Breckinridge CAPITAL ADVISORS

January 2021 Market Commentary

Strategy and Outlook

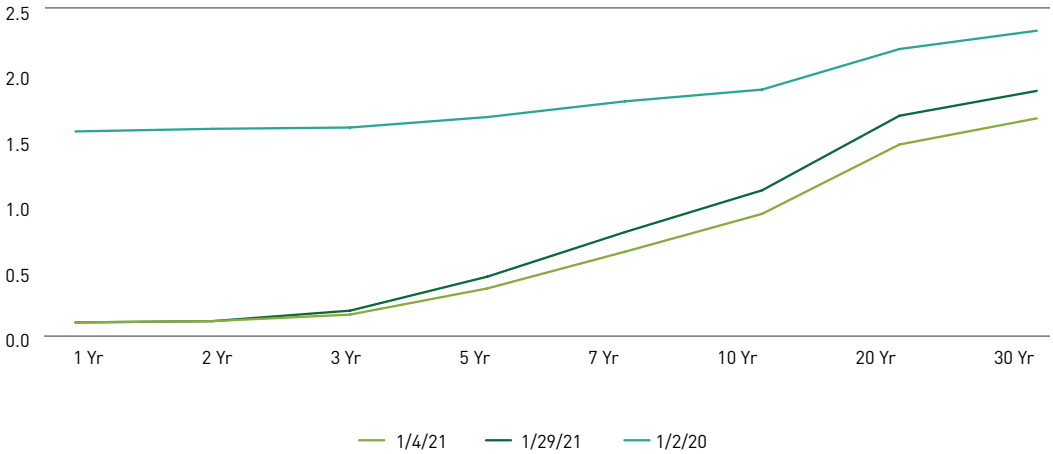
- **U.S. Treasury Curve:** Yields were higher on the long end of the curve while the short end was somewhat lower. The curve steepened.
- **Municipal Market Technicals:** January new issuance was $24 billion, per *The Bond Buyer*, lower than the prior month and lower than the year-over-year total for January.
- **Corporate Market Technicals:** Investment grade (IG) corporate fixed-rate bond gross supply was about $117 billion, per Barclays.
- **Securitized Trends:** Spreads on mortgage-backed securities (MBS) and asset-backed securities (ABS) narrowed during the month, according to Barclays indexes, delivering positive excess returns over Treasury securities of similar duration.

Market Review

Financial markets in January continued the relatively quiet conditions of December. Amid violent upheaval surrounding the arrival of a new administration in Washington, D.C., investors seemed to take a wait-and-see attitude.

The stock market, as measured by the S&P 500 Index, closed the month with its worst weekly performance since October, settling 1 percent lower for the month. Treasury yields moved higher, most substantially at the long end of the curve. Compared with one year ago, Treasury yields are about 145 basis points (bps) lower at 1-year spot and 46bps lower in the 30-years range.

FIGURE 1: U.S. TREASURY YIELDS

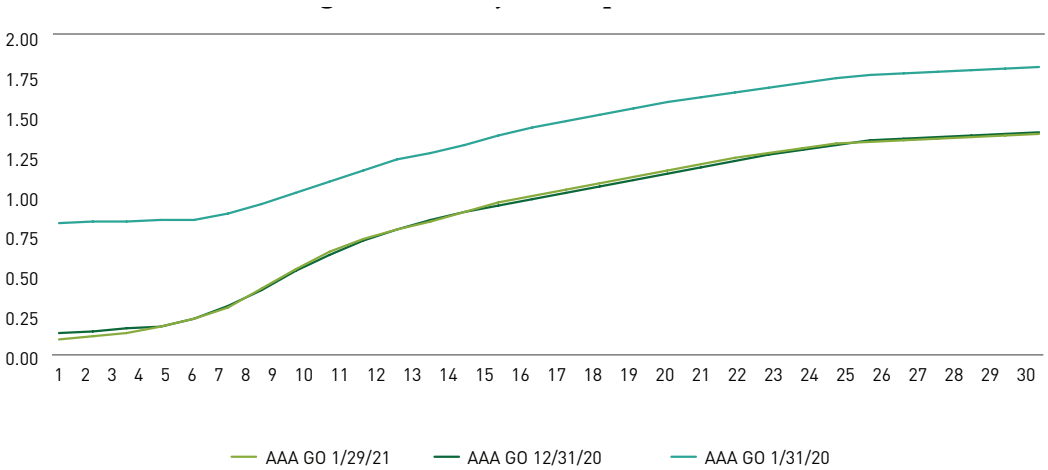


Source: U.S. Department of the Treasury 1/29/2021.

Unlike Treasuries, municipal bond yields moved marginally during January. As a result, municipals maturing in four years and shorter got more expensive. But yields for maturities from 14 to 22 years saw little change. Similar to Treasuries, municipal bond yields across the curve remain significantly lower than one year ago.

Corporate bonds also exhibited little change during the month. Yields were 1bp wider. Corporate earnings season began and, of the first 184 companies in the S&P 500 to report, 84 percent topped analyst expectations, far more than usual, according to Refinitiv data.

FIGURE 2: JANUARY MUNICIPAL BOND YIELDS



Source: Barclays 1/29/2021

Municipal Market Review

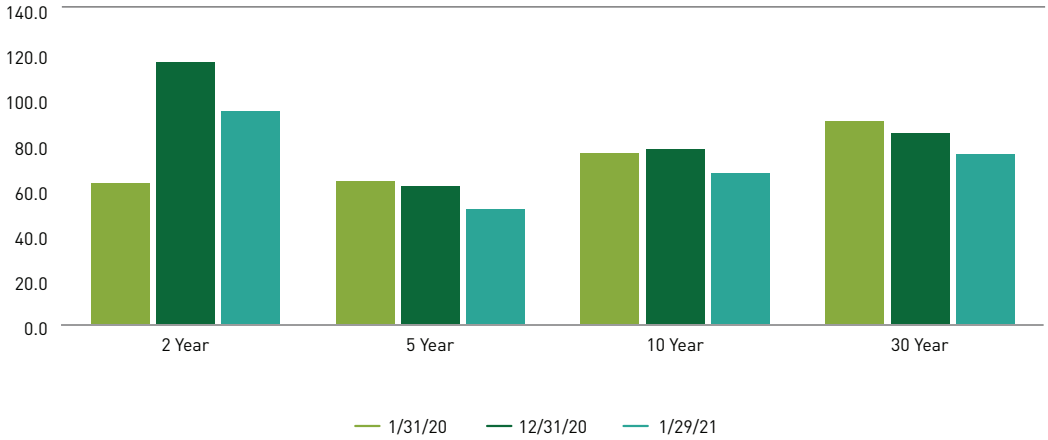
January's new issue supply totaled roughly $24 billion, according to *The Bond Buyer*, and marked its lowest level since 2018. Supply dropped more than $10 billion compared to the prior month and fell an estimated $8 billion versus January 2020. Taxable municipal bonds continued to be a strong presence, representing about 28 percent of total volume.

Cash from maturities and coupon payments swelled during the month. This coupled with strong mutual fund inflows, which totaled $13.8 billion, per JP Morgan, helped fuel strong demand, compressing spreads and pushing ratios lower.

The slope of the municipal yield curve was broadly unchanged during the month. The 2s and 5s, 2s10s and 5s10s curves steepened by 3bps, 4, bps and 1bp, respectively.

With Treasury yields increasing and municipal yields treading water, Municipal/Treasury (M/T) ratios were lower than one month and one year ago. Notably, the 5-year ratio hovered near 50 percent by month end.

FIGURE 3: M/T RATIOS DECLINED



Source: Barclays 1/29/2021.

For January, the Bloomberg Barclays 1-10 Year Blend Index gained 0.64 percent and the Managed Money Short/Intermediate Index finished 0.20 percent higher. Per Barclays, lower-rated bonds outperformed higher-rated bonds by a wide margin. Bonds with intermediate maturities—5 to 15 years—outperformed shorter maturities and trailed the 30-year bond return.

Our outlook remains for a recovery in the economy broadly and municipal sectors specifically as distribution of vaccines accelerates, fiscal relief is finalized and delivered, and accommodative monetary policies are extended. Timing may defer broad economic improvements to the second half of the year. In the near-term, supportive technical conditions are likely to continue.

Corporate Market Review

Investment grade (IG) corporate spreads widened by 1bp in January, ending the quarter at 97bps. BBB-rated corporate bonds, where spreads tightened, outperformed AA/A-rated bonds, which widened, while AAA bond spreads were unchanged. Longer-term maturities outperformed intermediate-term bonds.

The BBG U.S. Corporate Investment Grade Bond Index fell 1.28 percent for the month. According to Barclays, the best-performing corporate sectors for the month were Airlines, Building Materials, Healthcare and Refining. The worst-performing sectors were Integrated Energy, Transportation Services, Wireless, Cable/Satellite and Health Insurance.

Index-eligible IG corporate supply was more than $117 billion over the month, per Barclays. IG fund inflows were $30 billion, per EPFR Global. After a record year in 2020, we expect IG supply to decline in 2021, but for the month of January, supply and demand dynamics contributed to a competitive market for high-grade corporate bonds, keeping yield spreads narrow and prices high.

Our view is that as the economy recovers, corporate profits rebound and markets move on from the extraordinary intervention of the Fed last year, fundamentals will return to prominence as a valuation determinant.

Securitized Market Review

According to Bloomberg Barclays indexes, securitized sectors reported the following results in January. Agency MBS had the best month since April 2020 and produced 24bps of excess returns. Thirty-year conventional MBS led the way at 42bps, driven primarily by 3 percent to 5 percent coupons. Fifteen-year conventional MBS also had a strong month, earning 40bps above U.S. Treasuries. The underlying bear steepener—when long-term interest rates increase at a faster rate than short-term rates—was a significant factor, as higher coupons and 15-year securities are typically shorter duration. Government National Mortgage Association (GNMA) securities struggled, underperforming on an excess return basis by 26bps. Headline risk around mortgage insurance premium cuts and forbearance-related buyouts were the main catalysts in the sector.

Commercial mortgage-backed securities (CMBS) and Agency CMBS (ACMBS) delivered 47bps and 23 bps, respectively, of excess returns for January, based on their respective Barclays indexes.

With 17bps of excess returns for the month, ABS underperformed other securitized sectors. Auto loans, with a monthly excess return of 19bps, outperformed credit cards at 13bps, according to the BBG Asset-backed Securities Index.