



# Portfolio Commentary

## Navigator® Taxable Fixed Income

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## The Economy: Saved by Zero

*Saved by Zero* is a song from the Fixx in 1983. It has almost a meditative beat. Stark, grim and haunting imagery presents the listener with a passage into an uncertain future. Pushed past your comfort zone, you leave everything behind and start at "zero" and decisions are made with nothing left to lose.

Jerome Powell may have been listening to this song in his ear buds as by quarter end, the Fed was forced to respond to a pandemic and a historically unprecedented downturn in our economy. Trying to be *Saved by Zero* rates is part of the Fed's response.

Here is how the quarter unfolded:

### January

In January, bullish sentiment drove stocks higher as moderating trade tensions between the U.S. and China dominated headlines during the first weeks of the month, reducing investors' pessimism surrounding a global recession. Coronavirus cases dominated headlines during the second half of the month as investors worried over the negative effects on economic growth from the virus. For the month, the S&P 500 Index finished flat at -0.16%, the Bloomberg Barclays US Aggregate Index posted a return of 1.92%, and the Bloomberg Barclays 5-year Muni Index improved by 1.22% as bonds benefited from the end of the month uncertainty.

### February

February got off to a positive start, as the S&P 500 Index was up over 4.5% during the first two weeks of the month. Coronavirus concerns seemed to be restricted to China, with limited potential impact on U.S. economic activity. However, sentiment quickly soured during the second half of the month as fears increased over the spread of the coronavirus as it expanded past China's borders and Italy and Iran quickly became secondary viral epicenters. The S&P 500 Index finished the month down 8.41%. The Bloomberg Barclays US Aggregate Index and the Bloomberg Barclays 5-year Muni Index were both positive, finishing the month up 1.80% and 0.60%, respectively, as investor risk aversion quickly shifted from risk-on to risk-off, as coronavirus fears continued to increase.

### March

In March, investors were hit with unprecedented volatility across all asset classes. Fear surrounding the coronavirus pandemic quickly escalated as the virus continued to spread across the globe. During the month, the United States reported its first confirmed cases and increased social distancing began taking its toll on both the U.S. and global economy. The S&P 500 Index experienced its quickest decline in history during March, taking only three weeks to reduce 35% of the index value and ending the longest bull market in U.S. history, which had started in March 2009.

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During 12 trading days during the month, the S&P 500 Index swung violently by more than 4% in either direction, as investors continued to digest quick news flow stemming from the emergence of the coronavirus as a global pandemic. The CBOE Volatility Index, which measures market volatility, reached a peak value of 82.69 on March 16<sup>th</sup>, surpassing the previous record of 80.86 occurring during the 2008 financial crisis. The fixed income market was not immune to this volatility as yields dropped substantially with the 10-year Treasury yield declining from 1.15% on February 28<sup>th</sup> to 0.67% on March 31<sup>st</sup>, as investors sought safety in the highest quality and most liquid assets.

The month of March was unkind to investors as the S&P 500 Index logged its worst quarter since 2008 and the Dow posted its worst quarter since 1987. The S&P 500 Index fell by 12.35% in March, the Barclays US Aggregate Index dropped 0.59% and the Barclays 5-year Muni Index declined 2.81% during the month as investors removed credit risk, including municipals, from their portfolios and rushed to cash and other short-term, high-quality investments in an extreme flight to safety. For the quarter, the S&P 500 Index was down 19.60%, the Bloomberg Barclays US Aggregate Index finished positive 3.15%, and the Bloomberg Barclays 5-year Muni Index dropped by 1.04%, in total return terms.

## \$2.1 Trillion CARES Act

In an effort to calm investor anxiety, address the economic fallout from the coronavirus, and hopefully avoid a prolonged slowdown, Congress passed the \$2.1 trillion CARES Act during the month. The \$2 trillion CARES Act is the largest economic stimulus act ratified by Congress and, in terms of size, is more than double the \$800 billion American Recovery and Reinvestment Act of 2009 passed after the financial crisis in 2008. The CARES Act creates a \$454 billion Economic Stabilization Fund to inject liquidity into the fixed income capital markets, including both corporate securities and municipal securities. This provides the Federal Reserve the ability to include municipal bonds as part of its asset purchase program. We highlight here some of the notable provisions that will have a material effect on municipal markets:

- \$150 billion Coronavirus Relief Fund appropriated for direct funding to state and local government for costs associated with dealing with the coronavirus.
- \$120 billion appropriated for not-for-profit hospitals, nursing homes, and other healthcare providers.
- \$35 billion appropriated to transportation infrastructure, including airports and mass-transit agencies.

- Over \$30 billion for education funding including higher education and K-12 school districts.

We believe markets responded positively to the Congressional passing of the CARES Act and ratification by President Trump on March 27<sup>th</sup>. The muni market saw liquidity return, pricing stabilize, and yields dropping into more traditional, yet still attractive, ranges as a result. Our view is that the CARES Act should continue to offer some pricing stability as liquidity begins to return to the market. In addition, the provisions should provide some needed relief to already stretch state and local government budgets as they continue the front-line fight against the ongoing coronavirus crisis.

As the first quarter concludes, our view is that the U.S. economy has a high potential to enter a recession stemming from the continuing spread of the coronavirus epidemic. Economic conditions will continue to deteriorate as work-from-home mandates, limitations on public gatherings, and other social distancing measures dampen economic activity. The length and severity, however, remains uncertain as investors continue to question if aggressive monetary and fiscal stimulus packages will be enough to stimulate economic growth during the second half of the year.

## Navigator® Taxable Fixed Income

The Navigator® Taxable Fixed Income strategy finished the first quarter down with a mid-single digit decline, slightly trailing its benchmark. The first quarter was a challenging quarter for the taxable market, as extreme volatility stemming from the coronavirus pandemic and a resulting economic slowdown pushed valuations down across all sectors.

Since the inception of the taxable fixed income strategy, we have maintained exposure to the high yield sector. As we headed into the end of 2019, we were cognizant of the tight spreads in investment grade and high yield bonds. Our high yield exposure was down, and our cash levels were a little elevated after a positive 2019. In March, investment grade bond spreads widened, and high yield bonds sold-off sharply, resulting in negative returns.

## Taxable Outlook

We have a seasoned portfolio team that has traded through many different economic cycles and has witnessed many financial and economic crises dating back to the early 1980s. The Fed has responded with all its might to resolve this crisis with its traditional tools used back in 2008. However, there is no history of snuffing out an economy and trying to restart it at some future date, and the Fed's response may not have the same probabilistic outcome as in the past. We will have to see on that front.

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The portfolio has some exposure to the Consumer and Energy sectors that we will look to adjust as we move into the summer. We believe the heat of the summer and reduced infection rate should restart some economic activity and calm fears while reducing volatility. During this time frame, we will be able to adjust and move forward as we analyze our portfolio. We have already taken steps such as increasing credit quality purchasing newer issuers in the single A or better ratings category.

We experienced a similar period of underperformance after

the 2016 election as people worried about rising rates and a newly elected President, who was comfortable with high interest rate borrowing often utilized in the balance sheets of many of his businesses. We re-positioned the portfolio and performance rebounded strongly in the ensuing months after the 2016 election. With our tactical management style, we are hopeful for a similar outcome.

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The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 75% of U.S. equities.

Bloomberg Barclays U.S. Aggregate Bond Index: The index is unmanaged and measures the performance of the investment grade, U.S. dollar denominated, fixed-rate taxable bond market, including Treasuries and government-related and corporate securities that have a remaining maturity of at least one year.

The Bloomberg Barclays 5 Year Municipal Bond Index is a capitalization weighted bond index created by Bloomberg Barclays intended to be representative of major municipal bonds of all quality ratings with an average maturity of approximately five years.

The CBOE Volatility Index, known by its ticker symbol VIX, is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options.

Fixed income securities are subject to certain risks including, but not limited to: interest rate (changes in interest rates may cause a decline in market value of an investment), credit, payment, call (some bonds allow the issuer to call a bond for redemption before it matures), and extension (principal repayments may not occur as quickly as anticipated, causing the expected maturity of a security to increase). Non-investment grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities.

The 10 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 10 year. The 10 year

treasury yield is included on the longer end of the yield curve. Many analysts will use the 10 year yield as the "risk free" rate when valuing the markets or an individual security.

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