# FIXED INCOME UPDATE
# FIRST QUARTER 2020

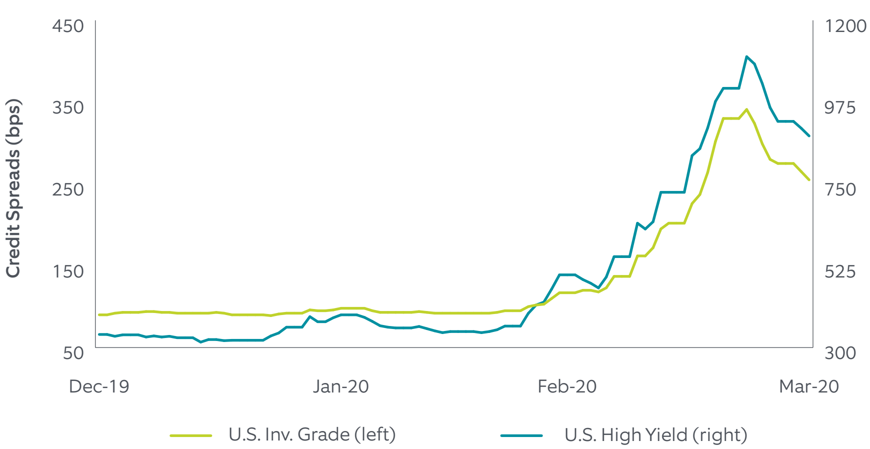
### KEY POINTS

- COVID-19, declared by WHO as a global pandemic in March after rapidly spreading to Europe then to North America, triggered historic movements in the fixed income markets and put an end to the record long U.S. bull market.
- Deepening containment measures left the world on the cusp of a brutal economic contraction, and global central banks and governments were swift to introduce accommodative monetary policies and record fiscal responses.
- Credit spreads increased substantially due to fundamental reasons and liquidity issues. Even Treasury markets — normally the most liquid market in the world — had stresses.

### IN THIS ISSUE



### CREDIT SPREADS




As of 3/31/2020
SOURCE: Northern Trust Fixed Income; Bloomberg Barclays

### Long-Term Views

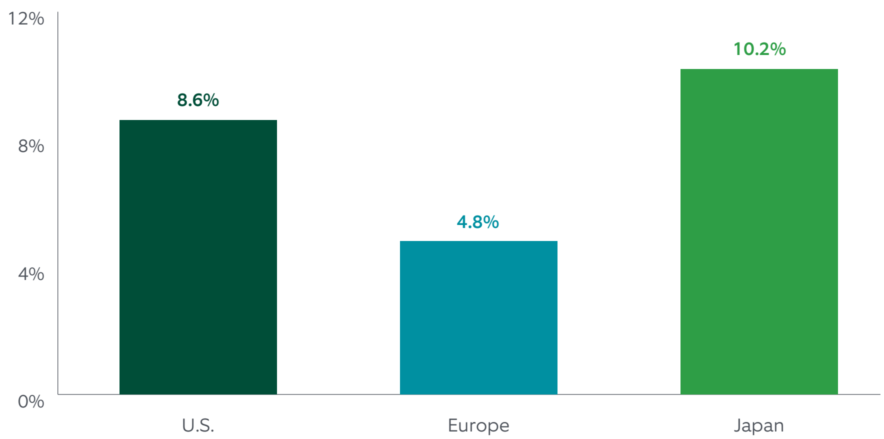
- Given the uncertainty from the coronavirus we expect global growth to continue to slow and interest rates to remain low.
- Major central banks globally will remain accommodative for the foreseeable future, with near-zero prospects for any rate hikes.
- U.S. Federal Reserve liquidity actions have started to improve liquidity conditions in credit markets, though the markets remain a long way from "normal".

## MACRO UPDATE

- U.S. payroll declined for the first time in over a decade; March unemployment increased to 4.4%—however the reference period of the report comes before the virus led to widespread layoffs and does not reflect the full impact of the virus.
- In addition to the virus, the oil price war between Saudi Arabia and Russia further amplified risk asset decline and led to a nearly 70% drop in the price of oil during the quarter.
- U.S. Senate passed the CARES Act, the largest stimulus package in history, in an effort to stabilize the economy during the coronavirus pandemic. The U.S. and Japan had an aggressive Fiscal policy response. Fiscal measures in the rest of the world were smaller and more incremental.

The U.S. stimulus package is much larger and was more quickly deployed than that crafted during the Financial Crisis; Europe's stimulus is smaller due to already in place "automatic stabilizers" (e.g., a better social safety net).

FISCAL STIMULUS (% OF GDP)

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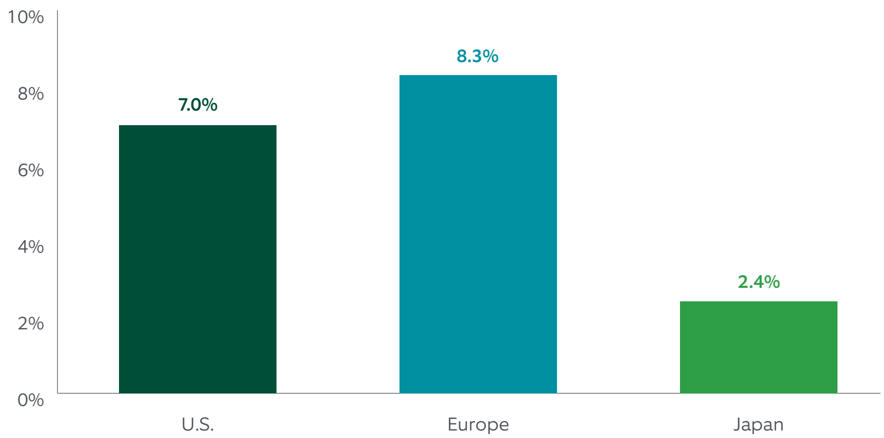
## CENTRAL BANK UPDATE

- Global central banks embraced a "whatever it takes" attitude to provide aid during the pandemic and unleashed vast programs to purchase assets in an attempt to improve market liquidity.
- In the U.S., the Fed unexpectedly cut rates by 50 basis points (bps) on March 3rd, then by another 100 bps on March 15, bringing the interest rate policy to zero. In March, the Fed announced unlimited QE and launched various lending facilities in an effort to boost liquidity and restore proper functioning to the credit markets.

Liquidity injections could grow substantially depending on how long the QE programs last and to what degree the various liquidity facilities are tapped.

FIRST QUARTER MONETARY INJECTIONS (% OF GDP)

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## ULTRA-SHORT/CASH UPDATE

**Market Overview:**

- 1-3 year spreads as measured by the Bloomberg Barclays U.S. Corporate 1-3 Year Average Option Adjusted Spread rose from a multi-year low of 40 basis points to 390 basis points before finishing March at 261 basis points.
- Government money market funds experienced record inflows during the period – climbing fiscal stimulus will push the supply of Treasury Bills meaningfully higher than expected throughout the first half of 2020.
- The Fed unveiled an array of programs to support liquidity in money markets, including expanding repo operations up to $1.5 Trillion (which pinned overnight rates near 0.00%), and the return of the Money Market Liquidity Facility, which allows money market mutual funds to sell certain assets to the Fed.

### Ultra-Short Performance

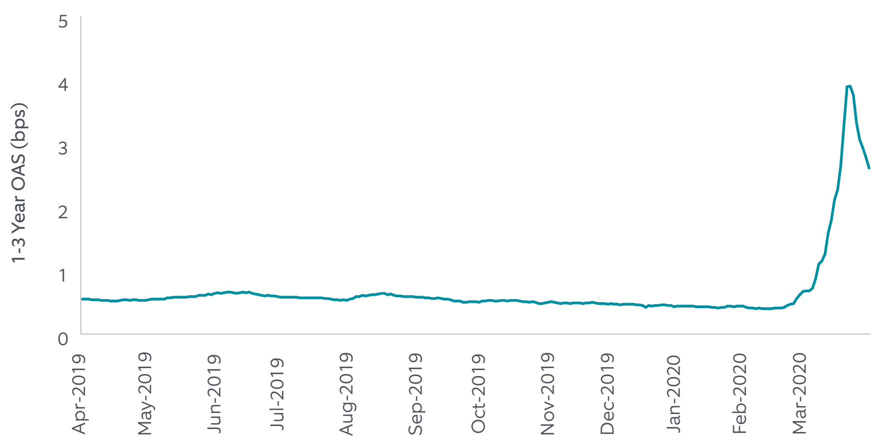
- Contributor – Duration
- Detractor –Asset Allocation

### Current Positioning:

We continue to favor corporate credit and are neutral to long on our duration target.

Money markets and short duration debt were not immune to the significant volatility and challenging liquidity conditions that occurred across global markets.

**1-3 YEAR OPTION ADJUSTED SPREAD**




As of 3/31/2020
SOURCE: Northern Trust Fixed Income; Bloomberg Barclays

## TREASURYS & TIPS UPDATE

### Market Overview:

- The combination of the virus and the surprise oil war sent rates on U.S. government bonds to all-time lows. The yield on the benchmark 10-year Treasury declined to 0.3% and the 30-year to 0.7%, taking the whole U.S. yield curve below 1% for the first time in history.
- Changes in Fed policy, expectations for global growth, and a flight to safety continued to put downward pressure on the curve. Though yields sit at the low end of historical ranges, virus-driven uncertainty will weigh on the curve as long as the virus persists.

### Rates Performance

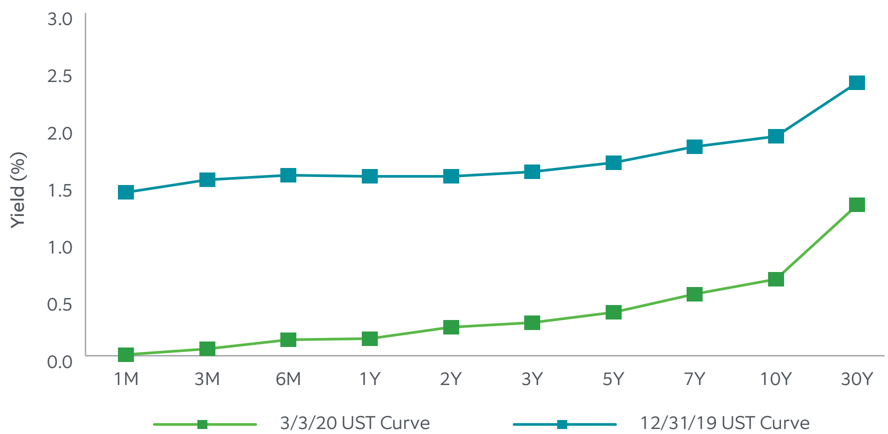
- Contributor –Security Selection and Duration
- Detractor— Curve Positioning

### Current Positioning:

Portfolios are positioned with a neutral-to-long duration relative to their benchmarks.

Treasury bid-ask spreads are quite wide compared to normal levels.

#### TREASURY YIELD CURVE



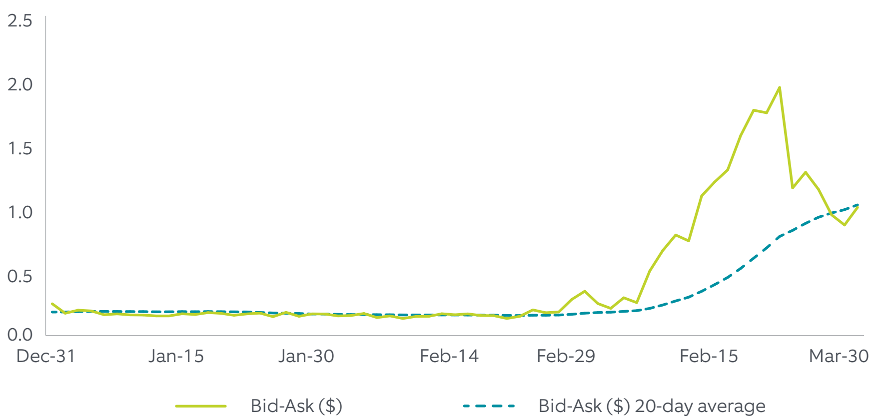

As of 3/31/20
SOURCE: Northern Trust Fixed Income; Bloomberg Barclays

## INVESTMENT-GRADE CREDIT UPDATE

**Market Overview:**

- The investment grade market returned 3.15% for the quarter.
- The significant credit spread widening was largely due to challenged liquidity—we estimate fundamental concerns drove 30% of the spike in spreads, with 70% of the selloff being liquidity-driven.
- Reflecting the extreme market illiquidity, the bid-ask spread on investment grade bonds, which has historically been $0.20, ballooned out to as far as $1.94.

U.S. INVESTMENT GRADE HISTORICALLY EXPENSIVE




As of 3/31/20
SOURCE: Northern Trust Fixed Income; Bloomberg Barclays

### Credit Performance

- Contributor – Asset Allocation, Duration
- Detractor— Security Selection

### Current Positioning:

We have modestly added to our credit overweight during the turbulence, focusing on higher quality, defensive credit in the belly of the yield curve.

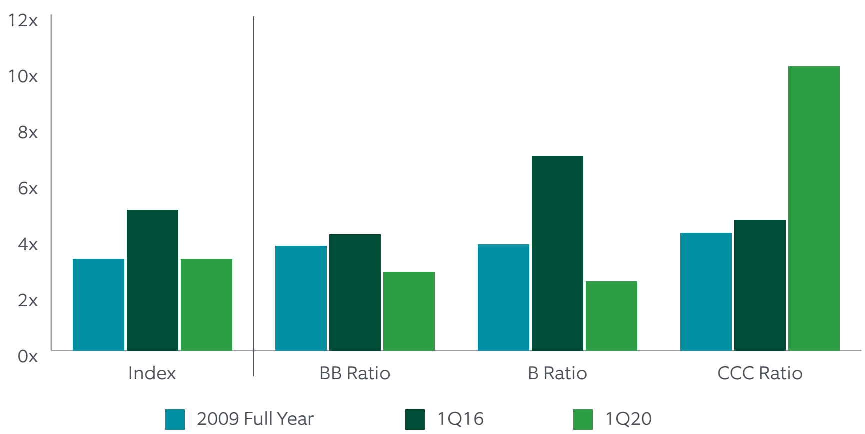
The bid-ask spread showed QE and Fed liquidity programs (such as the ability to buy IG in the primary and secondary market) began to take effect.

## HIGH-YIELD BOND UPDATE

**Market Overview:**

- The high yield market posted a quarterly return of -12.68%, with March being the second worst monthly performance on record.
- Returns by rating favored the highest quality credits. Double-B securities returned -10.26%, Single-B securities returned -13.03%, and Triple-C securities returned -20.67%.
- The high yield market continues to benefit from stable credit fundamentals driven by corporate earnings.

HIGH YIELD RATIO OF DOWNGRADES TO UPGRADES

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SOURCE: Northern Trust Fixed Income; Bloomberg Barclays

### High-Yield Performance

- Contributor – Allocation and Sector Positioning
- Detractor – Security Selection

### Current Positioning:

Portfolios are positioned in the mid-range of the credit quality spectrum. Issuer selection is of utmost importance.

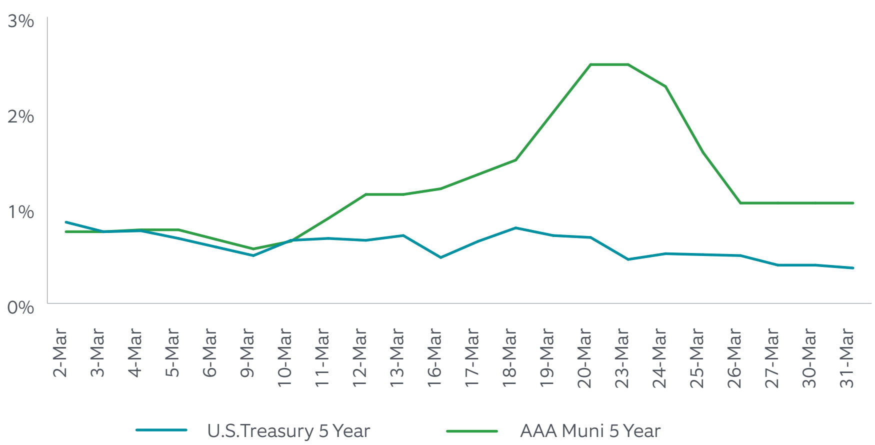
While CCC rated credits have fared the worst, with a downgrade to upgrade ratio in excess of 10x, this is not unprecedented. CCC credits saw more than 200 downgrades and only one upgrade during 4Q08.

## MUNICIPAL BOND UPDATE

**Market Overview:**

- Munis fell 9-10% in mid-March, then rallied back to end down 2-3%.
- High quality outperformed dramatically in March, with AAA's -2.2% and BBBs -8.7%
- Ratios remain at extreme highs, attracting non-traditional muni buyers.

### RATE VOLATILITY IN A 'RISK CONTROL' ASSET

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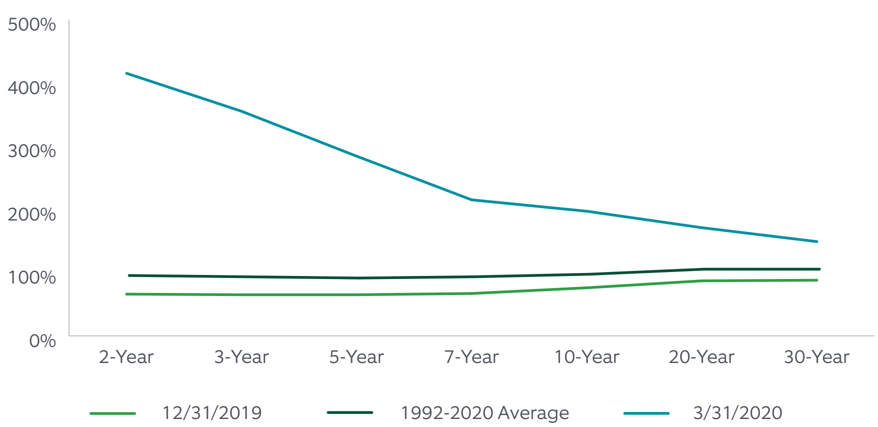
### RATIO: AAA MUNI YIELD TO TREASURY YIELD

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SOURCE: Northern Trust Fixed Income; Bloomberg Barclays

## Municipal Performance

- Contributor – Credit Quality, Yield Curve Positioning
- Detractor – Duration

## Current Positioning:

We expect mutual fund outflows to slow, liquidity to continue to improve, credit spreads to remain wide and the yield curve to steepen. Municipals remain very cheap relative to Treasuries. Credit quality is supported by aggressive fiscal and monetary actions.

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