

FIXED INCOME MARKET UPDATE

August 2020

MONTH IN REVIEW

The Fed stays dovish in pursuit of 2% average inflation

At the August economic symposium in Jackson Hole, Wyoming, Federal Reserve (Fed) Chairman Jerome Powell announced a slight change in monetary policy strategy, shifting to an “average inflation target” of 2%. The fixed income market’s reaction was mixed; risk assets reacted positively to the assumed long-term support from the Fed, while interest rate sensitive markets got spooked by the hint at long-term tolerance of higher inflation. High yield posted another month of solid returns, while Treasury yields rose across the curve. In general, risk performed well, and duration did not. Elsewhere, high yield defaults continue inching higher, and consumer non-cyclicals lagged the recovery in other corporate sectors like energy and transportation. Read on for a snapshot of the fixed income universe for August 2020.

MARKET SUMMARY

High yield enjoyed a strong August relative to other major fixed income categories, but Treasuries remain the top performer thus far in 2020.

YIELDS & RETURNS (%)¹

	Duration (years)	Yield	August Return	YTD Return
Treasuries	7.06	0.49	-1.10	8.75
Investment Grade Corporates	8.53	1.95	-1.38	6.94
High Yield Corporates	3.47	5.34	0.95	1.67
Municipal Bonds	5.35	1.30	-0.47	3.31

U.S. TREASURY MARKET

The Treasury curve steepened in August. The short end remains anchored to very low – albeit positive – rates, while the long bond widened by 25 basis points (bps). Across the curve, year-to-date yields remain meaningfully lower than where they began 2020.

TREASURY YIELDS (%)¹

	Monthly Change	Year-to-Date Change	8/31/2020	7/31/2020	6/30/2020	5/31/2020
90-Day T-Bills	0.00	-1.45	0.09	0.09	0.14	0.15
2-year Treasury	0.02	-1.43	0.13	0.11	0.15	0.16
5-year Treasury	0.04	-1.42	0.26	0.22	0.29	0.30
10-year Treasury	0.15	-1.22	0.69	0.54	0.65	0.64
30-year Treasury	0.25	-0.93	1.45	1.20	1.41	1.40

Treasury returns gave back some ground in August, but year-to-date performance remains very positive. Despite losing over 6% in August, long Treasuries, at a nearly 24% year-to-date return, remains one of the strongest performing categories in fixed income.

TREASURY RETURNS (%)¹

	Duration (years)	August Return	YTD
90-Day T-Bills	0.16	0.01	0.63
2-year Treasury	1.91	-0.04	3.01
5-year Treasury	4.89	-0.22	7.49
10-year Treasury	9.49	-1.29	12.53
30-year Treasury	25.64	-6.13	23.77
U.S. Treasury TIPS	5.39	1.09	9.63

BROAD INVESTMENT GRADE

Performance was mixed among the broad investment grade (IG) asset categories. In general, risk performed well and duration did not. The Bloomberg Barclays U.S. Aggregate Index was negative for the month, driven by negative returns from long corporates and Treasuries. Asset-backed securities (ABS) were the top performer at +25 basis points. Mortgage-backed securities also performed well, backed by continued aggressive buying by the Federal Reserve.

Spreads on corporate bonds were mixed, as long corporate spreads widened and intermediate corporate spreads tightened.

The search for yield with a tolerance for risk was evident among investment grade corporates, as BBBs outperformed the higher quality A to AAA bonds. BBBs were the only category to outperform Treasuries.

INVESTMENT GRADE INDEX & SECTOR RETURNS (%)¹

	Duration (years)	Yield	August Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
U.S. Aggregate	5.97	1.15	-0.81	0.07	6.85	-0.99
Treasuries	7.06	0.49	-1.10		8.75	
Agencies	3.58	0.52	-0.27	0.08	5.23	-0.55
Mortgage-Backed Securities	1.91	1.23	0.04	0.09	3.73	-0.37
Asset-Backed Securities	2.04	0.59	0.25	0.30	4.01	0.59
Intermediate Corporates	4.53	1.29	0.00	0.32	5.80	-0.79
Long Corporates	15.18	3.02	-3.59	-0.37	8.87	-8.80

INVESTMENT GRADE SPREADS (basis points)²

	Monthly Change	Year-to-Date Change	8/31/2020	7/31/2020	6/30/2020	5/31/2020
Intermediate Corporates	-6	26	96	102	119	149
Long Corporates	2	48	184	182	202	217
MBS Current Coupon Spread	2	-8	72	70	92	101

INVESTMENT GRADE CORPORATE CREDIT QUALITY RETURNS (%)²

	Duration (years)	Yield	August Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
AAA	12.54	1.64	-2.78	-0.23	10.49	-3.94
AA	9.14	1.45	-1.90	-0.25	7.36	-2.46
A	8.59	1.61	-1.62	-0.18	8.01	-2.40
BBB	8.34	2.33	-1.05	0.30	5.98	-4.46

All but two of the broad IG sectors experienced spread tightening in August. Consumer Non-Cyclical spreads were flat, and Utility spreads widened. Energy spreads tightened the most. All sectors remain meaningfully wider than where they began the year.

INVESTMENT GRADE CORPORATE BOND SPREADS BY SECTOR (basis points)²

	Monthly Change	Year-to-date Change	8/31/2020	7/31/2020	6/30/2020	5/31/2020
Consumer Non-Cyclical	0	23	115	115	131	145
Technology	-2	28	102	104	119	134
Energy	-11	60	188	199	220	247
Consumer Cyclical	-4	29	122	126	147	173
Transportation	-3	62	158	161	179	208
Basic Industry	-8	29	161	169	197	222
Communications	-1	39	148	149	164	184
Capital Goods	-7	58	140	147	165	187
Utilities	4	37	134	130	146	161
Financials	-5	37	117	122	139	174

HIGH YIELD

Higher risk led to higher returns within high yield in August. CCCs returned nearly 2% for the month as spreads tightened by over 30 bps. High yield outperformed Treasuries by 1-2% across all ratings categories.

HIGH YIELD SECTOR RETURNS (%)²

	Duration (years)	Yield	August Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
High Yield Corporates	3.47	5.34	0.95	1.21	1.67	-3.39
BB	4.12	3.87	0.61	0.98	5.74	0.11
B	2.73	5.52	0.96	1.09	-0.24	-4.79
CCC	2.52	10.34	1.98	2.08	-7.40	-11.87

HIGH YIELD OPTION-ADJUSTED SPREADS (OAS) (basis points)²

	Monthly Change	Year-to-Date Change	8/31/2020	7/31/2020	6/30/2020	5/31/2020
High Yield OAS	-11	141	477	488	626	637
BB OAS	-5	152	334	339	456	452
B OAS	-12	165	489	501	643	627
CCC OAS	-34	109	978	1012	1209	1191

High yield sector spread moves were mixed. Consumer Non-Cyclical spreads widened the most, and Transportation spreads tightened the most. Like the IG corporate market, spreads remain wide of where they began the year, most notably in Transportation, which is still 500 bps wide for the year.

HIGH YIELD CORPORATE BOND SPREADS (OAS) BY SECTOR (basis points)²

	Monthly Change	Year-to-date Change	8/31/2020	7/31/2020	6/30/2020	5/31/2020
Consumer Non-Cyclical	26	83	401	375	536	541
Technology	21	121	356	335	513	488
Energy	-32	134	779	812	982	1087
Consumer Cyclical	-40	176	464	504	624	643
Transportation	-95	521	981	1076	1163	1219
Basic Industry	-15	141	488	503	633	674
Communications	11	45	358	348	469	418
Capital Goods	-32	195	463	495	637	653
Utilities	-8	101	336	344	443	396
Financials	-8	209	451	459	590	639

While high yield was a strong performer overall in August, individual credit assessment is warranted, as defaults moved higher for the 6th straight month. The default rate is now 8.5%, or roughly 1 out of every 12 issuers.

HIGH YIELD DEFAULT RATES

	Monthly Change	Year-to-Date Change	8/31/20	7/31/20	6/30/20	5/31/20
Number of Issuers in Default	6	32	61	55	50	43
Issuer Default Rate	0.8%	4.6%	8.5%	7.6%	6.9%	6.0%
Number of Issuers in Default (ex-commodities)	4	19	34	30	27	22
Issuer Default Rate (ex-commodities)	0.7%	3.2%	5.7%	5.0%	4.5%	3.7%

MUNICIPALS & OTHER

Municipal bonds posted strong returns in August with a bias toward long duration.

Muni yields continue to look attractive relative to Treasuries after considering their potential tax advantages.

MAJOR MUNICIPAL BOND INDEX RETURNS (%)¹

	YTW	Duration (years)	August Return	YTD Return
Short Duration (1-5 Years)	0.55	2.67	0.97	2.57
Intermediate (1-15 Years)	0.97	4.28	1.65	3.27
Long Duration (22+ Years)	2.16	8.20	3.07	3.28

MUNICIPAL YIELDS BY RATING CATEGORY AND DURATION (%)²

	AAA	AA	A	BBB
1 Year	0.13	0.25	0.60	0.82
5 Year	0.28	0.48	0.88	1.08
10 Year	0.79	1.06	1.54	1.65
30 Year	1.57	1.82	2.45	2.48

AA MUNICIPALS – HYPOTHETICAL AFTER-TAX YIELDS BY EFFECTIVE TAX RATE (%)

	20%	25%	30%	35%
1 Year	0.31	0.33	0.35	0.38
5 Year	0.60	0.64	0.68	0.74
10 Year	1.32	1.41	1.51	1.63
30 Year	2.28	2.43	2.60	2.80

U.S. Convertibles had another strong month and are up over 26% year-to-date.

Leveraged loans and emerging market bonds remain in negative territory for the year.

OTHER SECTOR RETURNS (%)^{1,2}

	Duration (years)	Yield	August Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
Emerging Markets	4.80	6.95	2.02	2.51	-0.61	-7.46
Global Treasuries (Unhedged)	8.62	0.51	-0.38	0.96	6.27	-4.19
S&P/LSTA Leveraged Loan 100	--	4.84	1.49	--	-1.29	--
Wells Fargo Hybrid & Pref. Securities Aggregate Index	--	5.33	1.25	--	2.75	--
U.S. Convertibles	1.77	1.22	8.37	--	26.21	--

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¹Source: Bloomberg.

²Source: yields from Barclays.

³Source: Bank of America Merrill Lynch.