TAXABLE FIXED INCOME
COMMENTARY 3Q 2020

Core Fixed Income, Current Income Portfolio, Intermediate Fixed Income and Income Opportunities are separately managed account investment strategies

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Volatility Continues

Talk about volatility - after gyrating in a roughly 22 basis point (bp) range during the third quarter, the 10-year Treasury ended only about 2 bps higher than where it started. There are many reasons for the volatility, although the majority are the result of COVID-19 headlines. In this environment, we continued our strategy of focusing on duration targets, yield curve positioning, sector selection and security analysis to provide returns with relatively less interest rate risk than the corresponding indices.

A Positive Third Quarter Overall:
Current Income Portfolio and Income Opportunities Strategies

All of our taxable fixed income model accounts produced positive returns for the third quarter, with a mix of over and underperformance versus the comparable indices. Both the Current Income Portfolio and the Income Opportunities strategies outperformed due to the strong contribution of the fixed rate preferred allocation. This sector allocation, along with the income generation capabilities of our strategies were the two largest positive contributors to the outperformance.

Core Fixed Income and Intermediate Fixed Income Strategies

For both of these strategies, the largest positive contributor to performance was the allocation component. This included our overweight to the investment-grade corporate sector (the best performing sector of both strategies) and an underweight to the Treasury allocation. The selection effect (on a relative basis to the comparable indices) was the largest drag on performance. We strive to perform in line with indices while reducing our interest rate risk - this is evidenced by the shorter duration positioning of our strategies versus the comparable indices. The duration component also provided a positive contribution to both strategies for the quarter.

Looking Ahead

As we look forward to the final quarter of the year, progress with the COVID-19 pandemic will continue to drive the direction of the markets. We also have no shortage of volatility-producing factors at play, including the general election on November 3. Although equity markets have been reacting to short-term headlines, fixed income markets generally have remained within a pretty steady trading range. We believe the backstop of the Federal Reserve, along with the likelihood of ultra-low rates for years to come, will keep fixed income trading ranges reasonably steady with one caveat - the potential for strong moves in reaction to vaccine news or election headlines.

Adjustments to our Strategies

With this outlook, we will continue to shift duration closer to index-neutral and pick up some yield, but still stay relatively short versus the index to reduce volatility associated with interest rate movements. Technical signals in the market are showing the potential for a short-term move in yields and creation of a new trading range. Maintaining our shorter duration positioning will allow us to reduce volatility with any upward move in rates, but shifting slightly towards a neutral duration versus the index gives us the opportunity to be positioned further out the yield curve once the new trading range is established.

Our Firm

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