

# Fixed income market update

March 2021

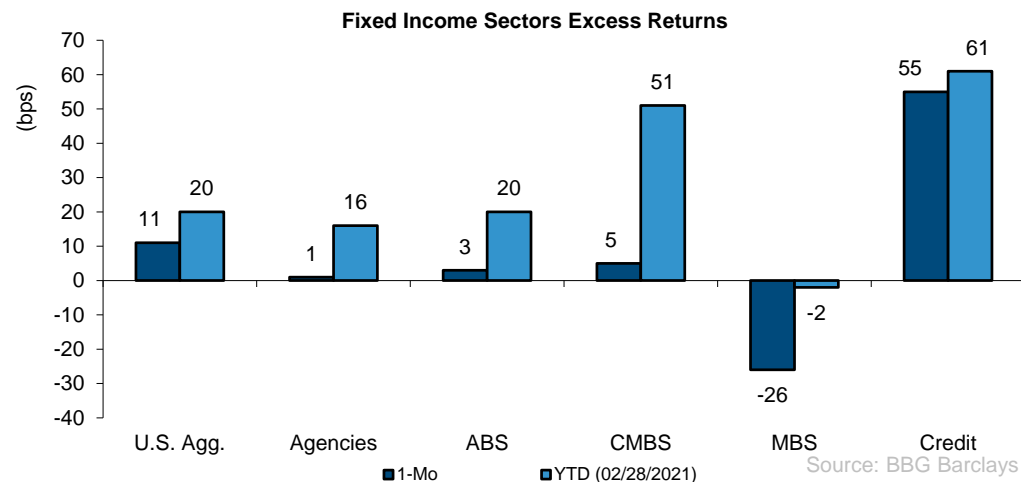
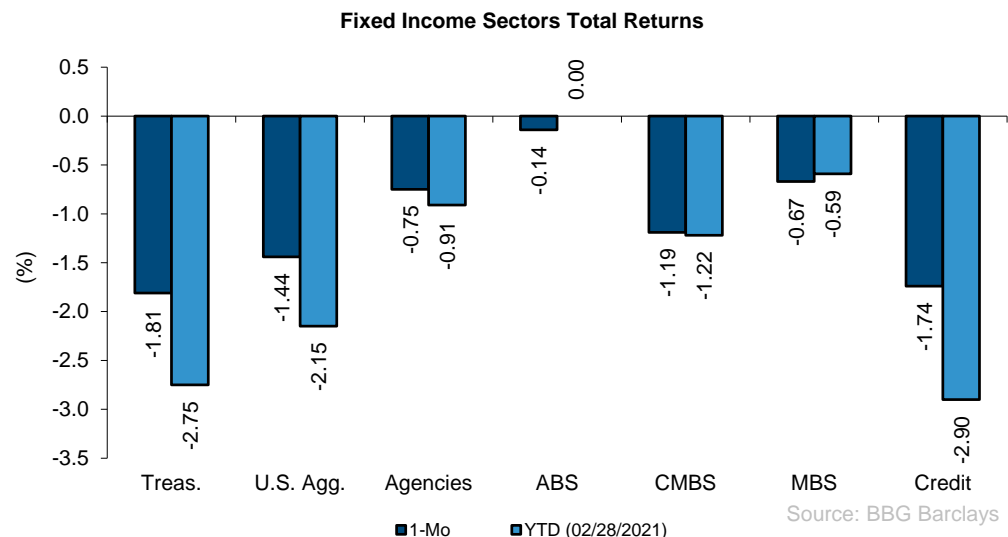
**BMO Fixed Income**

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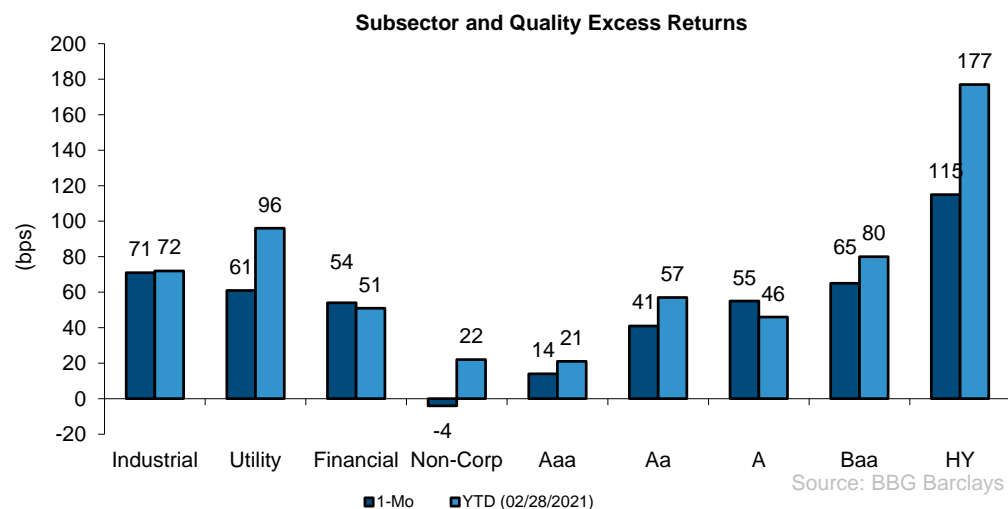
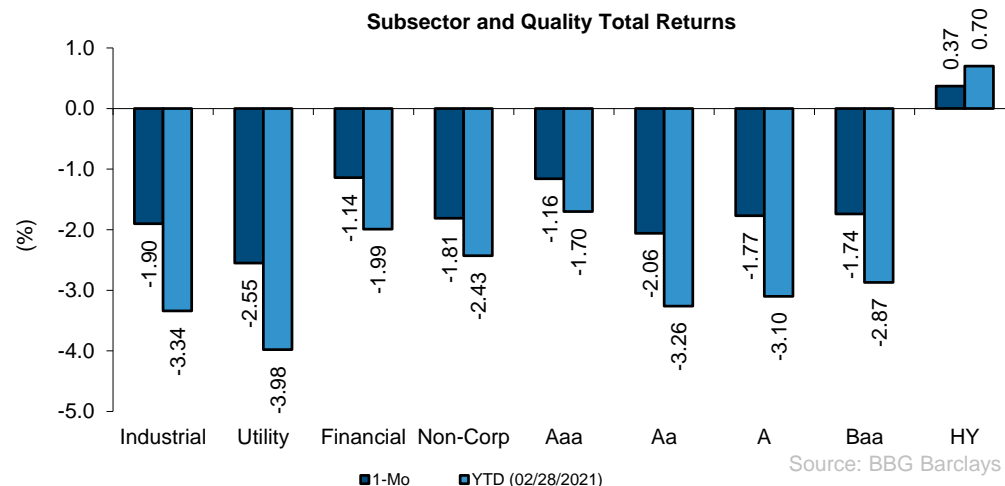
# Fixed income market update

- For the month ended February 28, 2021, the Bloomberg Barclays U.S. Aggregate Bond Index returned -1.44%. Year to date, the index has returned -2.15%.
- U.S. Treasuries returned -1.81% during the month as the yield on the 10-year U.S. Treasury rose to 1.40% at the end of February from 1.07% at the end of January. For the month, long Treasuries (-5.57%) underperformed intermediate Treasuries (-0.84%).
- Mortgage-backed securities (MBS) returned -0.67% during the month, underperforming Treasuries by 26 basis points on a duration-adjusted basis. The option adjusted spread (OAS) of the Bloomberg Barclays U.S. Mortgage Index widened 2 basis points during the month, ending the period at 20 basis points.



# Fixed income market update (continued)

- Credit securities returned -1.74% for the month, outperforming Treasuries by 55 basis points on a duration-adjusted basis. The OAS of the Bloomberg Barclays U.S. Credit Index ended the period at 86 bps, 6 basis points tighter than at the end of January.
- For the month, industrials delivered 71 basis points of excess return on a duration-adjusted basis, outperforming utilities, financials and non-corporates by 10, 17, and 75 basis points, respectively.
- BBB rated securities were the best performing investment grade quality segment during the month, delivering 65 basis points of excess return and outperforming AAA, AA and A rated securities by 51, 24 and 10 basis points of excess return, respectively. High yield delivered 115 basis points of excess return for the month.

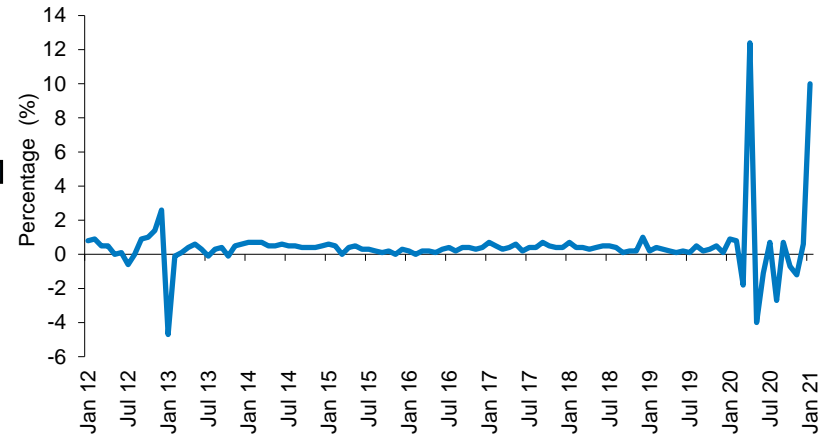


# Economic update

Personal income rose by 10% and the personal savings rate jumped to 20.5% in January, in large part due to the December stimulus package. Since February 2020, household savings have nearly tripled from \$1.4 trillion to \$3.9 trillion. Additional stimulus could boost these numbers further. Wage growth was a robust 5.4% for the trailing 12 months and unemployment declined from 6.7% in December to 6.3% for January. Underemployment declined from 11.7% to 11.1%; labor force participation fell by 0.1% to 61.4%.

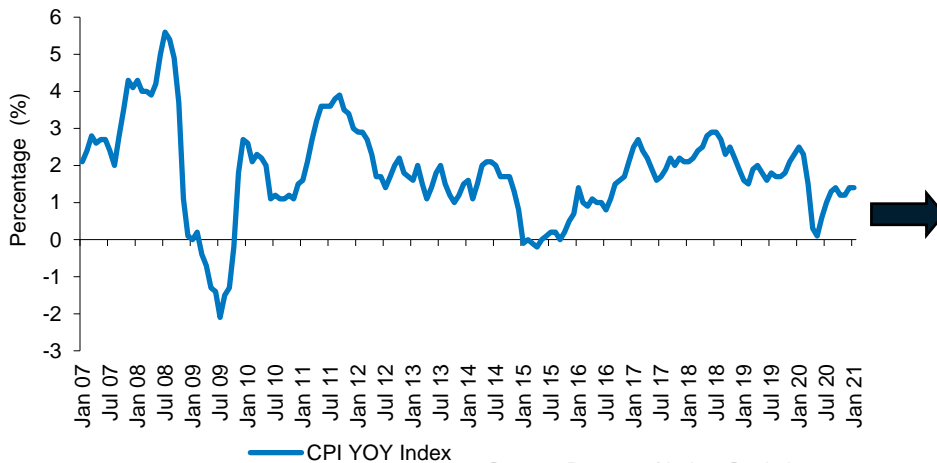


US Personal Income MoM SA



Source: Bureau of Economic Analysis

Consumer Price Index (YoY)



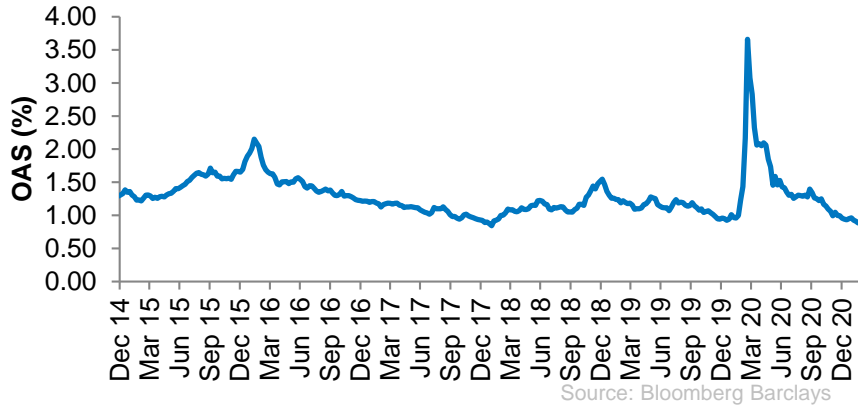
Source: Bureau of Labor Statistics



Projections for the release of pent-up economic demand later this year and expectations of additional fiscal stimulus have spurred discussions of a resurgence in inflation. While inflation expectations have increased, realized inflation as measured by the consumer price index (CPI) has remained subdued to date. In January, CPI rose 0.3% and 1.4% for the trailing 12 months. Core inflation, which excludes food and energy, was unchanged in January and rose by the same 1.4% for the trailing 12 months.

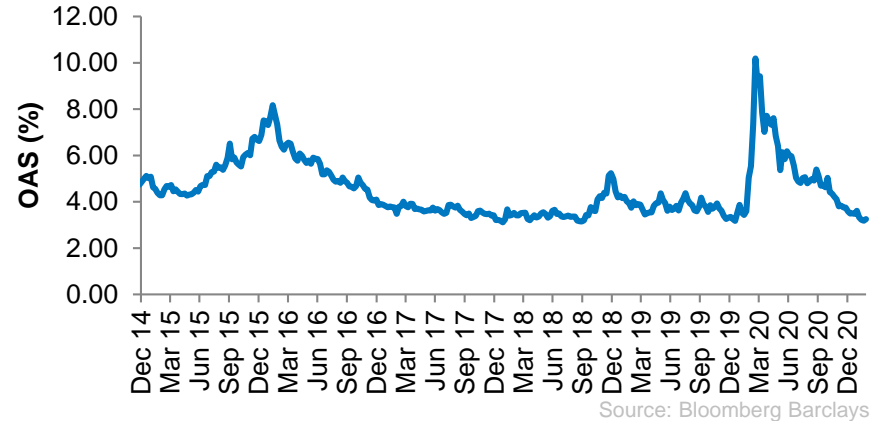
# Market update

**U.S. Investment Grade Corporate Spreads (weekly)**



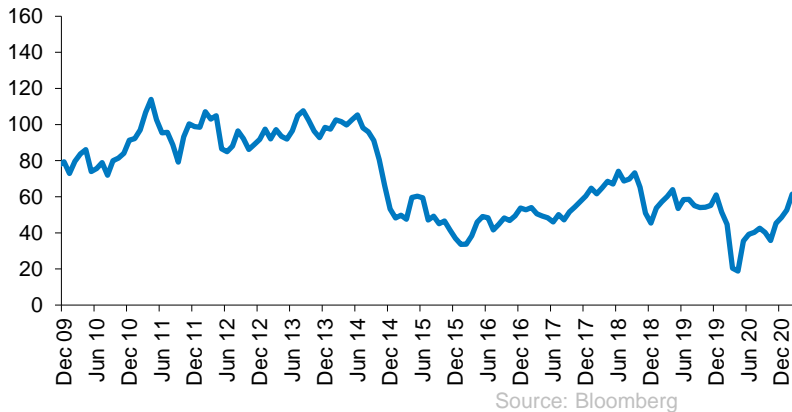
Credit spreads continue to tighten reflecting demand for income generating assets and positive economic expectations.

**U.S. High Yield Corporate Spreads (weekly)**



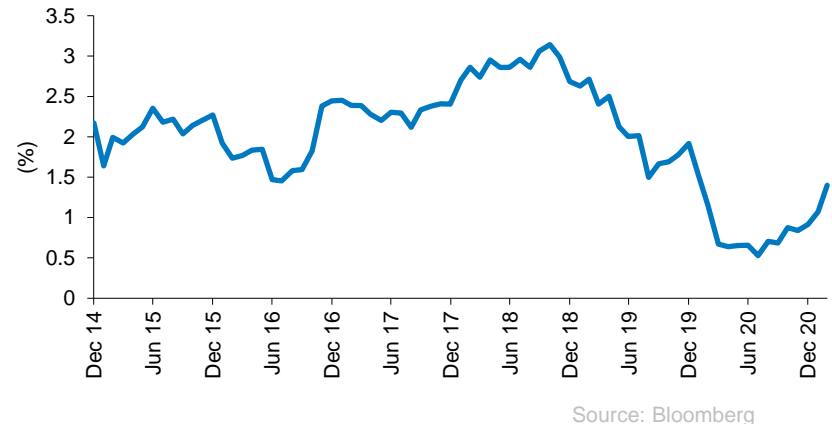
HY issuance is running meaningfully ahead (+25%) of last year's record pace, but issuance is being met by robust demand.

**Oil (WTI CRUDE FUTURE)**



Oil closed at \$61.50 a barrel at the end of February, 17% higher than the end of January and 27% higher than the beginning of the year.

**U.S. 10 Year Treasury Yields**



10 year Treasury yields had their largest monthly increase since 2016. Intramonth yields had climbed as high as 1.6%.

# News & nuggets

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## **Virus & Vaccine:**

- At the end of February, the Food & Drug Administration approved Johnson & Johnson single use coronavirus vaccine for emergency use in the U.S. Along with increasing production of the Pfizer and Moderna vaccines, the supply of vaccines is expected to grow significantly by spring.
- The U.S. has been averaging 1.7 million vaccines administered per day over the last 7 days. In the U.S., more individuals have received at least one dose than have tested positive for COVID. As of the end of February, approximately 50 million Americans (~15% of the population) had received the first shot with approximately 25 million having received the second as well.

## **Fiscal Policy:**

- On February 27<sup>th</sup>, the U.S. House of Representatives passed a \$1.9 trillion stimulus package. The bill included a provision to increase the minimum wage to \$15 an hour. The senate is likely to pass the bill via reconciliation, however, the Senate parliamentarian ruled that a minimum wage hike is outside of the scope of the reconciliation process. With an annual GDP of approximately \$20 trillion, the package represents about 10% of GDP, a significant figure, particularly on top of prior packages.

## **Monetary policy:**

- Minutes from the Federal Open Market Committee January 26-27 meeting contained few surprises. The Fed noted their improving medium term outlook given progress on vaccines and the December stimulus. While inflation has been a growing topic, the minutes showed most Fed members were more concerned regarding the risks of low inflation.
- Optimism regarding the vaccine and stimulus has led some to believe the Fed will be forced to reduce accommodation sooner than indicated. On numerous occasions during the month, the Fed took the opportunity to remind markets of their intent to deliver accommodative policy for an extended period.

# Outlook and conclusions:

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## **Earnings:**

- With 96% of companies reporting, fourth quarter 2020 earnings have grown 3.9% according to FactSet. This would mark the first quarter of positive earnings growth since the fourth quarter of 2019. This growth is noteworthy given the original expectations for the quarter. As of the end of 2020, the expectations for fourth quarter earnings were a decline of 9.4%. For the full year 2020, earnings are set to decline 11.2% with a 1% decline in revenues. Corporate profits are expected to rebound sharply in 2021, with earnings growth of 23.9% and revenue growth of 9.3%.

## **Outlook:**

- Depending on the timeframe, 10 year Treasury yields have either tripled since their 2020 lows or are effectively flat to where they were a year ago. Given the recent rapid rise of rates, particularly on a percentage basis, the rate move has attracted attention. From our perspective, rates have been a notable outlier in the general market recovery since the first quarter of 2020 and some reversion is warranted. We are less convinced though that this move represents the beginning of a true breakout for rates. Growing expectations of inflation are understandable, but we believe they are overstated. Further, the Fed has taken pains to remind markets of their intention to provide accommodation; rates rising too significantly could constrain financial conditions, the opposite of the Fed's desired outcome. Similarly, fresh off the 2018 experience, we see potential for friction in risk markets if rates were to rise too abruptly; if this were to materialize, even a mild risk-off period could lead rates back lower. Economic data has improved, particularly in terms of corporate profits, and expectations are for significant further improvement. Against this backdrop credit spreads are reasonable, but in a historical context they remain toward the tighter end of ranges, leading us to some caution in positioning. We continue to observe that the riskiest securities and sectors have rallied the most, leaving cross-sector value in segments likely to be more defensive in a risk-off environment. Within that framework, we continue to see relative value opportunities across the sector, quality and security levels and strong demand for income generating assets.

# Fixed income returns as of February 28, 2021

Index Returns as of February 28, 2021				
	Total Return (%)		Excess Return (%)	
	Month-to-Date	Year-to-Date	Month-to-Date	Year-to-Date
U.S. Aggregate	-1.44	-2.15	0.11	0.20
U.S. Treasury	-1.81	-2.75	-	-
Intermediate	-0.84	-1.08	-	-
Long	-5.57	-8.97	-	-
TIPS	-1.61	-1.29	-	-
Agencies	-0.75	-0.91	0.01	0.16
U.S. MBS	-0.67	-0.59	-0.26	-0.02
ABS	-0.14	0.00	0.03	0.20
CMBS	-1.19	-1.22	0.05	0.51
U.S. Credit	-1.74	-2.90	0.55	0.61
Intermediate	-0.81	-1.15	0.16	0.16
Long	-3.31	-5.81	1.22	1.35
Industrial	-1.90	-3.34	0.71	0.72
Utility	-2.55	-3.98	0.61	0.96
Financial	-1.14	-1.99	0.54	0.51
Non-Corporate	-1.81	-2.43	-0.04	0.22
Aaa	-1.16	-1.70	0.14	0.21
Aa	-2.06	-3.26	0.41	0.57
A	-1.77	-3.10	0.55	0.46
Baa	-1.74	-2.87	0.65	0.80
High Yield	0.37	0.70	1.15	1.77
Floating Rate Notes	0.10	0.26	0.09	0.24

Source: Bloomberg Barclays



# Disclosures

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**All investments involve risk, including the possible loss of principal.**

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The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Basis points (bps) represent 1/100th of a percent (for example: 50 bps equals 0.50%)

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