National
Investment Services

777 E. Wisconsin Avenue | Suite 2350 | Milwaukee, WI 53202
Phone 414.765.1980

March 24, 2020

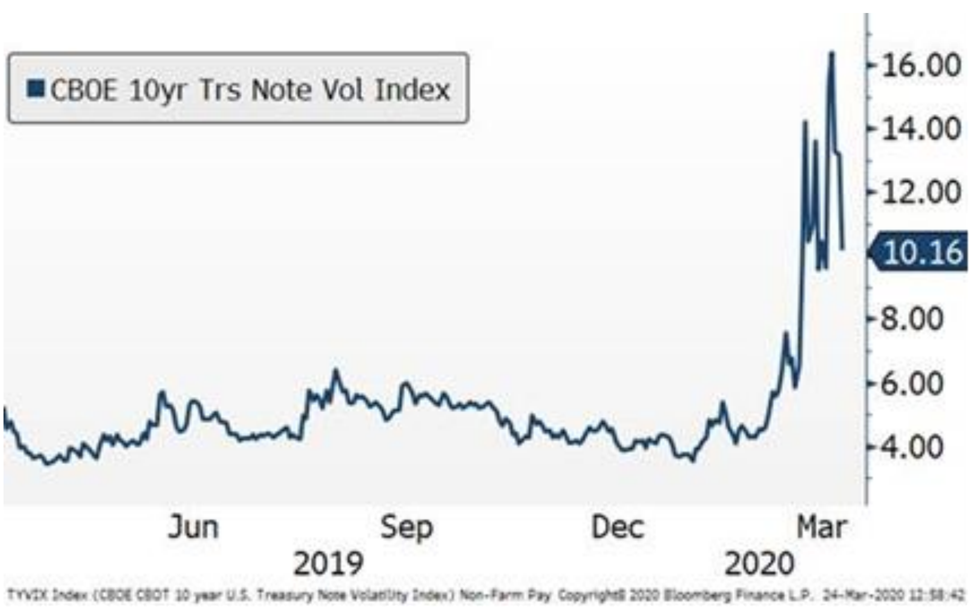
Topic: Coronavirus Market Impact Update

To Our Clients and Consultants:

After a long weekend and another poor Monday for risk assets, the tone in risk markets appears to be shifting. Markets are beginning to digest the latest round of Federal Reserve-based monetary stimulus, while eagerly awaiting some type of meaningful stimulus response from Congress. Although it seems shameful that politics is being played with such an important measure that in fact appears to be the case. Whether or not the Washington-based deals put the ‘right dollars in the right hands’, it will matter little to a market that seems starved for good news.

Credit markets are beginning to respond to the latest measures enacted by the Fed, as their focus on mortgage, corporate and even treasuries is improving the liquidity, albeit slowly in those markets that we monitor and invest in. Surprisingly, there has been a few new issue investment grade corporate bond deals over the last few days and they have been met with decent demand and have performed well, which we believe speaks to a relatively healthy and functioning bond market. There have been a few areas of the market seeing forced, margin-related liquidation, specifically mortgage-backed and municipal sectors. This selling comes at a time when investors are either moving to the sidelines or reallocating to equities.

While one day does not make a trend, we are encouraged by the strong open in risk markets this Tuesday and the fact that there was overnight demand from Asia, the largest outright broker bids in weeks and what we believe could be a changing of the narrative regarding the news flow surrounding the virus and its impact on the economy. We are closely monitoring market volatility measures for clues to more normalized conditions and are happy to report we are starting to see a thaw. Treasury volatility as measured by the CBOE has started to turn lower. We think this is an important first step but the journey remains long.



Sources: CBOE, Bloomberg

We realize the narrative within our markets and industry changes by the minute so please reach out to myself or our client services team members if we can be of assistance as we collectively help our clients navigate these rough and unpredictable seas.

Liquidity and color on select NIS sectors:

- **Treasuries**: Markets in off-the-run issues remain spotty, but on-the-run issues are trading much better.

- **Corporates**: Our managers feel that new issue IG corps are cheap. They are helping to define clearing levels for secondary bonds since liquidity is challenged. The easiest bonds to trade are these new issue deals and on-the-run bank 10yrs., and even those can be a 20bp market that moves at least 20bps every day. We have seen issuance from all six of the large money-center banks over the last week, but secondary trading is difficult.

- **Structured Agency MBS**: The sector is trying to stabilize with the Fed announcing "whatever it takes" kind of buying amounts. REIT selling had put huge pressure on the market, specifically spec pools. The wide difference between primary and secondary mortgage rates and expectations that the refi process will suffer some slowdown due to social distancing have also contributed as the value of call protection in spec pools has declined. Longer-term it's probably a good time to be adding spec pools (w/cheap call protection), but we don't think that's the best use of our marginal spread product dollar.

- **Non-Agency MBS, CMBS**: A stressed mortgage fund was in the market on Sunday evening, further pressuring an already tired market as reset trading levels lower. Late yesterday we spoke to one of our street contacts, who commented that many of their normal buyers (money managers) of bonds that we own have been out of the market for similar reasons as us – conserving cash for client rebalancing into stocks. She indicated that bid lists are receiving bids on maybe 25% of the bonds. There was a largely IG legacy bid list yesterday, which had some bonds on it that were matchers to what we own – not everything traded, but bids were in the mid-high single digit yield area on 3-5 yr. A/L bonds. Prices appear to reflect these new levels this morning.

- **ABS**: Short-dated prime auto and credit card spreads gapped 30bps wider yesterday and are out about 300bps on the month for benchmark sectors.

- **Taxable Municipal**: Subject to liquidity-driven pressures similar to the mortgage market as some levered tax-exempt funds have been forced sellers. Toll road and transportation revenue bonds have been hit as one would expect with a sharp slowdown in travel. BATA (Bay Area Toll) has a relatively strong balance sheet and its AA-rated long-bonds are trading a bit north of 300 off Treasuries vs. normally around treasuries +100. We believe there is value in issues like this and are buyers at the margin. We have been selling short-dated callable issues to help fund some of our distribution requests, as this has been a relatively liquid area of the muni market.

- **High Yield**: This remains a tough market to invest in right now as the devastation in the price of oil and the weakening of energy-related names fundamentals are sure to push default rates for the sector much higher in the following year. The market is also expecting over $200 billion in fallen angels (formerly Investment grade-rated issuers) to populate a market that has been shrinking at the margin due to flows. We expect the news flow in this sector to remain poor and the trading environment to remain challenging. We are being cautious with about 7% cash and a general underweight in corporate issuers (this is common for us).

- **Preferred Market:** Continues to trade in a liquidity-based, technical vacuum based on $25 par selling from ETF's. Compounding matters has been the $1,000 par fixed to floating issues as resets head to zero magnifying the extension risk. Overall valuations are at distressed levels blowing past 2016 and December 2018 wides. While we generally view this as a buying opportunity, we must weigh it against a tremendously uncertain, volatile and liquidity-driven marketplace. We are weighing our client cash requests against these attractive valuations and are buying high quality $25 higher reset preferred issues, while maintaining cash levels in the 7% area.

Please feel free to contact us with any follow-on questions.

Sincerely,

Mark Anderson

Mark Anderson, CFA
Chief Strategy Officer
National Investment Services
manderson@nisi.net

*Performance is preliminary as of 3/23/20 and gross of fees.

Source: Bloomberg