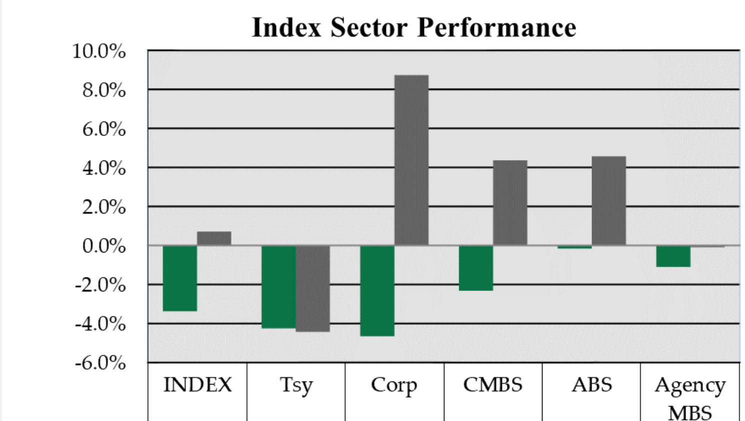
National Investment Services

Client Focused | Flexible Solutions | Consistent Results

FIRST QUARTER 2021 *INVESTMENT REVIEW*

FIXED INCOME OVERVIEW

It is hard to believe that it has been over one-year since COVID-19 became a household word while changing the world forever. During that time, the markets sank and rebounded as investors reacted to heightened uncertainty, reassessed liquidity and risk tolerances, and finally looked forward. During the first quarter of 2021, fixed income investors finally felt comfortable enough to acknowledge the improving outlook and the possibility of higher yields. The benchmark 10-yr Treasury began the year at 0.92% but moved solidly northward to finish at a yield of 1.74% by quarter-end, which was where it was in January of 2020. Treasuries and corporates within the index suffered, as they both finished down over 4%, while other sectors did marginally better but remained in the red. There were few places to hide from this relatively large rate move but our portfolios held up relatively well vs. their indices. The Bloomberg Barclays Aggregate Index lost 3.37% in the quarter, while the Barclays Intermediate Govt./Credit Index finished down 1.86%.



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q1 '21	-3.37%	-4.25%	-4.65%	-2.32%	-0.16%	-1.10%
One Year	0.71%	-4.43%	8.73%	4.36%	4.57%	-0.09%

Source: Bloomberg

CREDIT SPREADS

Investment grade corporate credit spreads continued to rally (5bps) on reopening optimism but started to show fatigue as the quarter ended. High yield spreads closed the quarter about 60 bps tighter and interestingly enough, at record low yields for the asset class. (Cont.)

For the latest on NIS happenings and firm updates

SCAN IT & GO

777 E Wisconsin Ave
Suite 2350
Milwaukee, WI
53202

Phone:
414.765.1980

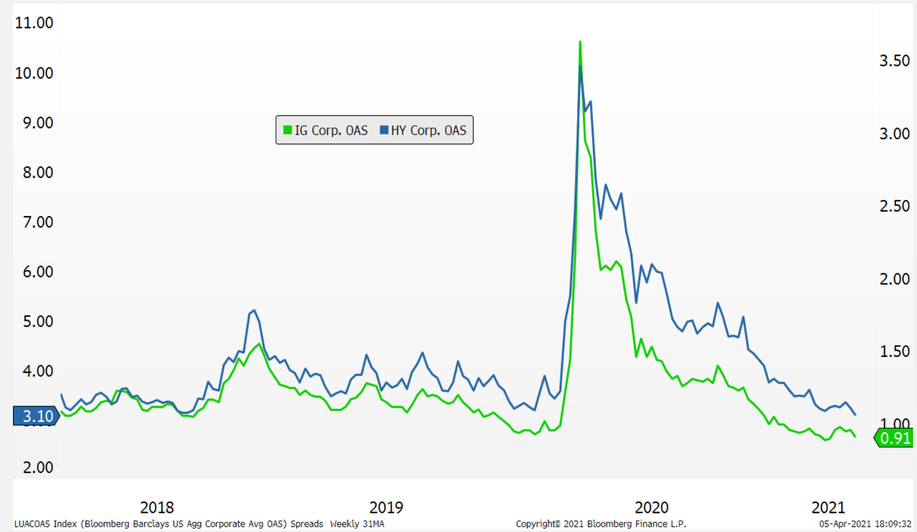
CHICAGO
MILWAUKEE

CREDIT SPREADS

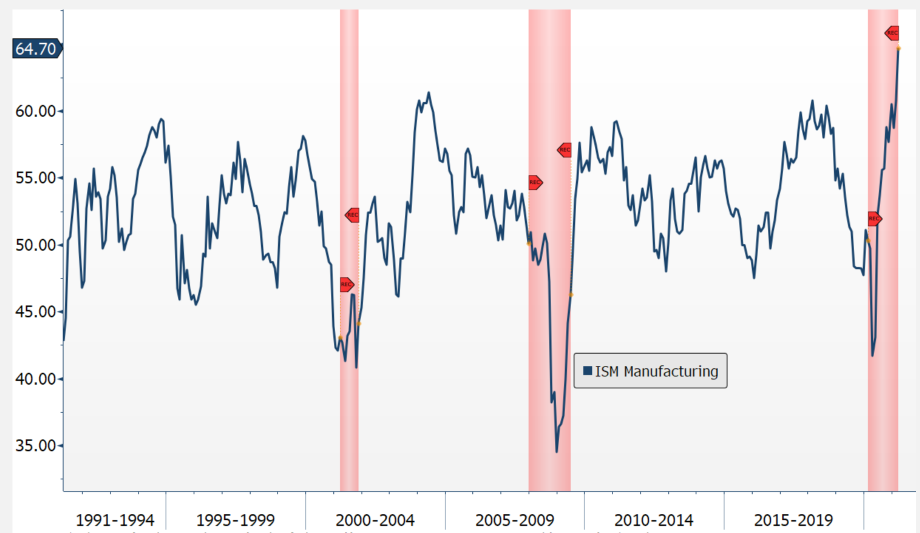
(Cont.) Our portfolios once again welcomed this general trend tighter, as many of our sectors perform well in this environment. Although many markets are trading at relatively tight levels, we are still finding reasonable values and are looking to trade up in quality and liquidity when possible and thankfully, the market has remained conducive to our objectives.

THE ECONOMY

Economic activity seems to be accelerating in the U.S. as the vaccine rollout is ahead of schedule and people are starting to trend back to travel according to TSA data. Shopping at an actual store and in-person dining seem to be seeing upticks as more folks venture away from their homes. Households are not the only ones with pent up demand as businesses are looking to restock depleted inventories and bolster their capacity by buying capital goods and spending on intellectual property. Non-defense capital goods spending (excluding aircraft) is back above its pre-recession peak. Supply chain disruptions due to February weather and a shipping blockage in the Suez Canal have only added to a fear of not having the correct inputs. Although a scarcity of some inputs could create upward pricing pressures and production disruptions, the industrial recovery appears well underway. One of our favorite barometers to watch, for overall economic health and correlation to the corporate bond market, is ISM manufacturing. The March ISM reading of 64.7 (not seen since 1983) helps explain why corporate bonds are trading at relatively robust levels.



Source: Bloomberg



Sources: Markit, Bloomberg, Wells Fargo, TSA, OpenTable.

FISCAL AND MONETARY POLICY

Reopening optimism captured in the most recent non-Farm payrolls data indicates to us that there is light at the end of the tunnel. The March reading of 916k jobs added was well above consensus estimates and further bolstered by positive revisions to both January and February numbers. Private payrolls are seeing large gains in leisure, which makes sense, but strength in construction and manufacturing is also encouraging. Surveys of architecture billings indicate that nonresidential construction could also be ready for an uptick, which would appear well timed since residential has been carrying the torch for the better part of a year. Payrolls are up 13 million jobs from the low, but still about 8 million below pre-COVID levels, so there remains wood to chop. Both the Federal Reserve and elected politicians are pledging continued accommodation to get that NFP back to trend (red line). We are anxiously watching how the 10-yr. Treasury yield (blue line) reacts to further stimulus initiatives.

The $1.9 trillion stimulus package finally became reality in March as stimulus checks, extended unemployment benefits and a boost to the child tax credit helped many. Additionally, schools, states, municipalities, live venues, restaurants and vaccine distribution were at the forefront of targeted aid to bolster job prospects and reopen the United States. Next up out of Washington D.C. is an infrastructure endeavor entitled The American Jobs Plan. Essentially, it is an encompassing and multifaceted infrastructure build that would add millions of jobs to the economy, rebuild our crumbling infrastructure, improve housing opportunities and bolster community and homebased health to mention a few. The approximate $2 trillion price tag is expected to be funded primarily through higher corporate taxes over a 15-year time horizon.

Source: Bureau of Labor Statistics, Bloomberg.

While there is sure to be some capricious and fickle debate out of Congress in the coming months, our Federal Reserve has remained steadfast in maintaining an accommodative stance. There was little change in their lift off projections as well as an overall willingness to maintain Treasury and MBS purchases. The Fed seems more than willing to tolerate some inflation in an effort to ensure a robust recovery but we wonder whether the markets will be as accepting.

SECOND QUARTER 2021 STRATEGY

Inflation could very well be the story of 2021 but it is really too early to tell and in the near-term there are set to be unusual year-over-year (higher) inflation headlines. Our analysis of the rates market keeps us cautious with our duration positioning (about 6% underweight the benchmark) in our traditional intermediate and core mandates and even lower in other mandates such as Dynamic Fixed Income accounts.

The rise in yields tends to help banks and we are finding relative value in this space. We believe there will be less issuance from many banks as their deposits are relatively high, thus improving the chances for spread compression. Industrial credits are getting a bit more difficult to source with valuations at historically tight levels so we are focusing on higher-rated credits with lower duration profiles. Overall, we remain constructive on the corporate sector as earnings look to rebound, liquidity remains high and market technicals favorable.

Data on the residential housing front remains very strong despite the modest uptick in mortgage rates. Our mortgage-backed team noticed that at the end of January there were a little over 1 million homes for sale in the U.S., which was down 26% from a year earlier and the lowest level on record going back to 1982. As a corollary, the National Association of Realtors' membership now exceeds the number of homes for sale. 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. Trends on the commercial mortgage side are slowly getting better. CMBS delinquency continues to decline through a combination of curing and forbearance/modification. Hotel and retail deals are now about 1/3 below their respective peaks of around 24% and 17%, while multifamily, office, and industrial are all in the low single digits. We should note that the office sector is probably not as far along and is likely to bottom in late 2021 or 2022. Our managers have moved the portfolios up in overall credit quality by selling some of our lower-rated positions as the credit curve flattened in the first quarter and spreads near their tights. We will remain below our normal CMBS weightings for the near future. We are taking a similar stance with ABS weightings but this is mostly a function of valuations as we generally like the fundamentals in this sector. Lastly, we continue to trim holdings within our taxable muni universe while looking to trade into more liquid and highly-rated corporate names.

Mark R. Anderson, CFA

Chief Strategy Officer

NIS