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Weekly Fixed Income Commentary

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A dovish Fed drives Treasury yields lower

U.S. Treasury yields declined sharply last week, led by 5-year maturities. Dovish comments from the Federal Reserve (Fed) fueled a move lower on Wednesday. Risk-off sentiment continued on Friday due to disappointing economic data out of Europe. The spread between the 10-year Treasury and the 3-month T-bill yields inverted, indicating a higher risk of recession over the next 12 months.

HIGHLIGHTS

- **Investment grade corporates produced the highest weekly total return.**
- **The municipal market staged a strong rally, following the U.S. Treasury market.**
- **The global aggregate sector experienced solid returns based on good performance in Asia.**

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TREASURY YIELDS FALL ON GLOBAL GROWTH CONCERNS AND DOVISH FED

U.S Treasury yields fell significantly last week for all maturities.[1] The decline occurred on Wednesday and Friday, led by the 5-year Treasury.[1] Markets expected Fed projections to reflect fewer rate hikes in 2019, but it was they surprising to see 11 FOMC participants anticipating no further hikes this year. Friday's decline surpassed Wednesday's move, triggered by strongly disappointing economic data out of Europe.[1]

Cautious market sentiment hit the highest risk fixed income sectors hardest. Senior loans, preferred securities and high yield corporates suffered the worst performance.[1] Loans were the only fixed income sector with a negative total return for the week, as investors continued to leave the sector.[1] Investment grade corporates produced the highest weekly total return.[1] Although spreads tightened only slightly, the sector's longer duration boosted returns as overall yields fell significantly.[1] The commercial mortgage-backed sector posted the second highest total return and delivered the best return relative to similar-duration Treasuries.[1] The global aggregate sector experienced solid returns based on good performance in Asia.[1]

The decrease in intermediate maturity Treasury yields caused the difference between the 10-year Treasury and the 3-month T-bill yields to invert, dropping into negative territory.[1] The Federal Reserve Bank of San Francisco's Economic Letter published August 27, 2018, identified this spread as the most reliable predictor of recessions. When this yield relationship inverts, with the 3-month maturity yield higher than the 10-year, it indicates a rising risk of recession over the next 12 months.

MUNICIPAL MARKET RALLY CONTINUES

The municipal market staged a strong rally last week, following the Treasury market.[1] Both markets closed Friday with a strong tone. New issue supply of $3.6 billion was readily absorbed.[2] Fund flows continued their positive streak at $1.4 billion.[3] New issue supply is expected to be $11 billion this week, and should be well received.[2]

Municipal market technicals remain favorable. March issuance is expected to be the lowest since 2011, when it was less than $11 billion for the month.[4] And fund flows total $21 billion year to date, the best annual start since data collection began in 1992.[5] Although municipals are expensive versus Treasuries, investors in high-tax states continue to invest in municipal bonds to minimize taxes.

Florida Board of Education issued $439 million bonds competitively (rated Aaa/AAA).[6] Illustrating the effect of the Fed's new moderate stance on interest rates, some municipal bonds traded 7 basis points lower by the end of the week, after the Fed meeting.

High yield municipal bond yields declined last week on average, but failed to match the larger decreases in high grade yields.[1] Credit spreads grew even more attractive as a result. The high yield municipal market's technical strength continues to build, from already at historical levels. Net fund flows re-accelerated last week at $480.3 million, the second highest weekly total of 2019.[3] The lack of supply appears to be helping the performance of Puerto Rico bonds, especially the new COFINA exchange bonds.[1] However, we expect supply relief from a $700 million deal for the city of Chicago and a $1.5 billion deal for Virgin Trains USA.[2]

When the 3-month Treasury yield is higher than the 10-year, it indicates a rising risk of recession.

INVESTMENT GRADE CREDIT RETURNS MARCH HIGHER

Investment grade corporate bonds led all taxable sectors last week.[1] The asset class posted a positive return for the third week in a row, maintaining its place as the month's top performer.[1] Fund inflows accelerated for the seventh consecutive week, with investors adding more than $5 billion.[3] Dovish Fed rhetoric sent longer-term interest rates sharply lower, which benefited investment grade corporates because of their longer duration (7.4 years versus 5.8 years for the Bloomberg Barclays U.S. Aggregate Bond Index).[1]

High yield corporates managed a moderate gain for the week, despite Friday's small loss.[1] The market traded firmly for most of the week, highlighted by strong inflows (nearly $2 billion) and the Fed's accommodative stance.[3] Performance cooled on Friday as U.S. stocks tumbled on fears of weakening global growth.[1] While overall high yield fundamentals remain strong and default expectations low, last week investors specifically preferred higher quality among below investment grade credits. Bonds rated BB had the highest returns, and CCCs the lowest.[1]

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Emerging markets (EM) logged another positive week amid mixed conditions.[1] Continued inflows into EM bond funds, limited new issuance and a supportive Fed were partly offset by spread widening and Friday's risk-off trades. Within the EM universe, high yield sovereign debt bore the brunt of the late-week selling. EM corporate bonds were more resilient, led by investment grade names.

In focus

A dove and beyond: The Fed takes it easier

The Fed exceeded dovish expectations at its meeting last week. While the decision to maintain its target fed funds rate at 2.25% to 2.50% was not a surprise, the accompanying statement and press conference showed the Fed's policy stance becoming more accommodative than markets had anticipated.

Underlying this increased dovishness is the Fed's economic outlook, which softened slightly. The Fed now forecasts 2019 gross domestic product (GDP) growth of 2.1%, down from 2.3% at December's meeting. At the same time, the Fed expects core inflation to remain well-anchored at 2%.

The closely watched "dot plot" was much flatter than it had been in December. The Fed now forecasts no rate hikes in 2019, versus two in its previous forecast. Only one increase is projected for 2020. In a further sign of looser monetary policy, the Fed said it will stop shrinking its balance sheet by the end of September, earlier than initially anticipated.

After sounding defiantly hawkish in December but far less so in January, Fed Chair Jerome Powell seems to have settled on a consistent message: The U.S. economy is still in good shape, but not so good as to require tighter monetary policy. We are not yet convinced the Fed will be able to get through the year without raising rates at least once, given pressure in the labor market that is forcing wages higher.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	2.32	-0.12	-0.20	-0.17
5-year	2.24	-0.15	-0.27	-0.27
10-year	2.44	-0.15	-0.28	-0.24
30-year	2.88	-0.14	-0.21	-0.14

Source: Bloomberg L.P. As of 22 Mar 2019. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	1.53	-0.05	0.05	-0.25
5-year	1.63	-0.07	0.04	-0.31
10-year	1.92	-0.12	0.18	-0.36
30-year	2.67	-0.18	0.31	-0.35

Source: Bloomberg L.P. As of 22 Mar 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	79
30-year AAA Municipal vs Treasury	93
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters. As of 22 Mar 2019. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	2.38	–	5.92[7]	0.67	1.17	2.48
High Yield Municipal	4.72	221	8.94[7]	1.19	2.11	3.35
High Yield Municipal, ex Puerto Rico	4.67	216	7.41	0.97	1.91	3.06
Short Duration High Yield Municipal[8]	3.97	224	3.66	0.46	1.05	2.30
Short Duration High Yield Municipal, ex Puerto Rico[8]	3.90	217	3.50	0.43	1.03	2.14
U.S. Aggregate Bond	2.97	44	5.84[9]	0.87	1.59	2.61
U.S. Treasury	2.42	–	6.20[9]	0.86	1.54	1.74
U.S. Government Related	3.04	62	5.47[9]	0.85	1.60	2.78
U.S. Corporate Investment Grade	3.67	119	7.40[9]	1.14	2.01	4.63
U.S. Mortgage-Backed Securities	3.11	35	4.13[9]	0.64	1.29	2.00
U.S. Commercial Mortgage-Backed Securities	3.02	66	5.28[9]	0.97	1.66	3.15
U.S. Asset-Backed Securities	2.72	37	2.17[9]	0.35	0.61	1.37
Preferred Securities	4.40	170	4.64[9]	0.10	0.88	7.87
High Yield 2% Issuer Capped	6.49	394	3.44[9]	0.28	0.59	6.89
Senior Loans[10]	6.92	460	0.25	-0.15	-0.05	3.85
Global Emerging Markets	5.30	287	5.78[9]	0.66	1.18	5.24
Global Aggregate (unhedged)	1.79	47	7.06[9]	0.95	1.39	2.34

7 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **8** Data is a subset of the S&P Short Duration Municipal Yield Index that is below investment grade/nonrated. Spread is the yield difference between this subset and the subset rated AAA. **9** Option-adjusted spread to Treasuries. **10** Spread refers to the 3-year discount margin. Duration is estimated based on the frequency of the reset date.

Source: Bloomberg L.P. and Credit Suisse. As of 22 Mar 2019. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. All index returns are shown in U.S. dollars. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting. **Effective duration** (expressed in years) measures the price sensitivity of a fixed-income investment to a change in interest rates, considering that expected cash flows will fluctuate as interest rates change. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account. All indices are unmanaged and unavailable for direct investment.

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1 Bloomberg L.P. **2** The Bond Buyer, 22 Mar 2019. **3** Lipper Fund Flows. **4** MMA Strategist, 18 Mar 2019. **5** JPMorgan, 20 Mar 2019 **6** Market Insight, MMA Research, 20 Mar 2019.

Any reference to credit ratings refers to the highest rating given by one of the following national rating agencies: S&P, Moody's or Fitch. Credit ratings are subject to change. AAA, AA, A and BBB are investment grade ratings; BB, B, CCC, CC, C and D are below-investment grade ratings.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

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Investing involves risk; principal loss is possible. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. The value of convertible securities may decline in response to such factors as rising interest rates and fluctuations in the market price of the underlying securities. Senior loans are subject to loan settlement risk due to the lack of established settlement standards or remedies for failure to settle. These investments are subject to credit risk and potentially limited liquidity, as well as interest rate risk, currency risk, prepayment and extension risk, and inflation risk

Investors should contact a tax advisor regarding the suitability of tax-exempt investments in their portfolio. If sold prior to maturity, municipal securities are subject to gain/losses based on the level of interest rates, market conditions and the credit quality of the issuer. Income may be subject to the alternative minimum tax (AMT) and/or state and local taxes, based on the state of residence. Income from municipal bonds held by a portfolio could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

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