National Investment Services

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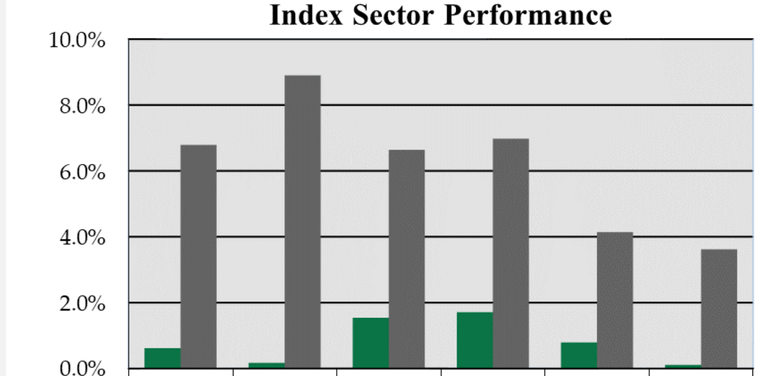
THIRD QUARTER 2020 *INVESTMENT REVIEW*

FIXED INCOME OVERVIEW

Many sectors within the fixed income markets enjoyed gains as interest rates stayed relatively steady and bond spreads tightened as investors grew more comfortable with the scope and trajectory of the current economic recovery. Despite a robust new issue calendar in the middle of a usually weak season for deals, corporate bonds managed to gain a healthy 1.5%, easily besting Treasuries and agency mortgages. For the quarter, the Bloomberg Barclays Aggregate Index gained 0.62%, while the Bloomberg Barclays Intermediate Govt./Credit Index returned a similar 0.61%. CMBS and ABS did well for the Aggregate Index as evidenced below and we are happy to report that these same sectors, along with non-agency and taxable municipal bonds, helped deliver favorable performance for our investment grade portfolios.

Index Sector Performance



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q3 '20	0.62%	0.17%	1.54%	1.71%	0.79%	0.11%
YTD	6.79%	8.90%	6.64%	6.98%	4.14%	3.62%

Source: Bloomberg

CREDIT SPREADS

Corporate credit spreads rallied throughout July and August before giving back some of their gains during the last two weeks of September. While the reasons for the small pullback vary from the usual suspects of a rise in COVID-19 cases and election and stimulus uncertainty, the chart below highlights just how far we have come since the dark days of March. Given all of the headwinds cited above, it is somewhat remarkable that the barometer for investment grade corporate credit traded within a very narrow 15 basis point band. (Cont.)

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SCAN IT & GO

777 E Wisconsin Ave
Suite 2350
Milwaukee, WI
53202

Phone:
414.765.1980

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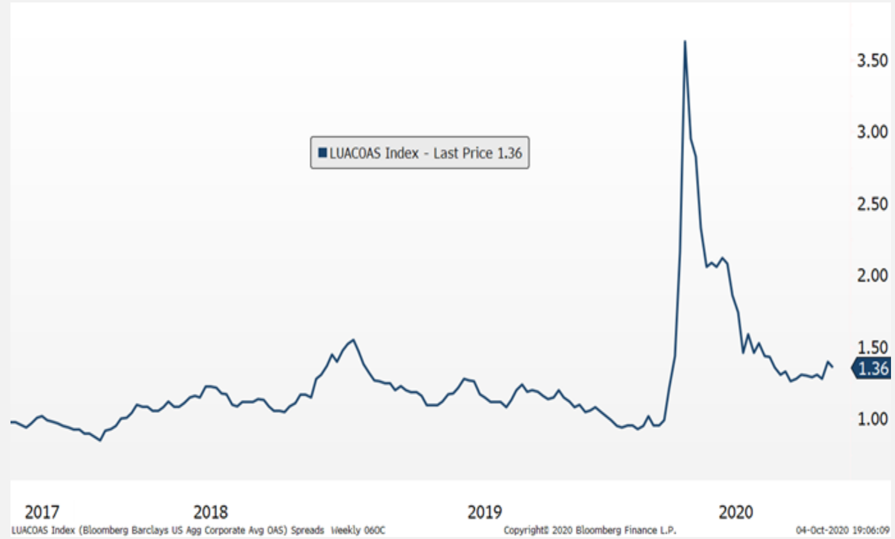
CREDIT SPREADS

(Cont.) Our traders also noted that during the recent sell-off, the market remained liquid despite some rather large blocks being out for the bid at quarter-end when dealers generally try to peel back their risk. We believe this is a positive development and that it could help set the table for further spread compression in the months ahead.



Source: Bloomberg

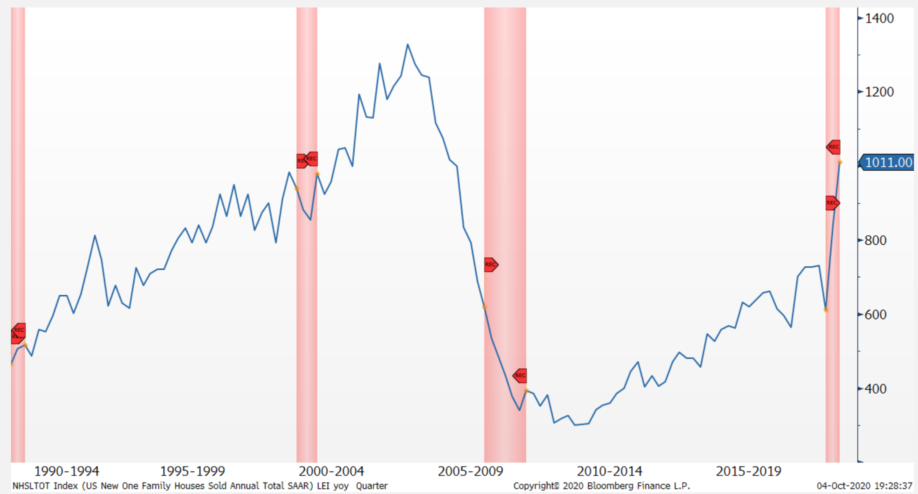
FISCAL AND MONETARY POLICY

We wish we had better news to report on the fiscal front, but unfortunately, the Phase 4 Spending Bill is tied up in D.C. in a very partisan political battle. At least both sides agree there needs to be further stimulus. The Federal Reserve governors and Fed Chair Powell have also made it rather clear to Congress that something should be done. For their part, the Federal Reserve reiterated their willingness to keep interest rates low for an extended period as the 2023 dot projections show only four members moving off the lower bound. The ten-year Treasury yield in the U.S. seems to share this sentiment of being stuck in the low range as it has bounced off a low of about 0.50% in early August to trade briefly above 0.75% by the end of that month. The very near-term technicals favor a slight move higher, for which our portfolios are well-positioned. However, we are well aware of the gravitational pull of the Fed and the prospect of market volatility in the coming months, and therefore won't aggressively push this duration underweight stance, as most portfolios carry an approximate 95% of index duration.

Source: Bloomberg

THE ECONOMY

As the U.S. economy continues to recover, we must recognize that the path forward will neither be straight nor without bumps. Aside from the direct and indirect human and psychological toll that COVID-19 causes, it has also affected millions of people's employment prospects. The September jobs report showed a smaller-than-expected increase in non-farm employment. Judging by the recent headline-grabbing layoff announcements, it seems like further gains in the employment market will be more difficult in the months ahead. Additionally, the increase in consumer spending was also the smallest gain in recent months and ISM manufacturing was a small disappointment. Housing, however, remains a very bright spot in the U.S. economy as the recent spike in sales of single family homes indicates. Furthermore, the 20-City Case-Shiller Index showed a 3.95% year-over-year gain, its highest reading since December of 2018, and it is estimated that 40-50% of COVID-related delinquencies due to forbearance have cured. We remain positive on the mortgage-backed debt sector.



Source: Bloomberg, U.S. Census Bureau

FOURTH QUARTER STRATEGY

Although prospects for outsized gains in the fixed income market have diminished as the low rate environment and spread compression have certainly pulled some performance forward, we wanted to highlight a few opportunities. Recent bouts of curve steepening on the longer-end of the Treasury curve are reminders that it is important to focus on the small things to enhance and protect client portfolios, and this starts by focusing on duration in our intermediate and core accounts in the 95% of index duration range. Our corporate bond managers are monitoring the bevy of new deals as low interest rates have encouraged companies to tap the marketplace, pushing supply to record highs and at times offering opportunities to participate or to find value within an existing credit curve.

(Cont.)

FOURTH QUARTER STRATEGY

(Cont.)

Speaking of new issuance, analysts at Bank of America project 2020 issuance for both esoteric and total ABS to be down about 25% from 2019. The CMBS marketplace is experiencing the same phenomenon and it has helped propel recent performance in this sector. We recently bought CLIF 2020-3A A, rated A, at new issue with a 5-yr weighted average life. The majority of the pool are refrigeration container units, which tend to exhibit lower volatility than dry containers and are generally more recession-resistant since much of the cargo is food. In addition, most of the portfolio is on North-South trade routes, and therefore less exposed to the ongoing trade disputes with China. Our structured finance managers also favor certain auto-based ABS deals and non-agency MBS as referenced in the prior section. We currently carry sector overweights in ABS, CMBS and non-agency MBS. Lastly, we believe that taxable munis and some newer issue hospital credits appear attractive to similarly-rated corporate debt and have been actively trading this sector in search of attractive opportunities.

We thank each of you for your business and patience during this ever-evolving marketplace and we remain optimistic that we can continue to harvest some of these advantageous yield spreads on your behalf. Be safe.

Mark R. Anderson, CFA

Chief Strategy Officer

NIS