




## Fixed Income Review - April 2019

The positive trends of the first quarter extended into April with broad-based total return gains across nearly every major fixed-income category. Only the safest corners of the bond markets posted negative returns last month, albeit those losses were quite minor in contrast with the positive returns since the end of 2018.

Returns in April, across the spectrum of indices, were not as impressive as those seen in the first three months of the year. No one expected those types of moves nor would anyone, having enjoyed them, expect them indefinitely. The performance for the rest of the year no doubt depends more on coupon than price appreciation as spreads are tight and headwinds, especially in credit-sensitive sectors, are becoming more obvious as we will discuss below.

As mentioned, the only two modest losers in April were Treasuries and securitized products (mortgages, asset-backed, and commercial mortgages). Otherwise, the high yield sector again won the day head and shoulders above investment grade corporates, the next closest performer. According to the heat map below, like last month, all sectors are green across all longer time frames adding emphasis to the impressive rally seen since Christmas.

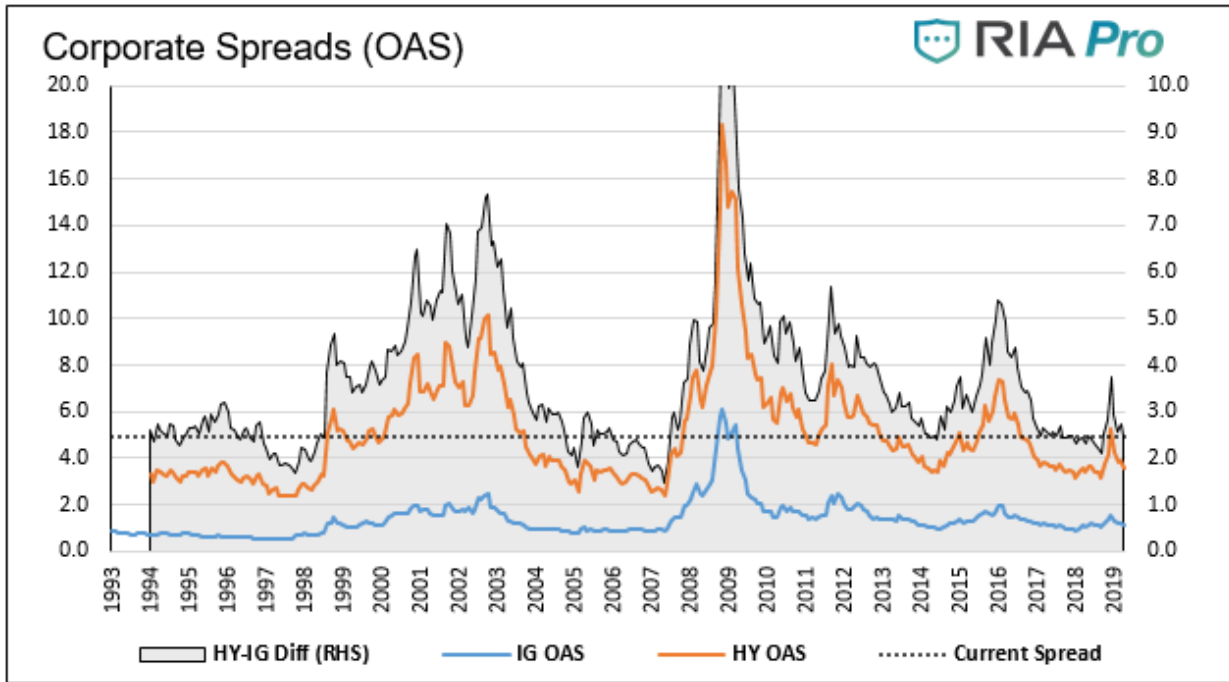
 RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return	Current Yield to Worst
U.S. Aggregate	0.03	1.89	2.95	5.29	2.97
Agg. Treasury	-0.28	1.35	1.83	4.77	2.41
Agg. Investment Grade - Corp.	0.54	3.28	5.62	6.50	3.60
Agg. High Yield - Corp.	1.42	4.08	8.55	6.74	6.12
Agg. Securitized (ABS, MBS, CMBS)	-0.04	1.37	2.18	4.97	3.17
Agg. Investment Grade - Muni.	0.38	2.51	3.25	6.16	2.30
Agg. Emerging Markets	0.40	2.58	5.75	5.88	5.32

Data as of 04/30/2019

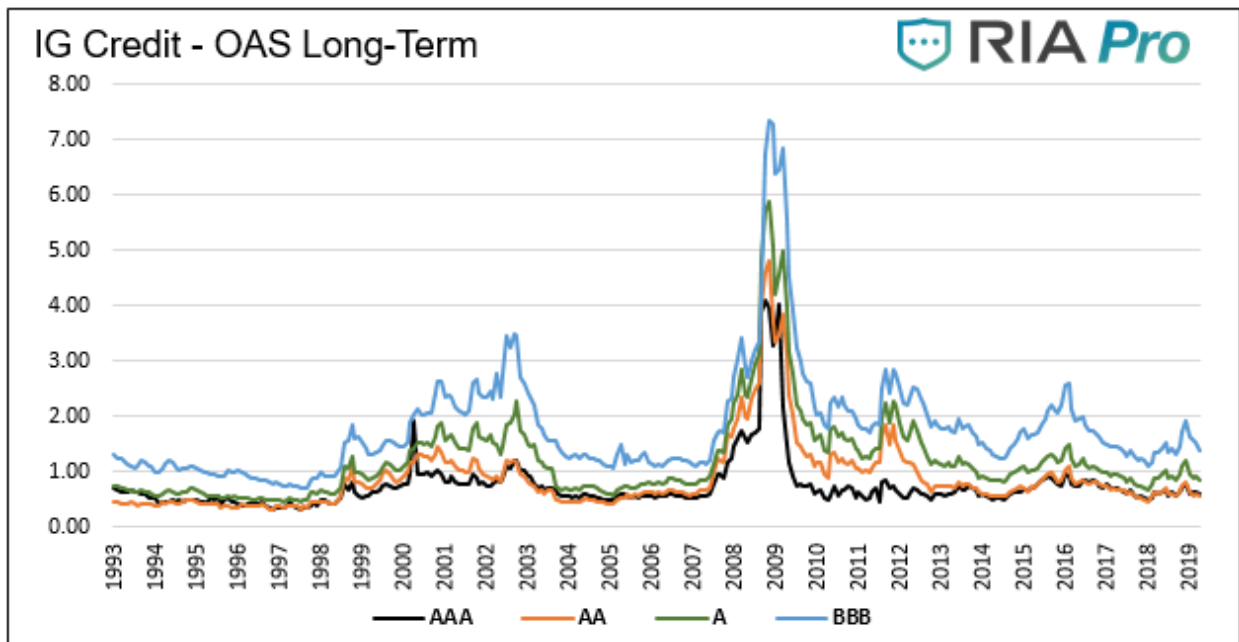
We would not speculate on the likelihood of this trend continuing, as odds favor a weaker performance trajectory. That does not mean poor performance, but risks rise with prices and spreads perched at historically tight levels.

The charts below illustrate the option-adjusted spreads (OAS) for the major categories in the corporate universe. They have all tightened dramatically since the end of the year. **If we are correct that the spread tightening is largely done, then the preference would be to play for safety, and some interest carry for the next few months.** In doing so, one may miss another unexpected move tighter in very risky high yield bond spreads; however, given current spread levels, one may also avoid increased odds of poor performance and possible losses.

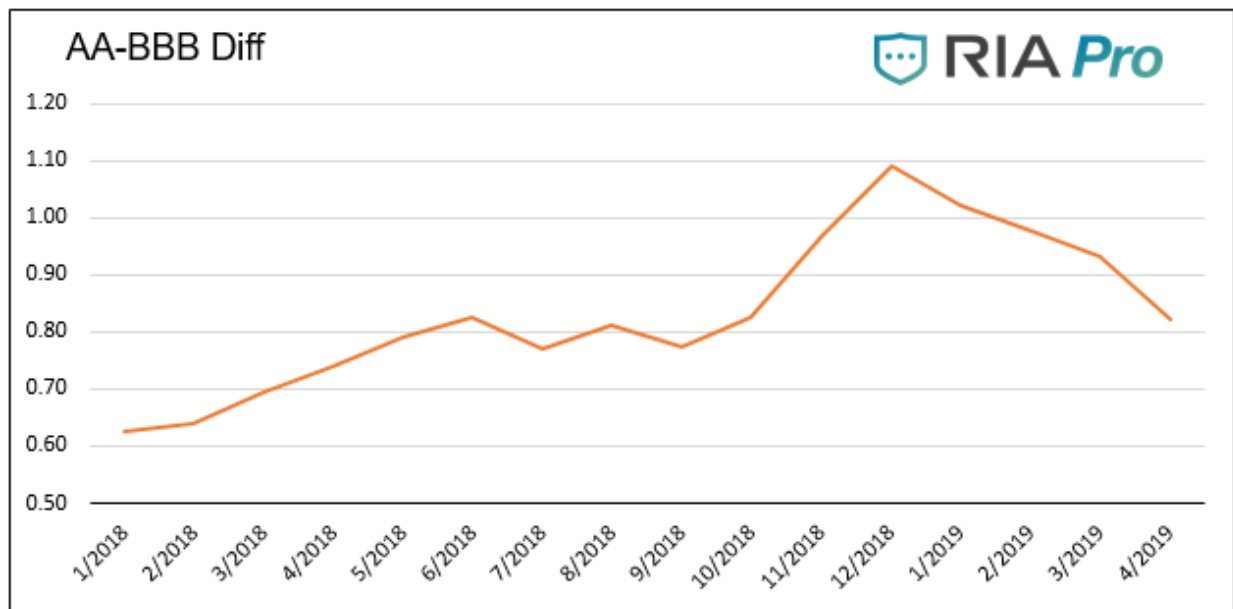
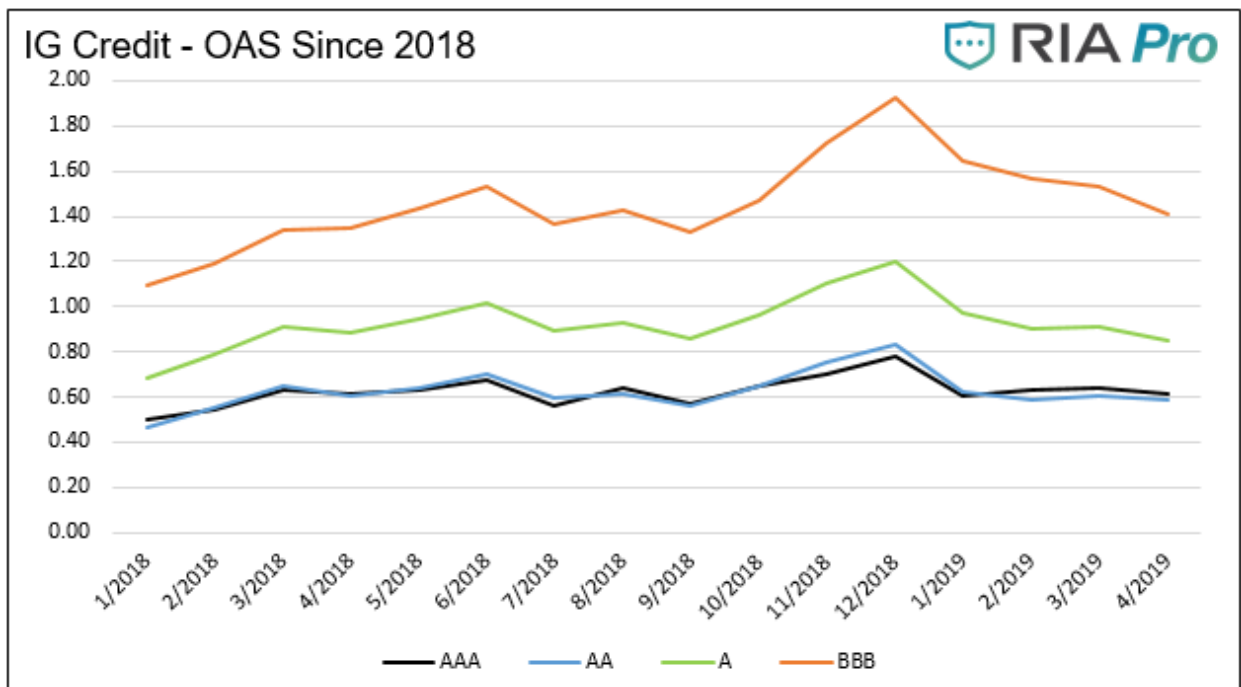
Understanding that compounding wealth depends on avoiding large, damaging, emotional losses we would prefer to accept the risk of lower returns with high-grade securities while reducing our exposure to the riskier, more volatile sectors.



Although cheapening more dramatically than the Investment Grade (IG) sector in the fourth quarter, High Yield (junk) bonds recaptured much of that in the first four months of this year and in doing so returns junk bonds to (more than) full-value status.



The same can also be said for the lower credit sectors within the IG population. A long-term perspective offers proper context for where valuations are today relative to the past 25 years. The risk is clearly skewed to wider credit spreads and cheaper valuations (losses).



### The Trend Continues

The recent tightening of spreads offers little new to discuss other than some *deceleration* of price and spread action. Importantly, and as recent articles have emphasized, this is a very late stage cycle rally. Risks are rising that corporate margin headwinds, slowing global economic activity, and a high bar for rate cuts given the optical strength of the economy limit the scope for price and spread gains in credit.

Overweighting lower rated credit sectors of the fixed income market is currently akin to the well-known phrase *?picking nickels up in front of a steam roller.?*

All Data Courtesy Barclays