National Investment Services

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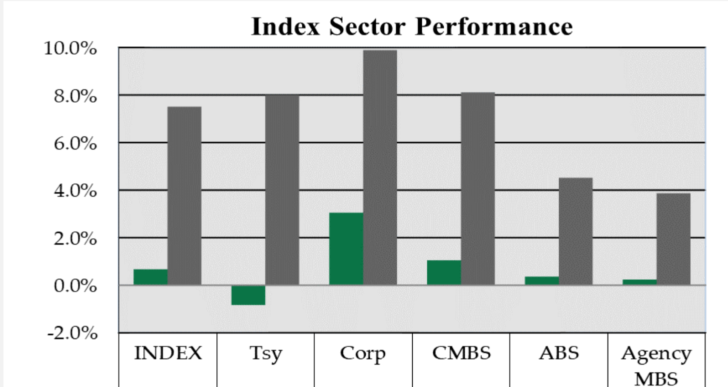
FOURTH QUARTER 2020 *INVESTMENT REVIEW*

FIXED INCOME OVERVIEW

Thanks in large part to approved vaccines, the fixed income market managed to navigate worsening COVID statistics, a contested election and an uncertain fiscal stimulus package. This "risk-on" rally was apparent in many markets and not just the fixed income arena. Stocks and commodities made heady gains, while interest rates started to creep higher. Our managers were cautious with regard to higher yields; the first sector to feel the move was the U.S. Treasury market, as the curve steepened on optimism surrounding the return to a more normal functioning society. Treasuries within the index finished down 83 basis points, while the other sectors finished above water. This helped the Bloomberg Barclays Aggregate index to gain 0.67% in the quarter. The Barclays Intermediate Govt./Credit Index finished about 20 basis points behind at 0.48% in a mediocre quarter for fixed income returns. Corporate bonds of all stripes were the standout performers this quarter as investors clamored for yield while maintaining liquidity.



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q4 '20	0.67%	-0.83%	3.05%	1.05%	0.36%	0.24%
YTD	7.51%	8.00%	9.89%	8.11%	4.52%	3.87%

Source: Bloomberg

CREDIT SPREADS

Investment grade corporate credit spreads rallied almost 40 basis points and high yield issues gapped over 150 basis points tighter despite a rather heavy new issuance calendar in both markets. Although this bid for spread was unrelenting, the markets exhibited good two-way flow near the end of the year allowing investors and trading desks to position for 2021. Our portfolios welcomed this move tighter, given that this more optimistic backdrop supports many of our sectors. We must point out one of the byproducts of this strong move: there does not seem to be much room for spreads to go meaningfully tighter from here. (Cont.)

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CREDIT SPREADS

(Cont.) Therefore, our corporate bond managers are trimming in fully valued areas. We are focused on sectors where we still see value, such as money center banks, communications technology and certain energy-related credits.

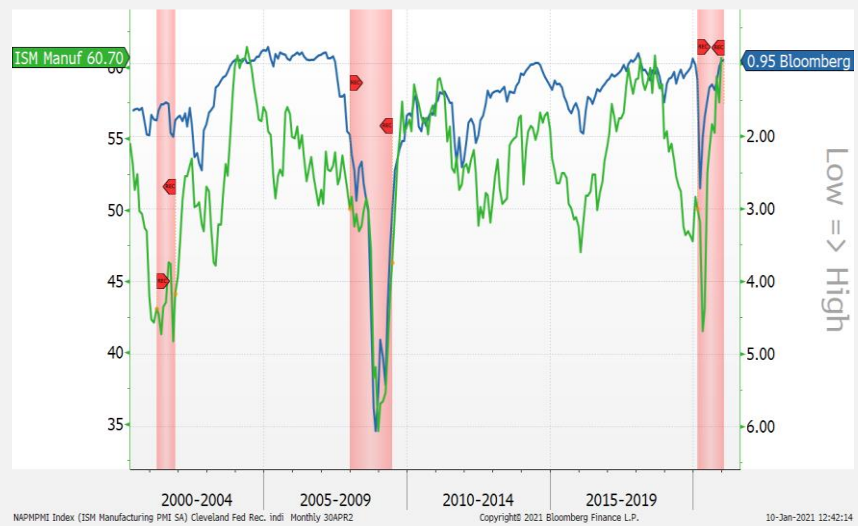
THE ECONOMY

Despite the worsening trends in Covid throughout the U.S., the economy remains strongly in recovery mode. Jobs are coming back, wages are up and the housing market is on solid ground. The December jobs report reflected the near-term slowing as Nonfarm payrolls decreased by 140k after showing steady gains since May. Employment bright spots include fewer than anticipated initial jobless claims, an uptick in average hourly earnings and a better than expected print in manufacturing payrolls. Manufacturing readings and factory orders have been running ahead of schedule, while business inventories do not at all appear out of whack. We like to keep a close eye on manufacturing given its strong correlation between it and corporate bond spread behavior.

Solid manufacturing coupled with an anticipated uptick in travel and leisure in the back half of the year sets up well for a decent year of labor gains. Spread volatility should also be more muted in 2021 and we believe corporate spreads could remain on the tighter side of their ranges.

We also like to keep a close eye on the health of the U.S. consumer. We report that they have a relatively clean bill of health. Debt to income remains manageable (unlike 2008) and personal savings rates are at generational highs. Unfortunately, these consumer metrics are at the aggregate level; many Americans are not participating in the overall prosperity. It sure looks like a policy priority of the new Congress and the Presidential Administration will target those in need. These policies should be an important step in the continued economic recovery.

Source: Bloomberg



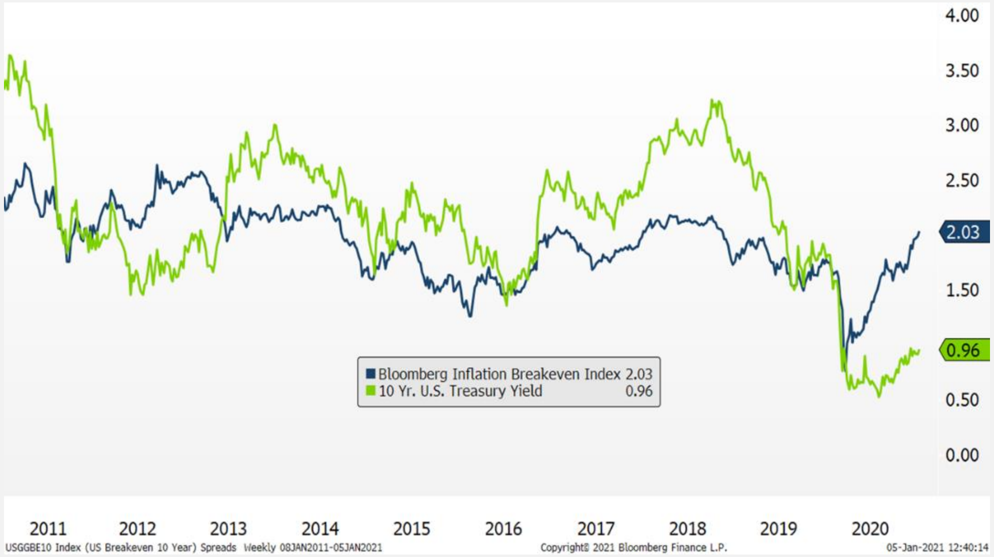
Source: Markit, Bloomberg

FISCAL AND MONETARY POLICY

After much uncertainty and tremendous political wrangling throughout the fourth quarter, U.S. lawmakers pushed through another round of fiscal stimulus. The $900 billion total package with $600 relief payments is now on the way to those eligible. The final push for $2,000 payments did not quite make it despite support from, ironically, President Trump. President-elect Biden and the new majority Congress appear ready to fast track additional fiscal stimulus in the first 100 days. As a result, the rates markets are starting to respond. Moreover, a still very dovish Federal Reserve shows no change in policy, keeping borrowing cost targets near zero through 2023. There has been some recent handwringing as to whether the Fed will try to step in on the long-end of the yield curve. Their intention may be to mitigate what is starting as a sharp move higher in long-rates and a steepening curve. So far, most of the dialogue has been rather dovish to that regard.

FIRST QUARTER 2021 STRATEGY

The New Year begins with a healthy dose of market optimism. Investors appear positioned for a fast growing economy based on a successful vaccine rollout, additional fiscal stimulus out of Washington D.C. and a still accommodative Federal Reserve. We feel that the fixed income market has started adjusting for this scenario. There is an upward pressure on the longer end of the yield curve and index level bond spreads are trading at tight levels. Our relative value strategy continues to focus on adding intelligent yield and closely monitoring portfolio durations. We are somewhat concerned that inflation expectations whether real or perceived along with additional stimulus may combine to push yields higher in the coming months. The chart to the right highlights the relationship between Treasury break-even yields and the current 10-year U.S. Treasury Bond yield.



Source: Bloomberg

(Cont.)

FIRST QUARTER 2021 STRATEGY

(Cont.)

Our intermediate and core accounts start the year relatively underweight duration at 95% of index levels, while our DFI accounts fall into the 85%-90% range. Our corporate bond managers feel that companies will pull forward new issuance in anticipation of higher yields later in the year. Consequently, we have kept some dry powder to participate in this area. We also favor the banking sector, especially the money centers, as the steeper curve and higher yield tends to benefit this area.

The work from home environment seems to be permanently changing both where and how work is being done. The Case-Shiller Home Price index is up 8% year over year and Homebuilder Confidence is at levels higher than before the Great Financial Crisis. Our managers remain positive on residential mortgage credit and are focusing efforts on seasoned deals, as they tend to carry lower loan balances, above market coupons and exhibit more consistent prepayment speeds. We continue to carry a sector overweight in ABS, as supply technicals are favorable and believe non-agency CMBS outperforms agency CMBS based on dealer inventories, supply forecasts and valuation. Lastly, we feel that some credits within our taxable muni universe are near or close to fully valued. We will look to trim holdings there.

We thank each of you for your business and patience during 2020. It was an unfortunate and sad year for so many, a volatile year for the markets and a new way of life for everyone. We view 2021 as an opportunity to get back to some semblance of normality and to continue to appreciate the small things in life. We wish you a healthy and prosperous New Year.

Mark R. Anderson, CFA

Chief Strategy Officer

NIS