Clark Capital Management Group

Portfolio Commentary

Navigator® Fixed Income SMA

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The third quarter fixed income themes were dominated by positive macro data in July, accommodative Fed commentary in August, and heightened political uncertainty in September. During the quarter, COVID-related news returned to the front burner as both Europe and the U.S. experienced a significant uptick in new cases. At the beginning of the quarter, the yield on the 10-year U.S. Treasury bond was 0.66%; it finished the quarter on September 30th with a slightly higher reading of 0.69%.

Investment grade credit spreads compressed by 14 basis points and high yield spreads declined by 109 basis points during the quarter as both markets experienced positive fund flows with investors adding over $110.4 billion to investment grade funds and over $5.6 billion to high yield funds. Fund flows contributed to the positive performance for the corporate bond credit markets during the third quarter.

The Bloomberg Barclays Intermediate Corporate Bond Index finished the quarter up 1.33%. Municipal bonds finished the third quarter slightly higher. Using the Bloomberg Barclays Municipal Bond Total Return Index as a reference, the muni market appreciated 1.23% on a total return basis during the quarter.

The 5-year MMD scale experienced a 17 basis point drop during the quarter ending on September 30th with a reading of 0.26% as positive fund flows for the asset class drove municipal bonds yields lower during the third quarter. According to the Investment Company Institute (ICI), the municipal bond asset class experienced positive fund flows totaling over $26.2 billion during the third quarter (as of 09/23/2020), continuing a positive inflow trend from the prior quarter.

Below is a monthly recap of the third quarter:

July

In July, a tailwind from Central Bank policy, coronavirus vaccine optimism, positive expectations surrounding a fifth coronavirus relief package, and positive earnings surprises, were all cited as factors supporting optimistic investor sentiment during the month. The U.S. Central Bank responded to the corona virus pandemic by proposing a financial asset purchase program, increasing its balance sheet by over $3.0 trillion from February to July to sustain market liquidity. This unprecedented policy response has suppressed interest rates, compressed corporate bond spreads, dampened volatility, and smothered bearish positioning. Bond yields continued to fall during July as the U.S. 10-year Treasury bond yield dropped by over 0.12% finishing the month with a yield of 0.53%.

Muni yields followed suit, decreasing by 18 basis points and finished the month with a 0.23% yield on July 31st, using the 5-year MMD scale. The muni market finished July with an impressive 1.16% positive performance as referenced by the Bloomberg Barclays 5-year Municipal Bond Index. The corporate bond market experienced a noteworthy positive performance of 1.50% during the month, as referenced by the Bloomberg Barclays Intermediate Corporate Bond Index.

August

The risk-on rally continued in August as investors continued to push equity markets

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higher. U.S. Treasuries finished lower as the yield curve steepened during the month. The 10-year U.S. Treasury began August at 53 basis points and finished the month higher with a yield of 71 basis points. The primary performance driver in August was attributed to continued massive monetary and fiscal stimulus implemented as a result of the of the coronavirus outbreak, with many investment strategists predicting the Fed's balance sheet could eventually exceed $20 trillion.

The FOMC announced at the end of month its intention to implement further policy accommodation if inflation continues to fall short of expectations. The corporate bond market performance was flat with the Bloomberg Barclays Intermediate Corporate Bond Index returning 0.00% in August. Municipal bonds performance was negative during the month following the sell-off in the U.S. Treasury market.

The 5-year MMD scale finished up 3 basis points in August, finishing the month with a yield of 0.26%; the Bloomberg Barclays 5-year Municipal Bond Index declined by 0.04% during the month. Despite investor worry over the inability of the White House and Congress to reach a deal on a fifth coronavirus relief package, municipal bond mutual fund lows remained positive in August as investors added over $10.5 billion into the asset class during the month, according to ICI, continuing a positive trend from the spring.

September

U.S. Treasury yields were mostly stable during September. The 10-year U.S. Treasury started the month yielding 71 basis points and finished the month relatively flat with a yield of 69 basis points. The coronavirus pandemic remained an overhang during the month as many European countries observed a significant increase in positive cases and the U.S. death toll eclipsed 200,000. The White House and Congress continued to differ on the size and scope of a possible fifth round of coronavirus fiscal stimulus.

The September FOMC meeting minutes indicated that the Fed has no intention to raise rates until at least 2023, and reiterated their August guidance towards a flexible inflation target. Election and political uncertainty were consistent throughout the month. The death of Supreme Court Justice Ruth Bader Ginsburg increased political uncertainty as Democrats resist President Trump's Supreme Court nominee, potentially lowering the likelihood of a Congressional agreement towards an additional round of coronavirus stimulus. At the end of the month, the presidential candidates squared off an in raucous debate that was filled largely with more interruptions than policy positions, leaving investors unclear on the candidates' plans as we march into the November election.

Positive fund flows continued in September as investors seemed to ignore the political uncertainty during September by adding over $6.2 billion (as of 09/23/2020) to municipal bond mutual funds during according ICI. The 5-year MMD scale finished September relatively flat, yielding 0.26%. The municipal bond market logged a modest rise in September as the Bloomberg Barclays 5-year Municipal Bond Index improved slightly by 0.16%. Corporate bonds posted a modest decline during the month as the Bloomberg Barclays Intermediate Corporate Bond Index declined 0.18%.

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The Bloomberg Barclays US Intermediate Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers that have between 1 and up to, but not including, 10 years to maturity.

The Bloomberg Barclays US Treasury: 10-Year Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury with 10 years to maturity.

The Bloomberg Barclays U.S. Municipal Total Return l Index covers the USD-denominated long-term tax exempt bond market.

The Bloomberg Barclays 5-Year U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market for bonds with 5-year duration.

MMD Index means the interest rate released by Municipal Market Data for its "Aaa" General Obligation Yield for uninsured bonds for a term equal to the remaining numbers of years from the effective date of the Alternate Term Rate to the Maturity Date, rounded up to the nearest full year in the event of a partial year.

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