

# Fixed income market update

## September 2020

**BMO Fixed Income**

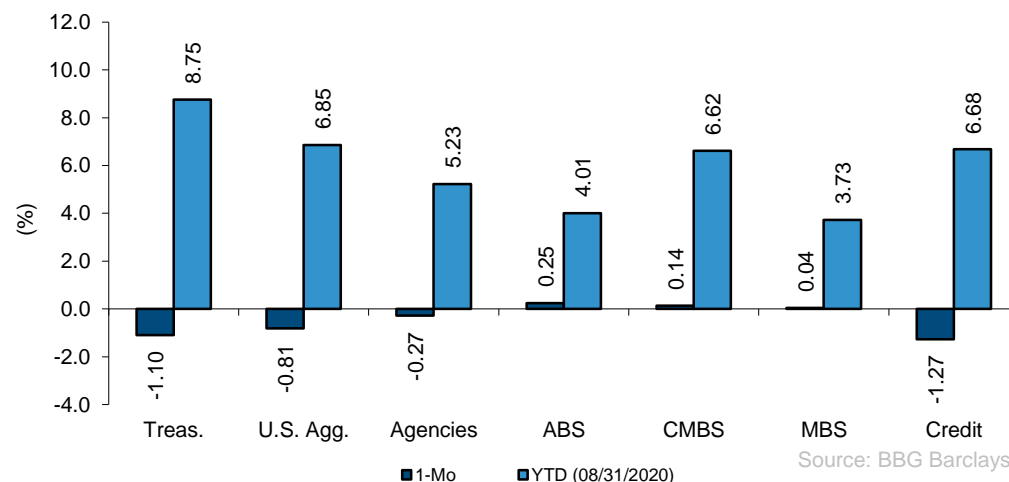
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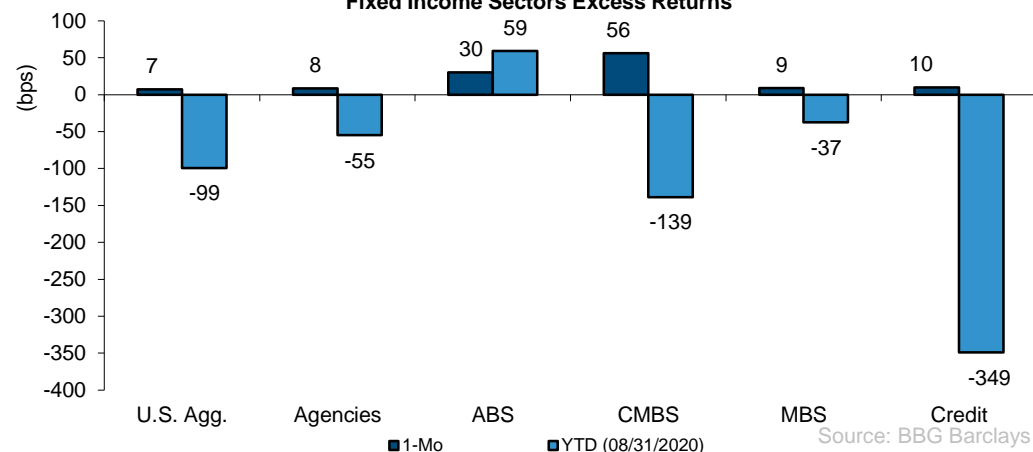
# Fixed income market update

- For the month ended August 31, 2020, the Bloomberg Barclays U.S. Aggregate Bond Index returned -0.81%. Year to date, the index has returned 6.85%.
- U.S. Treasuries returned -1.10% during the month as the yield on the 10-year U.S. Treasury rose to 0.71% at the end of August from 0.53% at the end of July. For the month, long Treasuries (-4.31%) underperformed intermediate Treasuries (-0.20%).
- Mortgage-backed securities (MBS) returned 0.04% during the month, outperforming Treasuries by 9 basis points on a duration-adjusted basis. The option adjusted spread (OAS) of the Bloomberg Barclays U.S. Mortgage Index tightened 2 basis points during the month, ending the period at 56 basis points.

Fixed Income Sectors Total Returns

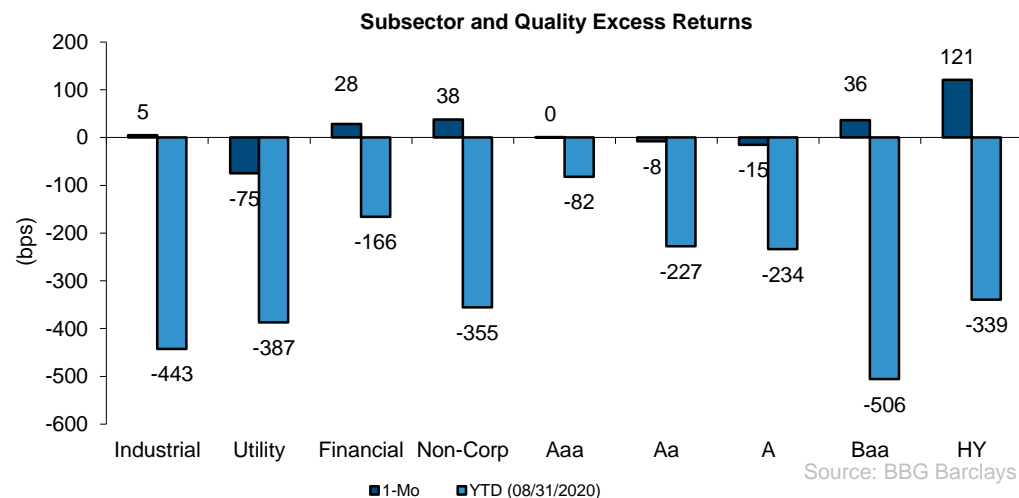
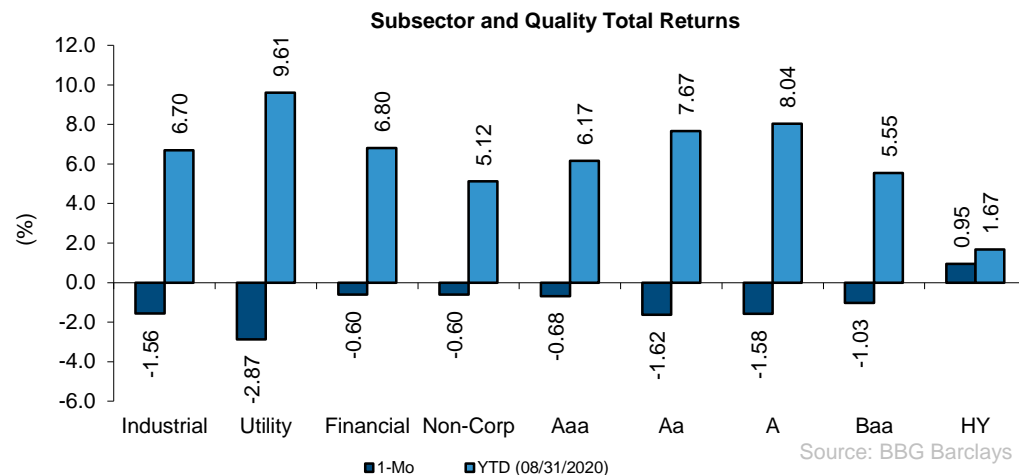


Fixed Income Sectors Excess Returns



# Fixed income market update (continued)

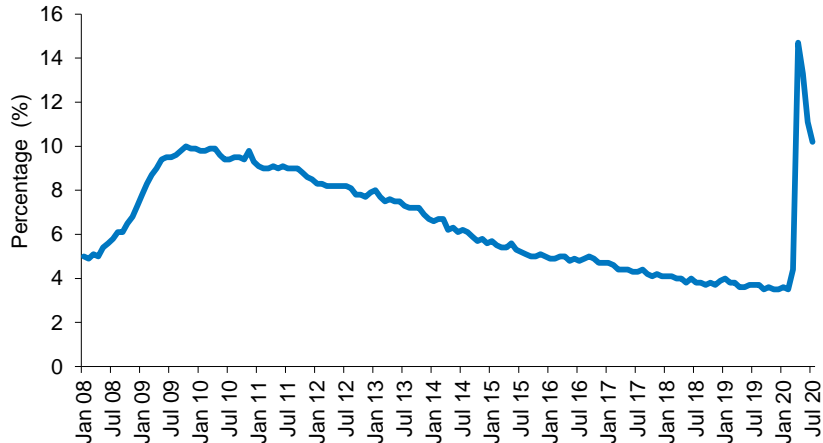
- Credit securities returned -1.27% for the month, outperforming Treasuries by 10 basis points on a duration-adjusted basis. The OAS of the Bloomberg Barclays U.S. Credit Index ended the period at 122 bps, 4 basis points tighter than at the end of July.
- For the month, non-corporates delivered 38 basis points of excess return on a duration-adjusted basis, outperforming financials, industrials and utilities by 10, 33 and 113 basis points, respectively.
- BBB rated securities were the best performing investment grade quality segment during the month, delivering 36 basis points of excess return and outperforming AAA, AA and A rated securities by 36, 44 and 51 basis points of excess return, respectively. High yield delivered 121 basis points of excess return for the month.



# Economic update

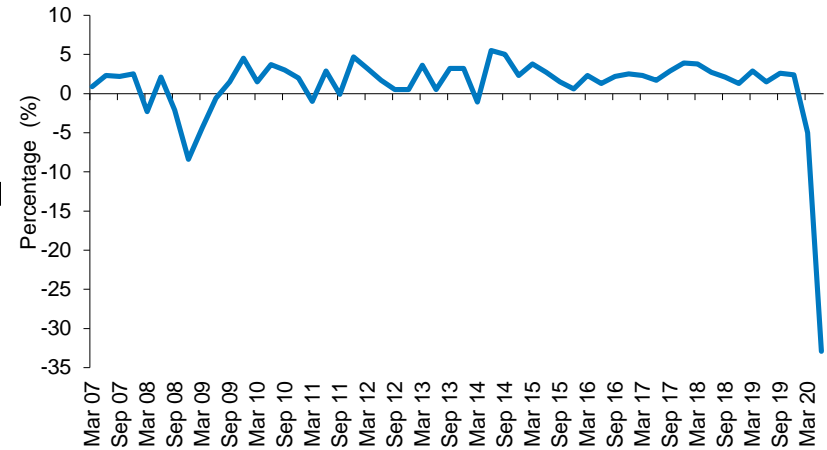
The second reading of second quarter U.S. GDP showed improvement to an annualized decline of 31.7% from 32.9% at the initial reading. The GDP results beat expectations of -32.5%, but remained the worst GDP figure since quarterly data collection began in the 1940s. Expectations for third quarter GDP improved to +21.0% growth from +18.0% last month. For the full year 2020, the economy is expected to shrink 5.0%.

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



Source: Bureau of Labor Statistics

Gross Domestic Product (GDP)



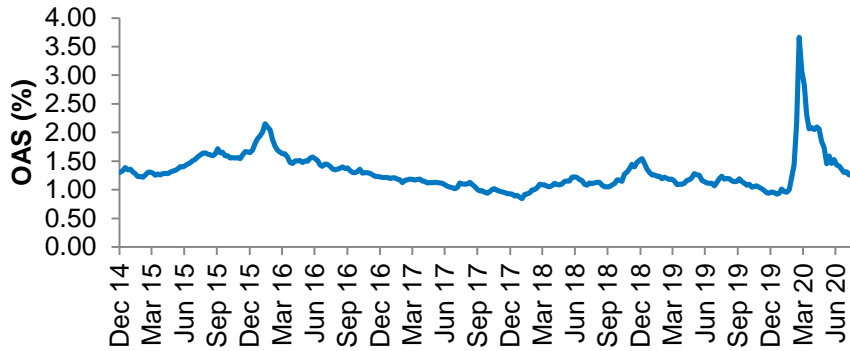
Source: Bureau of Economic Analysis

The U.S. unemployment rate, which had peaked at 14.7% in April, fell for the third consecutive month to a rate of 10.2%. Initial jobless claims remain elevated, however, averaging over 1 million per week the past four weeks.

After enhanced unemployment benefits expired at the end of July, President Trump used executive orders to extend the benefits at a reduced level.

# Market update

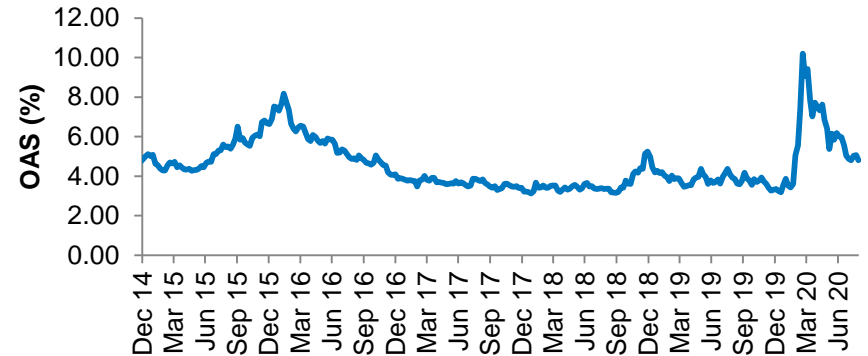
**U.S. Investment Grade Corporate Spreads (weekly)**



Source: Bloomberg Barclays

IG credit spreads were effectively unchanged in the month despite continued strong risk sentiment and Fed support.

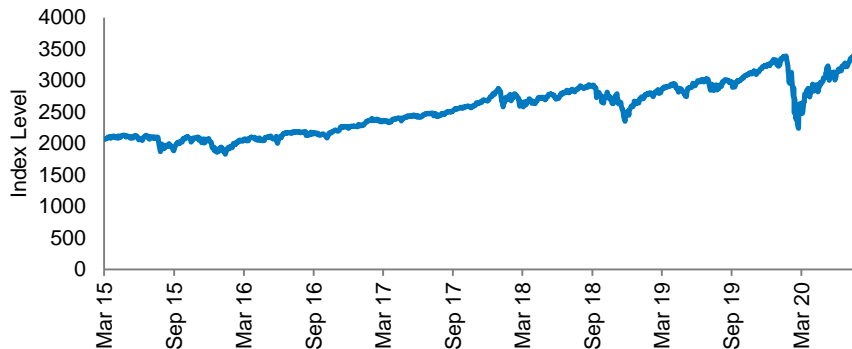
**U.S. High Yield Corporate Spreads (weekly)**



Source: Bloomberg Barclays

U.S. high yield issuance topped \$50B in August, the second largest month of issuance on record as demand remained robust.

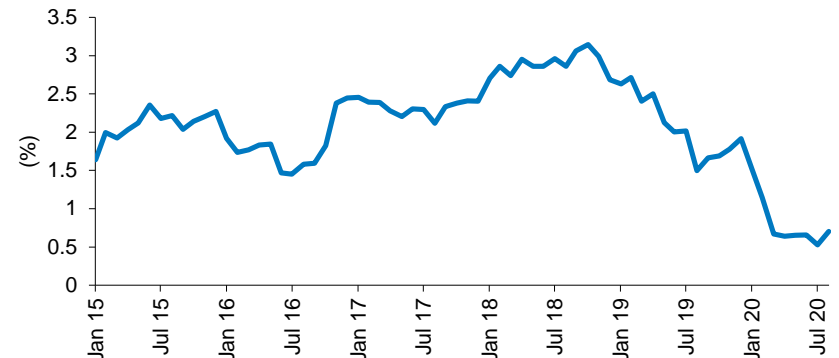
**S&P 500**



Source: Standard & Poor's

U.S. equities rallied over 7% in the month, setting a new record for highest monthly close. Year to date, the S&P is up just shy of +10%.

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



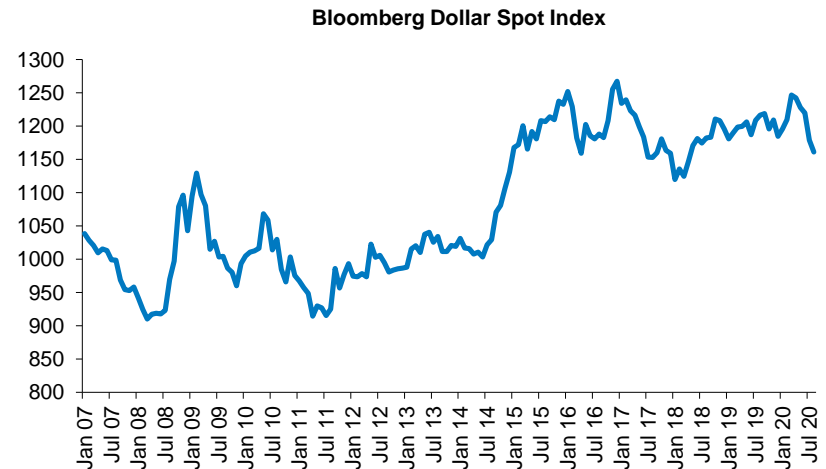
Source: Bloomberg

10 year Treasury yields rose from July's all-time lowest monthly close of 0.53% to end at 0.71%, the highest level since February.

# News & nuggets

- Shinzo Abe, Japan's longest serving Prime Minister, announced he would resign due to health concerns. Abe has been known for a program designed to revive Japan's economy, dubbed Abenomics, which combined policy supports and structural reforms.
- With about 98% of second quarter earnings reported, earnings declined 31.8% year over year according to FactSet. This was the worst quarterly earnings period since the first quarter of 2009, but an improvement vs. the end of July figure (-35.7%) when about 2/3 of companies had reported. Estimates are for a 18.6% decline in earnings for calendar year 2020 with revenues falling 3.1% and a rebound in earnings of 26.2% in 2021 with revenues rising by 8.1%.
- As of the end of August, the trend in coronavirus cases has been improving in the U.S., though Europe appears to be facing an uptick. Multiple countries saw new cases at their highest levels in months, with Spain, Italy, France, and the UK all reporting multi-month new highs in cases. On the positive side, Abbott Laboratories has won U.S. clearance for a 15-minute rapid test that will be priced at just \$5.

- The U.S. dollar continued to weaken in August, falling 1.5% against 10 leading currencies as measured by the Bloomberg Dollar Spot Index. Since the end of April, the dollar has fallen 6.9% against the basket. Since April, the dollar has fallen in value from \$1.10 per Euro to \$1.19 per Euro.



Source: Bloomberg

## Outlook and conclusions:

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- The Fed released minutes on August 19 for the July 28-29 meeting. Of note, the minutes suggested that officials were still uncertain about yield curve control, which came as somewhat of a disappointment to the market. The minutes noted “that yield caps and targets would likely provide only modest benefits in the current environment, as the Committee’s forward guidance regarding the path of the federal funds rate already appeared highly credible and longer-term interest rates were already low.” They also noted the challenge that there are “potential costs associated with yield caps and targets.”
- In coordination with Fed Chair Powell’s commentary at the Jackson Hole Symposium, the Federal Reserve announced a revision to their longer-run goals and monetary policy strategy. As expected, the FOMC will retire its symmetric 2% inflation target, in favor of aiming to achieve an inflation rate averaging 2% over time. The Fed also adjusted its maximum employment objective, by focusing primarily on shortfalls from the maximum employment level rather than deviations as it had previously.
- In our view, in a landscape of improved risk sentiment and strong demand for yield, U.S. corporates appear attractive even noting the recompression of spreads since the first quarter. While corporates have retraced a significant portion of their year to date widening, other sectors and asset classes have gone further, leaving corporates relatively well positioned. With global government yields as low as they are, demand for income is strong. At the same time, the March volatility is still fresh, making the more balanced profile of investment grade corporates appealing. Further, with the Fed’s changes to inflation policy, an even longer timeline for accommodation appears on the horizon. To date, the Fed’s accommodative policies have kept rates low while risk assets have rebounded and this longer timeframe for accommodation could keep this dynamic in play for a prolonged period. The recent downward trend in coronavirus cases in the U.S. along with hopes of improved testing have sparked optimism, but we do not discount the possibility of future volatility. While some economic data such as economic growth is expected to improve, other data such as employment figures remain challenged, highlighting the remaining uncertainty and need for balance in portfolios.

# Fixed income returns as of August 31, 2020

| Index Returns as of August 31, 2020 |                  |              |                   |              |
|-------------------------------------|------------------|--------------|-------------------|--------------|
|                                     | Total Return (%) |              | Excess Return (%) |              |
|                                     | Month-to-Date    | Year-to-Date | Month-to-Date     | Year-to-Date |
| U.S. Aggregate                      | -0.81            | 6.85         | 0.07              | -0.99        |
| U.S. Treasury                       | -1.10            | 8.75         | -                 | -            |
| Intermediate                        | -0.20            | 5.95         | -                 | -            |
| Long                                | -4.31            | 20.88        | -                 | -            |
| TIPS                                | 1.09             | 9.63         | -                 | -            |
| Agencies                            | -0.27            | 5.23         | 0.08              | -0.55        |
| U.S. MBS                            | 0.04             | 3.73         | 0.09              | -0.37        |
| ABS                                 | 0.25             | 4.01         | 0.30              | 0.59         |
| CMBS                                | 0.14             | 6.62         | 0.56              | -1.39        |
| U.S. Credit                         | -1.27            | 6.68         | 0.10              | -3.49        |
| Intermediate                        | 0.00             | 5.60         | 0.29              | -0.82        |
| Long                                | -3.40            | 8.55         | -0.23             | -8.92        |
| Industrial                          | -1.56            | 6.70         | 0.05              | -4.43        |
| Utility                             | -2.87            | 9.61         | -0.75             | -3.87        |
| Financial                           | -0.60            | 6.80         | 0.28              | -1.66        |
| Non-Corporate                       | -0.60            | 5.12         | 0.38              | -3.55        |
| Aaa                                 | -0.68            | 6.17         | 0.00              | -0.82        |
| Aa                                  | -1.62            | 7.67         | -0.08             | -2.27        |
| A                                   | -1.58            | 8.04         | -0.15             | -2.34        |
| Baa                                 | -1.03            | 5.55         | 0.36              | -5.06        |
| High Yield                          | 0.95             | 1.67         | 1.21              | -3.39        |
| Floating Rate Notes                 | 0.23             | 0.96         | 0.22              | 0.38         |

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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