.S. Treasury bond market, using market capitalization weighting and a standard rule based inclusion methodology.

Bloomberg Barclays Government/Credit Bond Index Unmanaged index that tracks the performance of US Government and corporate bonds rated investment grade or better, with maturities of at least one year.

Bloomberg Barclays Intermediate Aggregate Index: Is an unmanaged index that consists of 1-10 year Governments, 1-10 year Corporates, all Mortgages, and all Asset-Backed securities within the Aggregate Index (i.e. the Aggregate Index less the Long Government/Corporate Index).

Bloomberg Barclays U.S. Aggregate Bond Index: Is an unmanaged index composed of securities from the Bloomberg Barclays Government/Corporate Bond Index, Mortgage-Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization.

Bloomberg Barclays U.S. Credit Index: Is composed of all publicly issued, fixed-rate, nonconvertible, investment-grade corporate debt. Issues are rated at least Baa by Moody's Investors Service or BBB by Standard & Poor's, if unrated by Moody's. Collateralized Mortgage Obligations (CMOs) are not included. Total return comprises price appreciation/depreciation and income as a percentage of the original investment.

Bloomberg Barclays U.S. Intermediate Credit Index: Measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. The index only includes securities with maturity between one and ten years. It is composed of the Bloomberg Barclays U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

Bloomberg Barclays U.S. Corporate High Yield Index: Is an unmanaged index that is comprised of issues that meet the following criteria: at least \$150 million par value outstanding, maximum credit rating of Ba1 (including defaulted issues) and at least one year to maturity.

Bloomberg Barclays U.S. Mortgage-Backed Securities Index: Is an unmanaged index that tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by GNMA, FNMA, and FHLM.

Bloomberg Barclays U.S. Treasury Inflation-Protected Securities (TIPS) Index: Represents securities that protect against adverse inflation and provide a minimum level of real return. To be included in this index, bonds must have cash flows linked to an inflation index, be sovereign issues denominated in U.S. currency, and have more than one year to maturity, and, as a portion of the index, total a minimum amount outstanding of 100 million U.S. dollars. An individual cannot invest directly in an index.

Bloomberg Barclays Municipal Bond Inter-Short 1-10 Year Index: Is an unmanaged index of municipal bonds traded in the U.S. with maturities ranging from 1-10 years.

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