Breckinridge CAPITAL ADVISORS

COMMENTARY

MARCH 2020 MARKET COMMENTARY

SUMMARY

- **U.S. Treasury Curve:** Investment markets were dominated during March by COVID-19 concerns. Treasury yields dropped by 63 basis points (bps) in the 2-year spot and 52 bps at 5-years, 43bps in 10 years and 30bps in 30 years. The 10-year Treasury closed at 0.67 percent.
- **Tax-Exempt Municipal/Treasury (M/T) Ratios:** Municipal bonds traded at historically low yields at the beginning of March and were expensive relative to Treasuries as measured by M/T ratios. As virus concerns increased, yields and ratios skyrocketed.
- **Municipal Market Technicals:** New issue supply closed the month at nearly $17B, down 39 percent year-over-year, per The Bond Buyer.
- **Corporate Market Technicals:** During the last full week of March, the market saw record-high investment grade (IG) corporate supply, with $110 billion pricing, per Bloomberg.
- **Securitized Trends:** Securitized sectors experienced high volatility until the Federal Reserve (Fed) stepped in during March. Mortgage-backed securities (MBS) spreads returned to pre-virus levels as a result. Heavy selling weighed on the asset-backed security (ABS) sector.

MARKET REVIEW

The economic effects of COVID-19 and global efforts to adjust to them dominated investment markets during March. In the U.S., jobless claims increased. Gross domestic product projections deteriorated. Treasury yields declined during the month. The curve steepened after the Fed took steps to shore up liquidity in funding markets. Congress passed the $2 trillion CARES Act, which will provide an unprecedented amount of fiscal stimulus to the U.S. economy across industrial sectors and business segments.

Throughout the month, markets were volatile and reflected severe liquidity strains at times. Treasuries, often seen as a haven during times of market stress, outperformed municipal bonds across the curve by a wide margin, per Barclays. Liquidity was challenged even in the Treasury market at times in March, with wider trading spreads between on (newly issued) and off-the-run (previously issued) Treasuries.

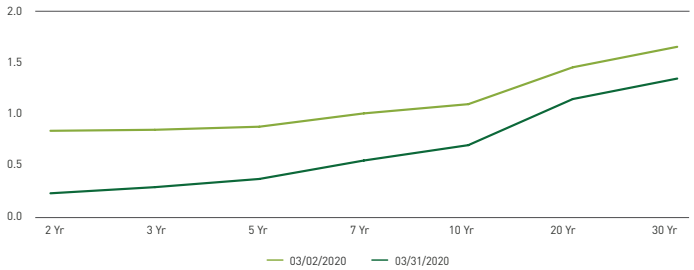
The markets experienced dramatic moves in both directions during March until actions by the Fed and Congress appeared to reassure investors and reduced volatility. The yield curve steepened in response.

MUNICIPAL MARKET REVIEW

Even the normally quiet municipal market dealt with extreme swings in volatility during March following the COVID-19 outbreak. Record setting outflows from municipal funds strained liquidity and triggered one of the worst historical weeks for municipal bond performance, per The Bond Buyer. By month end, steps taken by the Federal Reserve and Congress appeared to reassure markets and market volatility moderated.

During the month, Treasury yields dropped by 63 bps in the 2-year spot and 52 bps at 5-years, 43bps in 10 years and 30bps in 30 years (Figure 1). Prior to the dislocation beginning in early March, municipal bonds were trading at historically lows yields, and were expensive relative to Treasuries as measured by municipal/Treasury ratios. Further, credit spreads were tight. As virus concerns escalated during March, investor sentiment changed swiftly; yields skyrocketed, ratios ballooned, and spreads widened. The BBG Municipal Bond Index declined 3.63 percent and the BBG Municipal 1-10 Year Blend Index fell 2.52 percent. Relative to these broader indexes, returns for longer maturity and lower quality bonds were lower, per Barclays data.

FIGURE 1: TREASURY YIELDS PLUMMETED IN MARCH AND THE CURVE STEEPENED



Source: U.S. Department of the Treasury, as of April 1, 2020.

New issue supply closed the month at nearly $17B, down 39 percent year-over-year, based on data from The Bond Buyer. Also, per The Bond Buyer, taxable municipal bonds comprised a sizeable portion of March 2020's total issuance at 17.6 percent, while tax-exempt volume was lower than prior months, as market volatility during the month caused postponement of many tax-exempt bond offerings.

As the economic and social implications of COVID-19 responses continue to play out. Look for municipal credit fundamentals to be challenged, as issuers seek to manage through a period of reduced revenues across sectors. Downgrades from the ratings agencies will occur over the next several months. On the first of April, S&P Global Ratings placed all U.S. public finance sectors on negative credit watch.

CORPORATE MARKET REVIEW

Market action in March dominated the first quarter, as the world adjusted to the economic effects of COVID-19. U.S. jobless claims increased. Gross domestic product projections deteriorated. While Treasury yields declined during the month, the curve steepened after the Fed took steps to shore up market liquidity. Congress passed the $2 trillion CARES Act, which will provide an unprecedented amount of fiscal stimulus to the U.S. economy across industrial sectors and business segments.

Throughout the month, markets were volatile and reflected severe liquidity strains at times. By the end of the month, IG corporate bond spreads were 272 basis points (bps). Not surprisingly, spread widening varied across the quality spectrum, showing favor to higher-rated issues. Corporate bonds underperformed similar-duration Treasuries in March, as measured by the BBG U.S. Corporate Investment Grade Index and the BBG Treasury Index.

SECURITIZED MARKET REVIEW

Securitized sectors experienced high volatility until the Fed stepped in during March. Mortgage-backed securities (MBS) spreads returned to pre-virus levels as a result. The BBG U.S. MBS Index delivered a total return of 1.06 percent for the month, per Barclays. In the asset-backed securities (ABS) market, which has close linkage to the short-term funding markets, investors sold high quality, short duration ABS during the month in a search for liquidity. Dealers reported significantly higher than usual ABS bid-wanted volumes. The selling pressure ultimately weighed on spreads and the sector. The BBG Asset-Backed Securities Index declined 2.07 percent during March.