

Fixed income market update

November 2020

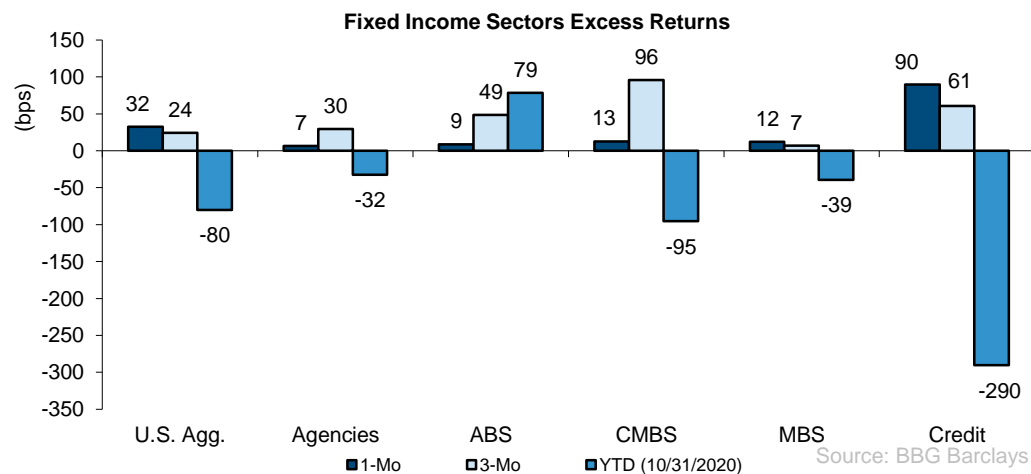
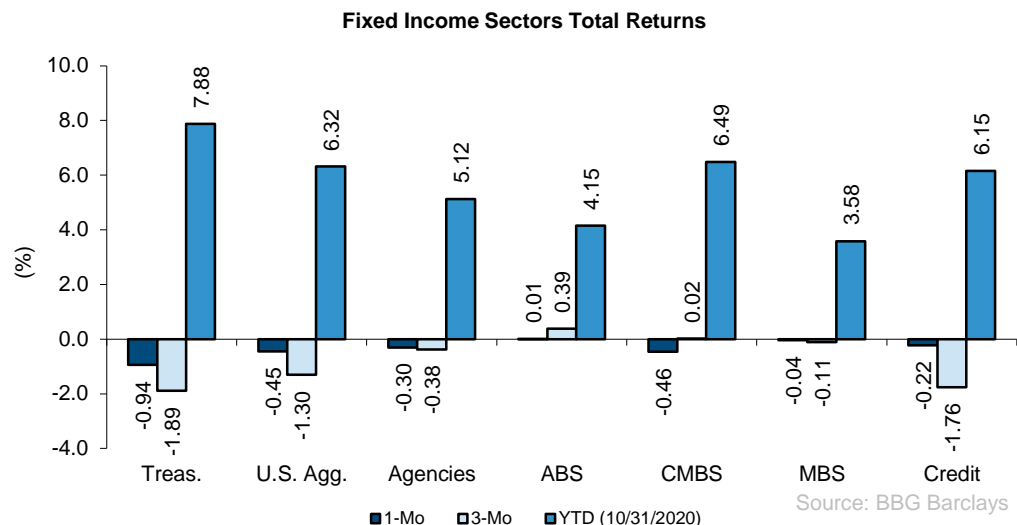
BMO Fixed Income

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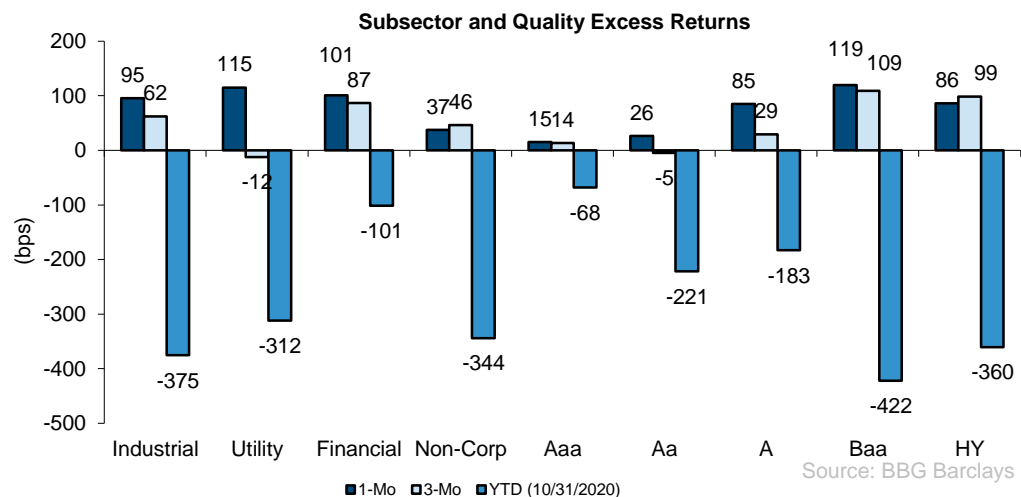
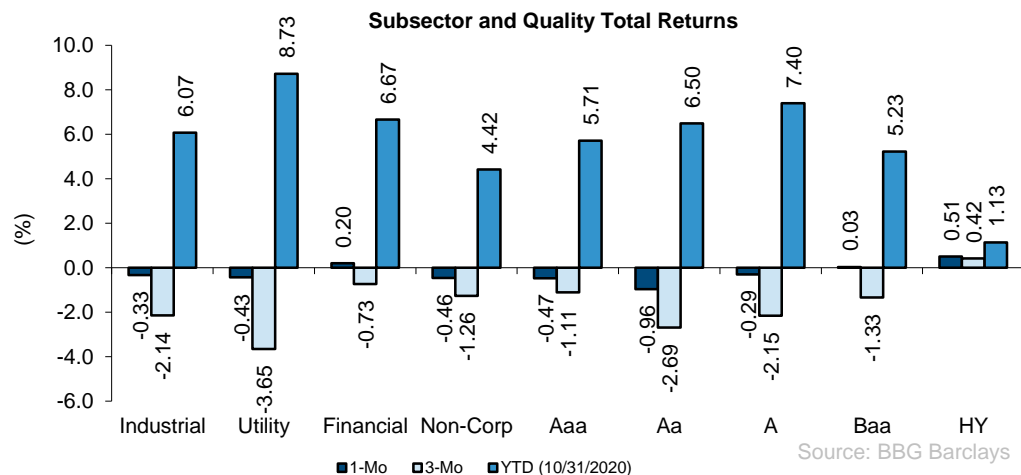
Fixed income market update

- For the month ended October 31, 2020, the Bloomberg Barclays U.S. Aggregate Bond Index returned -0.45%. Year to date, the index has returned 6.32%.
- U.S. Treasuries returned -0.94% during the month as the yield on the 10-year U.S. Treasury rose to 0.87% at the end of October from 0.68% at the end of September. For the month, long Treasuries (-3.01%) underperformed intermediate Treasuries (-0.38%.)
- Mortgage-backed securities (MBS) returned -0.04% during the month, outperforming Treasuries by 12 basis points on a duration-adjusted basis. The option adjusted spread (OAS) of the Bloomberg Barclays U.S. Mortgage Index tightened 9 basis points during the month, ending the period at 52 basis points.



Fixed income market update (continued)

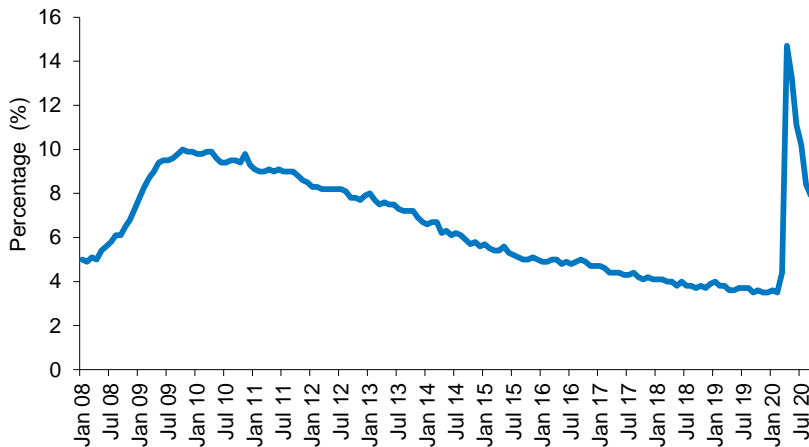
- Credit securities returned -0.22% for the month, outperforming Treasuries by 90 basis points on a duration-adjusted basis. The OAS of the Bloomberg Barclays U.S. Credit Index ended the period at 119 bps, 9 basis points tighter than at the end of September.
- For the month, utilities delivered 115 basis points of excess return on a duration-adjusted basis, outperforming financials, industrials and non-corporates by 14, 20 and 78 basis points, respectively.
- BBB rated securities were the best performing investment grade quality segment during the month, delivering 119 basis points of excess return and outperforming AAA, AA and A rated securities by 104, 93 and 34 basis points of excess return, respectively. High yield delivered 86 basis points of excess return for the month.



Economic update

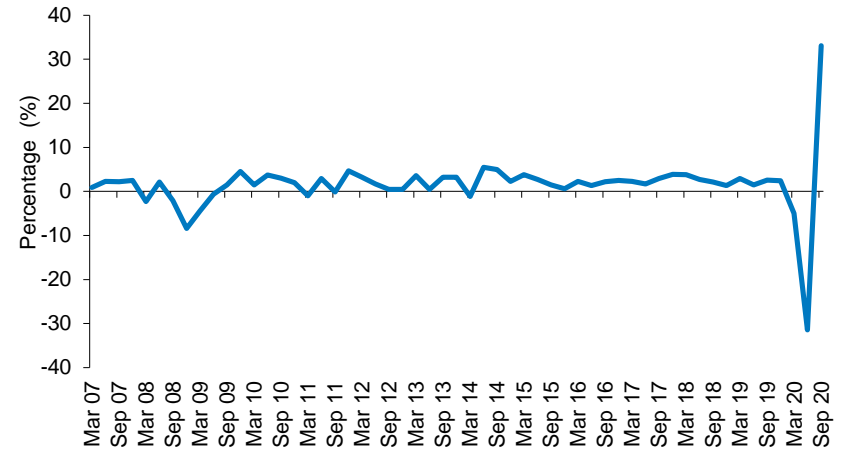
The initial reading of third quarter GDP showed record annualized growth of 33.1%, beating expectations of 32.0%, and more than doubling the previous record for growth. Of note, personal consumption rose 40.7% and private domestic investment rose 83% with a 59.3% increase in residential investment. Along with last quarter's annualized decline of 31.4%, this period has easily been the most volatile for growth on record. Expectations are for 4.0% growth in the fourth quarter, which would bring 2020 growth to -3.3%.

U.S. Unemployment (U-3 Seasonally Adjusted)



Source: Bureau of Labor Statistics

Gross Domestic Product (GDP)

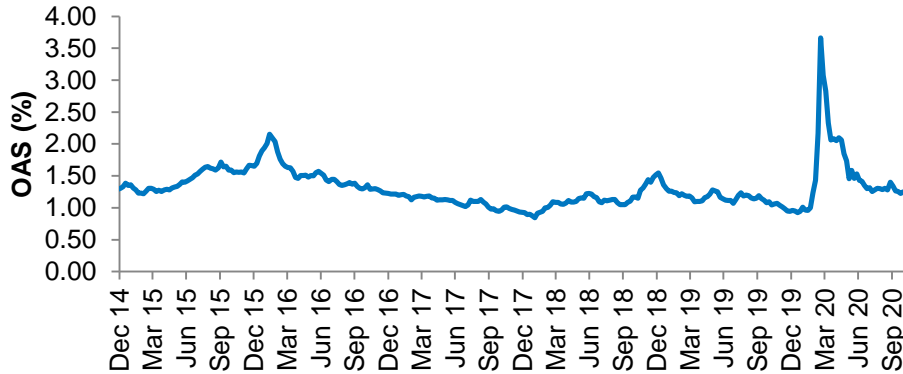


Source: Bureau of Economic Analysis

The U.S. unemployment rate fell for the fifth consecutive month to a rate of 7.9%, almost half the rate when unemployment peaked in April at 14.7%. The rate declined 0.5% from last month's level of 8.4% and beat expectations for an 8.2% unemployment rate. Underemployment fell from 14.2% to 12.8% after peaking in April at 22.8%. Initial jobless claims, which had previously raised concerns as they appeared to plateau, declined from averaging 992,000 in August to 870,000 in September to 788,000 in October.

Market update

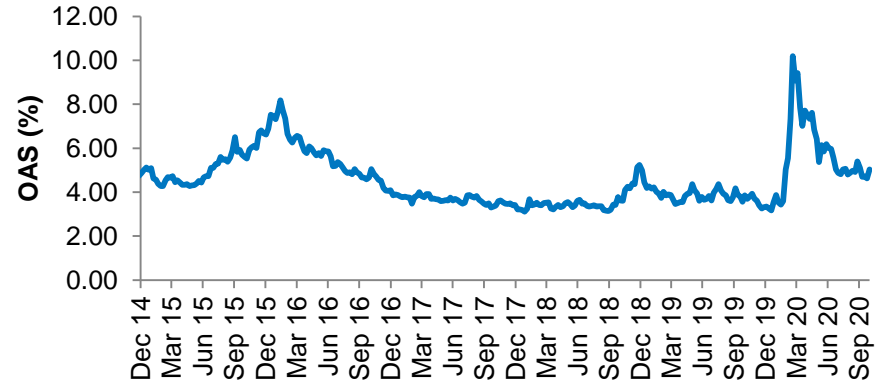
U.S. Investment Grade Corporate Spreads (weekly)



Source: Bloomberg Barclays

After IG corporate bond spreads widened in September, spread compression resumed in October for the sixth month in the last seven.

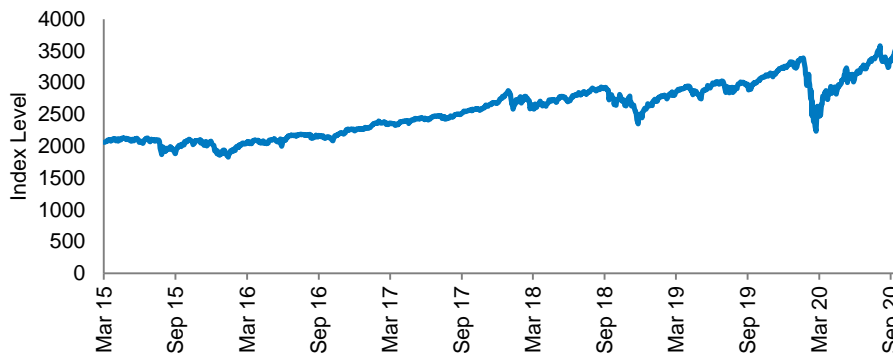
U.S. High Yield Corporate Spreads (weekly)



Source: Bloomberg Barclays

Though tightening in October, HY spreads remain wide to Jul/Aug levels and nearly 200 bps wider than beginning the year.

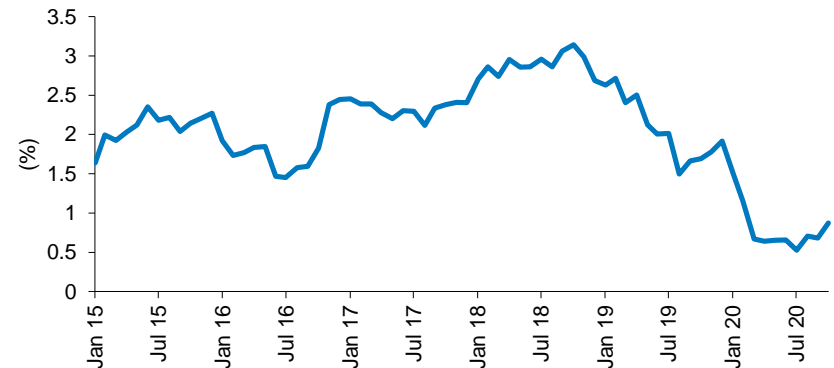
S&P 500



Source: Standard & Poor's

U.S. equities fell almost 3% in the month, bringing the two month decline to nearly 7%, though remaining modestly positive for the year.

U.S. 10 Year Treasury Yields



Source: Bloomberg

10 year yields rose from the range of 0.5% to 0.7% they had been in since the end of March, but remain 1% below where they began 2020.

News & nuggets: election 2020

- After a prolonged, tumultuous and unprecedented campaign cycle, the 2020 election is nearly at hand. Polling data suggests a clear advantage for Democrat Joe Biden with a 7.8% lead per RealClearPolitics (RCP) polling average (as of October 31), though perhaps due to the 2016 surprise, many polls also show voters expect President Trump will be re-elected. Prediction website FiveThirtyEight projects Biden's chance of winning at 90%, while gaming website PredictIt.org showed a bid price of 66¢ for Biden and 40¢ for Trump to win \$1.
- In our November 1, 2016 market update, we observed:
 - *“Real Clear Politics averages of polls as of 10/31/2016 shows Ms. Clinton having a nearly 3% lead, though even including all four national candidates, there is over a 5% pool of undecided voters. This level of undecideds and relatively high percentage of voters indicating their preference for a third party (7%), may benefit the anti-status quo (Mr. Trump) as it did in the Brexit surprise.”*
- Indeed, in 2016 the third party vote never fully materialized and undecideds broke for candidate Trump. In today's landscape, the lead for Biden is larger and fewer voters are indicating a third party vote. While polls missed in 2016, we would hope that pollsters learned from this experience and today's polls account for the factors that drove the miss last cycle. Nonetheless, while polls have typically been accurate, they are rarely precise and the decidedly closer polling in swing states (Biden +3.1%) suggests a path, if narrow, for a Trump upset.
- Over 90 million votes have been cast during early voting, with some states such as Texas, exceeding their entire 2016 voting counts already. While Republicans were originally projected to retain control of the Senate, the current RCP averages suggest a narrow Democratic take-over. There has been increasing correlation between presidential and down-ballot votes by party and we therefore expect the presidential election outcome to weight heavily on which party controls the senate.
- Our view at the time of this writing is more in line with the betting markets than the pundits, i.e. Biden is a favorite, but not prohibitively so. Given it is 2020, we have to allow for the most outlandish scenario to materialize, including an uncertain or disputed outcome or the long feared electoral college tie.

Outlook and conclusions:

- Coronavirus developments remained at the forefront with global Covid-19 cases setting a record at the end of October, rising by more than 500,000 in a single day. Increasing case counts have prompted new restrictions globally, with France adopting a month-long, nationwide lockdown and Germany enforcing a partial lockdown. The U.S. set a new daily record for Covid-19 cases, topping 89,000, and many are expecting daily new cases to exceed 100,000 in coming days.
- Minutes from the Federal Open Market Committee's September 15-16 meeting were released in October. While referring to the 'rapid' economic recovery, participants were in unanimous agreement that more fiscal policy support was needed. According to the minutes, many members had included assumptions of additional fiscal stimulus in their forecasts for this year and posited that the recovery could be slower if this support was delayed. The minutes once again highlighted the expectation of strong policy accommodation and low rates for a prolonged period.
- In our view, while elections have consequences, the consequences are rarely as stark or as predictable as prognosticators suggest. The immediate market reaction on election night in 2016 was a sell-off in equity futures, but fairly quickly the market reversed and the reflation or 'Trump trade' was on. Conversely, while Republicans were considered the more energy friendly party, the outcomes for energy investment have been underwhelming as it has been one of the few investment grade and high yield sectors with negative excess returns during the Trump presidency. While some policies will be contingent on election outcomes, we do believe that both parties would be amenable to passing additional fiscal stimulus on their terms. To date, this fiscal stimulus appears to have been delayed by partisan gamesmanship. Moving past the election will remove an obstacle to a further stimulus package, with election results steering the shape of that package. The election is the main focus today, but while that will (hopefully) be resolved soon, the uptick in global coronavirus cases and the decision to re-lockdown economies presents new challenges for an already challenged global recovery. There are also signs of lasting damage to the economy from earlier this year, though more recent U.S. economic data has continued to improve. As these trends work their way through, we continue to find relative value at the security level, while being more tempered in overall risk allocations.

Fixed income returns as of October 31, 2020

Index Returns as of October 31, 2020				
	Total Return (%)		Excess Return (%)	
	Month-to-Date	Year-to-Date	Month-to-Date	Year-to-Date
U.S. Aggregate	-0.45	6.32	0.32	-0.80
U.S. Treasury	-0.94	7.88	-	-
Intermediate	-0.38	5.62	-	-
Long	-3.01	17.69	-	-
TIPS	-0.65	8.52	-	-
Agencies	-0.30	5.12	0.07	-0.32
U.S. MBS	-0.04	3.58	0.12	-0.39
ABS	0.01	4.15	0.09	0.79
CMBS	-0.46	6.49	0.13	-0.95
U.S. Credit	-0.22	6.15	0.90	-2.90
Intermediate	0.01	5.46	0.45	-0.54
Long	-0.62	7.34	1.66	-7.69
Industrial	-0.33	6.07	0.95	-3.75
Utility	-0.43	8.73	1.15	-3.12
Financial	0.20	6.67	1.01	-1.01
Non-Corporate	-0.46	4.42	0.37	-3.44
Aaa	-0.47	5.71	0.15	-0.68
Aa	-0.96	6.50	0.26	-2.21
A	-0.29	7.40	0.85	-1.83
Baa	0.03	5.23	1.19	-4.22
High Yield	0.51	1.13	0.86	-3.60
Floating Rate Notes	0.12	1.13	0.11	0.53

Source: Bloomberg Barclays

Disclosures

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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