


Monthly Fixed Income Review - January 2019

Blowing the Call


Before reviewing January returns in the fixed-income markets, we digress for a moment to raise important questions about the character and integrity of financial markets nudged and cajoled by Federal Reserve (Fed) officials. In the recent National Football League (NFL) playoff games, there were several occasions where poor or missed calls by the referees influenced the outcome of the game. Despite all of the technology, cameras, camera angles and new "Play Review" rules, NFL commissioner Roger Goodell acknowledged a significant and obvious missed call in the Rams-Saints game but said the game is, after all, "*officiated by humans*". Fans and announcers, outraged at the errors, charged Goodell with avoiding the important issues on the matter and some have gone so far as to say Super Bowl LIII was "tainted". And yet in financial markets, we continually speak of the referees at the Fed as an omnipresent force that *needs* to be called upon to influence outcomes. In doing so, the Fed regularly chooses winners and losers in the capital markets with obvious intent. Is there a difference between the NFL referees and the Fed? Yes, of course, the economy and the welfare of the nation is infinitely more important than a football game. Is it proper? Legal? Most investors assume so since it is carried out at the Fed on a daily basis just as enthusiastically as it is at the Peoples Bank of (communist) China. Now for the hard question: Is it in the best interest of the public? The answer: No, it is not. The January edition of our fixed income review reveals just as much about these nefarious interventions by the Fed in bond markets as we observed in equity markets over the past month. Our perspective and characterization of those interventions is out of consensus as most people see no harm (and great help) in the outside influences brought to bear. The problem is that whether immediately recognized or not, the Fed's involvement in manipulating outcomes to their preference similarly damages their integrity and that of our markets and economy. The difference is that the NFL, although not entirely owning up to the problem publicly, understands what is at stake and will likely take corrective action to minimize these issues in the future. The Fed does precisely the opposite delving ever deeper into the business of manipulating economic outcomes as if it is their obligation. For the Fed, their tone-deaf perspective presents far bigger problems for the dollar, interest rates, the deficit and a multitude of other matters that will reveal themselves gradually ? and then suddenly ? over time.

January Performance Overview

The change in the Fed's policy posture between the December 19, 2018 and the recent January 30th FOMC meeting is stark. They went from a Fed intent on raising rates two to three more times in 2019 and having balance sheet normalization on "autopilot" to implying that they will remain on "hold" in terms of rates hikes and moderating the pace of balance sheet reduction. The dovish shift appears to have put to rest any concerns of overtightening, the primary *narrative* behind fourth quarter turbulence. Markets clearly started to believe in the Fed shift in later December and the positive momentum in risk sentiment carried markets through January. For the month of January, every credit sector posted positive returns led by the riskiest categories of high yield, emerging markets and investment grade.

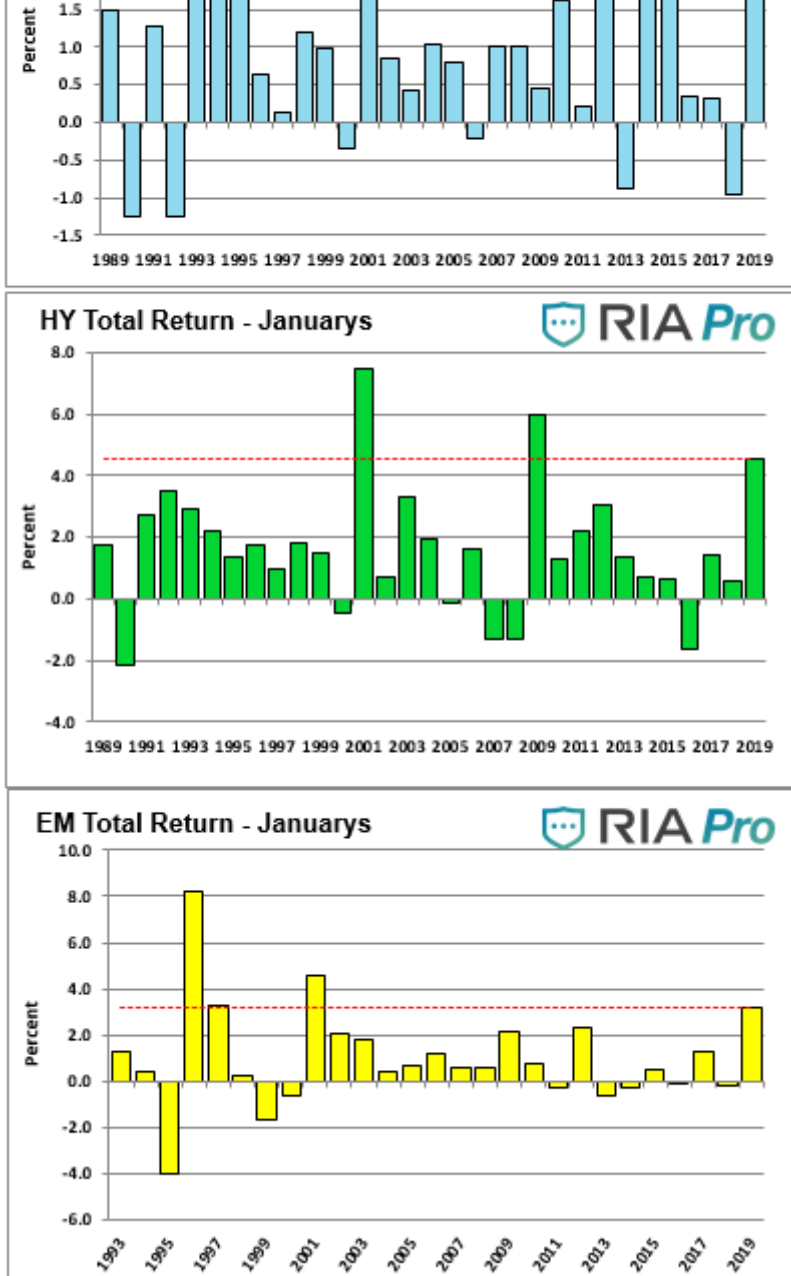
 RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return	Current Yield to Worst
U.S. Aggregate	1.06	3.53	1.06	2.25	3.15
Agg. Treasury	0.47	3.54	0.47	2.73	2.57
Agg. Investment Grade - Corp.	2.35	3.68	2.35	0.75	3.91
Agg. High Yield - Corp.	4.52	1.40	4.52	1.73	6.90
Agg. Securitized (ABS, MBS, CMBS)	0.80	3.50	0.80	2.99	3.28
Agg. Investment Grade - Muni.	0.76	3.09	0.76	3.26	2.58
Agg. Emerging Markets	3.19	4.43	3.19	0.82	5.54
Data as of 1/31/2019					

The story was the same for ETFs but with a few large variances from index performance owing to the uneven nature of flows quickly re-entering the riskiest classes.

 RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return
AGG (U.S. Aggregate)	0.91	3.45	0.91	2.16
GOVT (Agg. Treasury)	1.01	3.43	1.01	2.62
LQD (Agg. Investment Grade - Corp)	3.37	4.91	3.37	0.69
HYG (Agg. High Yield - Corp.)	4.94	2.34	4.94	2.77
MBB (Agg. Securitized (ABS, MBS, CMBS))	0.80	3.54	0.80	2.82
MUB (Agg. Investment Grade - Muni.)	0.38	2.86	0.38	2.48
EMB (Agg. Emerging Markets)	4.78	6.25	4.78	-0.31
Data as of 1/31/2019				

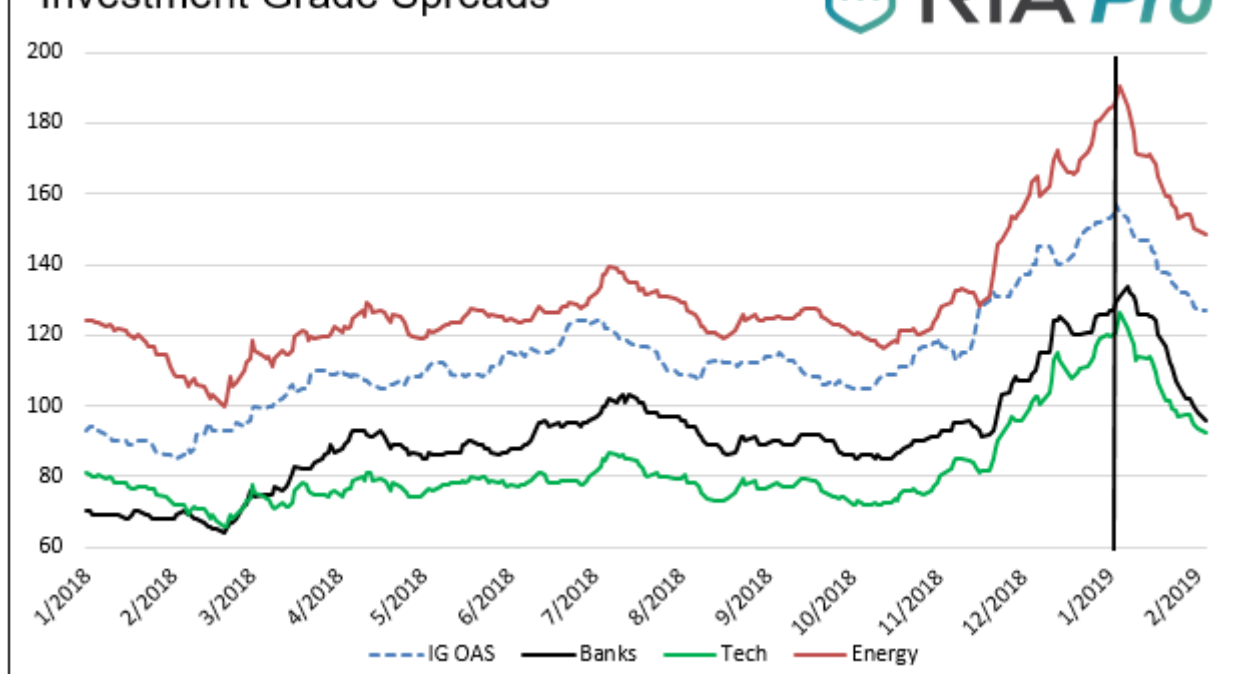
January Market Move

A lot was made of the fact that December was the worst month of December for the stock market since the 1930's. Using the same concept and to further highlight the strength of fixed income returns in January 2019, we compared last month with other Januarys over the past 30 years. Investment grade and high yield posted the third best month dating back to 1989 and emerging markets posted their fourth best since 1993 (earliest data available).



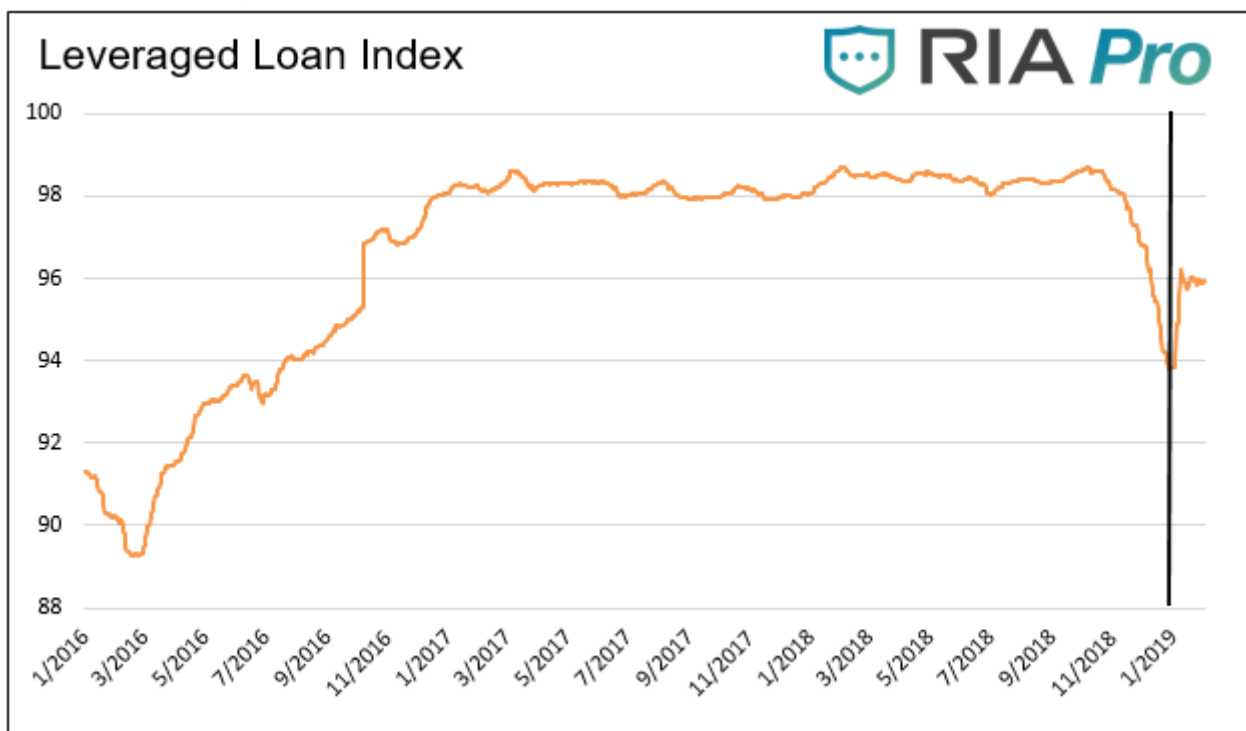
Drilling down a little deeper within the

investment grade category, we chose to look at the spread tightening that occurred in the banking, technology and energy sectors in January. The chart below shows the three sectors with the broad aggregate IG option-adjusted spread. The black vertical line marks December 31, 2018.



Using

similar context, the chart below highlights the *price movements* of the leveraged loan index since January 2016. Again, the black vertical line denotes December 31, 2018.



Summary

What the charts above reflect is the radical spread and price moves that took place as the Fed flipped their language and posture surrounding both future rate hikes and discussion about the pace of balance sheet normalization. What this suggests to us is not that the Fed is *data dependent* as they claim, but that they are entirely focused on assuaging market turbulence when it appears. Although anyone who watches sports cringes when a referee blows a call, no one is more humiliated than the referee himself. With the Federal Reserve, however, intentionally altering the game appears to be their daily objective. **All data courtesy: Barclays**