

FIXED INCOME MARKET UPDATE

October 2020

MONTH IN REVIEW

Risk Assets Outperform in Noisy October

October was a volatile month highlighted by market-moving headlines around COVID-19, political races, stimulus hopes, and more. Through all this substantial noise, risk assets performed better than safe assets, and spreads tightened in most corporate sectors. Third quarter earnings season is in full swing, as well, and corporate earnings have been generally positive. On the other hand, high yield defaults rose for the eighth straight month, highlighting the need for detailed credit analysis. SBH's Fixed Income team continues to focus on the fundamental drivers underpinning the credits and other securities we cover, while investing in those we feel are most likely to perform well under all the various paths that could unfold in the coming months. Read on to learn about the state of the fixed income markets for October.

MARKET SUMMARY

Risk assets generally outperformed safe assets in October. The first three weeks of the month were great for high yield (HY) investors before spreads widened in the final week; but HY was still able to outperform Treasuries, investment grade corporates and municipal bonds.

YIELDS & RETURNS (%)¹

	Duration (years)	Yield	October Return	YTD Return
Treasuries	7.02	0.58	-0.94	7.88
Investment Grade Corporates	8.57	2.03	-0.18	6.44
High Yield Corporates	3.90	5.78	0.51	1.13
Municipal Bonds	4.87	1.41	-0.30	3.02

U.S. TREASURY MARKET

The Treasury curve steepened in October, as intermediate and long Treasury yields rose. The short end of the curve stayed anchored around the low yields that have defined the past 8 months.

TREASURY YIELDS (%)¹

	Monthly Change	Year-to-Date Change	10/31/2020	9/30/2020	8/31/2020	7/31/2020
90-Day T-Bills	-0.01	-1.46	0.09	0.10	0.09	0.09
2-year Treasury	0.02	-1.41	0.15	0.13	0.13	0.11
5-year Treasury	0.11	-1.30	0.38	0.27	0.26	0.22
10-year Treasury	0.18	-1.05	0.86	0.68	0.69	0.54
30-year Treasury	0.18	-0.75	1.63	1.45	1.45	1.20

The steeper Treasury curve in October was likely influenced by the market pricing in a higher probability of fiscal stimulus and other policy changes following the U.S. elections. Treasury returns were negative across most of the curve in October but remain solidly positive for the year.

TREASURY RETURNS (%)¹

	Duration (years)	October Return	YTD
90-Day T-Bills	0.24	0.01	0.65
2-year Treasury	2.00	-0.05	2.98
5-year Treasury	4.97	-0.48	6.99
10-year Treasury	9.49	-1.63	10.94
30-year Treasury	24.26	-4.16	18.75
U.S. Treasury TIPS	7.75	-0.65	8.52

BROAD INVESTMENT GRADE

Calendar year 2020 has generally seen investors flock to assets perceived as safe, but October was the opposite. Most components of the Bloomberg Barclays U.S. Aggregate Index (the Agg) were negative for the month but outperformed similar-duration Treasuries. That said, Treasuries are still the highest-performing asset class within the Agg for the full year.

INVESTMENT GRADE INDEX & SECTOR RETURNS (%)¹

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
U.S. Aggregate	6.32	1.24	-0.45	0.32	6.32	-0.80
Treasuries	7.02	0.58	-0.94		7.88	
Agencies	3.94	0.54	-0.30	0.07	5.12	-0.32
Mortgage-Backed Securities	3.32	1.34	-0.04	0.12	3.58	-0.39
Asset-Backed Securities	2.13	0.55	0.01	0.09	4.15	0.79
Intermediate Corporates	4.58	1.37	0.04	0.51	5.65	-0.49
Long Corporates	15.08	3.12	-0.53	1.77	7.79	-7.41

While Treasury yields rose, spreads compressed on corporates and mortgage-backed securities in October. The end result was a negative return on both MBS and broad investment grade corporates.

INVESTMENT GRADE SPREADS (basis points)²

	Monthly Change	Year-to-Date Change	10/31/2020	9/30/2020	8/31/2020	7/31/2020
Intermediate Corporates	-9	24	94	103	96	102
Long Corporates	-11	41	177	188	184	182
MBS Current Coupon Spread	-17	-25	55	72	72	70

Lower quality outperformed higher quality investment grade corporates, and all quality categories outperformed Treasuries.

INVESTMENT GRADE CORPORATE CREDIT QUALITY RETURNS (%)²

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
AAA	12.54	1.74	-1.15	0.69	9.40	-3.07
AA	9.37	1.57	-0.83	0.47	6.25	-2.26
A	8.44	1.70	-0.26	0.89	7.39	-1.87
BBB	8.43	2.39	0.02	1.15	5.68	-3.62

All investment grade sectors tightened, led by Financials. Consumer Cyclical spreads are now just 18 bps wide of where they began the year, having tightened by 175 basis points since the end of March.

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

	Monthly Change	Year-to-date Change	10/31/2020	9/30/2020	8/31/2020	7/31/2020
Consumer Non-Cyclical	-9	20	113	122	115	115
Technology	-8	24	98	106	102	104
Energy	-5	67	195	200	188	199
Consumer Cyclical	-12	18	111	123	122	126
Transportation	-7	54	150	157	158	161
Basic Industry	-13	21	153	166	161	169
Communications	-9	38	147	156	148	149
Capital Goods	-9	49	131	140	140	147
Utilities	-10	34	131	141	134	130
Financials	-14	31	112	126	117	122

HIGH YIELD

High yield (HY) spreads tightened significantly through the first three weeks of October before giving back most of those spread gains in the final week as COVID-related economic fears took hold. Still, spreads tightened for all HY quality categories and returns were positive across the board.

HIGH YIELD SECTOR RETURNS (%)²

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
High Yield Corporates	3.90	5.78	0.51	0.86	1.13	-3.60
BB	4.36	4.39	0.46	0.92	4.72	-0.50
B	3.43	6.08	0.59	0.85	-0.58	-4.90
CCC	3.13	10.05	0.22	0.40	-6.75	-11.06

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

	Monthly Change	Year-to-Date Change	10/31/2020	9/30/2020	8/31/2020	7/31/2020
High Yield OAS	-8	173	509	517	477	488
BB OAS	-9	191	373	382	334	339
B OAS	-8	208	532	540	489	501
CCC OAS	-15	67	936	951	978	1012

HY sector spreads were mixed. Basic Industry (Chemicals, Metals & Mining, and Paper) spreads tightened the most, followed closely by Consumer Non-Cyclicals (Healthcare, Pharma, Supermarkets, et al).

Of the sectors that widened, Communications was the worst performer, led downward by advertising-heavy companies and regional sports networks.

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

	Monthly Change	Year-to-date Change	10/31/2020	9/30/2020	8/31/2020	7/31/2020
Consumer Non-Cyclical	-25	98	416	442	401	375
Technology	9	174	409	400	356	335
Energy	-21	176	822	843	779	812
Consumer Cyclical	-10	195	483	493	464	504
Transportation	10	528	988	978	981	1076
Basic Industry	-30	146	493	523	488	503
Communications	22	111	424	402	358	348
Capital Goods	-14	215	484	498	463	495
Utilities	1	147	382	381	336	344
Financials	-10	239	481	491	451	459

High yield defaults continue their steady migration higher, rising for the eighth straight month. The percentage of high yield issuers in default now sits at 9.4%.

HIGH YIELD DEFAULT RATES

	Monthly Change	Year-to-Date Change	10/31/20	9/30/20	8/31/20	7/31/20
Number of Issuers in Default	3	38	67	64	61	55
Issuer Default Rate	0.5%	5.5%	9.4%	8.9%	8.5%	7.6%
Number of Issuers in Default (ex-commodities)	0	19	34	34	34	30
Issuer Default Rate (ex-commodities)	0%	3.3%	5.7%	5.7%	5.7%	5.0%

MUNICIPALS & OTHER

Municipal returns were negative in October across the duration spectrum.

Year-to-date returns remain positive, however, as Munis have been benefited from their high credit quality and favorable tax treatment.

MAJOR MUNICIPAL BOND INDEX RETURNS (%)¹

	YTW	Duration (years)	October Return	YTD Return
Short Duration (1-5 Years)	0.61	2.77	-0.16	2.53
Intermediate (1-15 Years)	1.05	4.27	-0.25	3.09
Long Duration (22+ Years)	2.33	6.50	-0.43	2.70

MUNICIPAL YIELDS BY RATING CATEGORY AND DURATION (%)²

	AAA	AA	A	BBB
1 Year	0.16	0.35	0.50	1.02
5 Year	0.31	0.56	0.79	1.24
10 Year	0.93	1.26	1.60	1.88
30 Year	1.73	2.24	2.63	2.78

AA MUNICIPALS – HYPOTHETICAL AFTER-TAX YIELDS BY EFFECTIVE TAX RATE (%)⁴

	20%	25%	30%	35%
1 Year	0.44	0.47	0.50	0.54
5 Year	0.70	0.74	0.79	0.86
10 Year	1.57	1.67	1.79	1.93
30 Year	2.80	2.99	3.20	3.44

Emerging market bond returns were negative in October and are the worst performing “other” bond sector year-to-date. Convertibles were essentially flat for the month but have enjoyed a very strong year of returns, benefiting from generally strong equity markets.

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

	Duration (years)	Yield	October Return	Duration adj. vs. Treasuries	YTD Return	Duration adj. vs. Treasuries
Emerging Markets	5.33	6.98	-0.50	0.17	-3.61	-9.85
Global Treasuries (Unhedged)	8.66	0.50	0.13	1.32	6.25	-3.10
S&P/LSTA Leveraged Loan 100	--	4.79	0.20	--	-0.46	--
Wells Fargo Hybrid & Pref. Securities Aggregate Index	--	5.33	0.36	--	2.57	--
U.S. Convertibles	1.88	1.11	-0.01	--	23.49	--

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¹Source: Bloomberg.

²Source: yields from Barclays.

³Source: Bank of America Merrill Lynch.

⁴Hypothetical yields are calculated as the AA municipal yield divided by (1-tax rate). Actual tax-adjusted yields will depend on individual tax circumstances.