Fixed Income Review - March 2019

The first quarter of 2019 offered one of the most powerful surges in risky asset valuations seen in history. Closing at 2506 on December 31, 2018, the S&P 500 proceeded to rise 328 points (14.37%) to 2834 in the first quarter. The near vertical leap skyward corresponds directly to the abrupt change in posture from the Federal Reserve (Fed) as they eliminated all threats of rate hikes in 2019. They took the further step of announcing a schedule to halt quantitative tightening (QT).

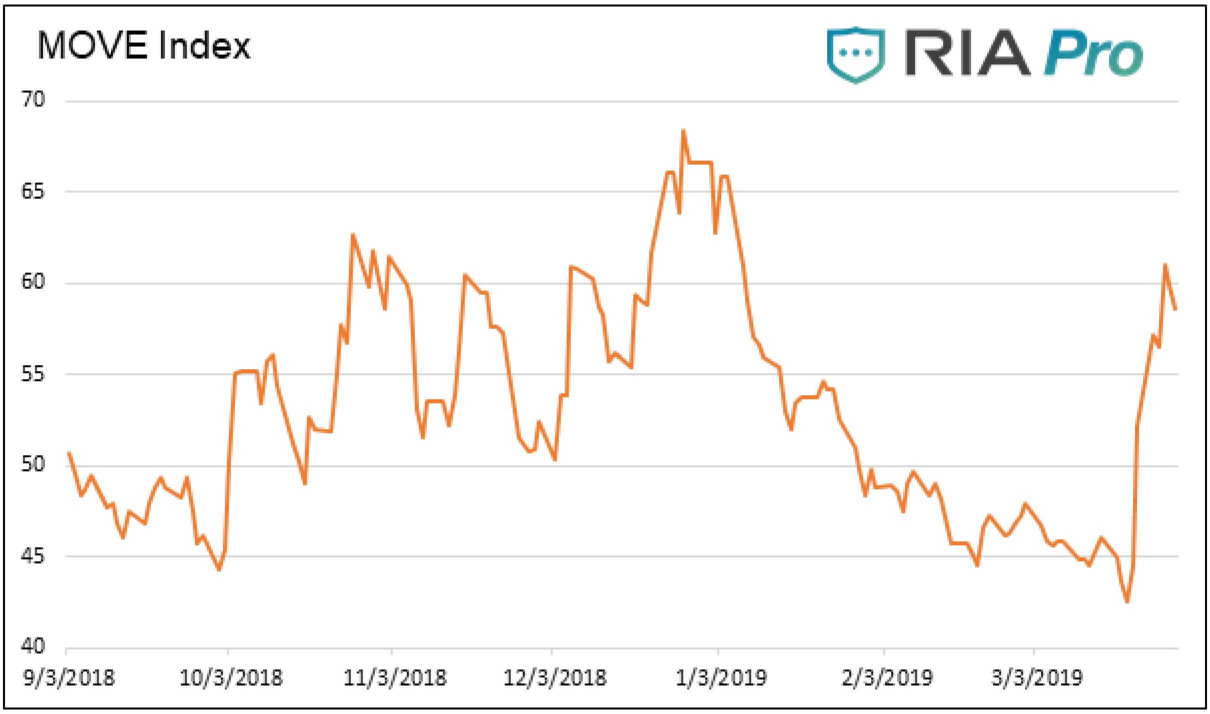
As might be expected, high yield credit was the best performing sector for the quarter with a total return of 7.26%. Somewhat counter-intuitively, U.S. Treasuries (+2.11%) also rallied for the quarter although they lagged all other major fixed-income sectors as shown in the table below.

RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return	Current Yield to Worst
U.S. Aggregate	1.92	2.94	2.94	4.48	2.93
Agg. Treasury	1.91	2.11	2.11	4.22	2.38
Agg. Investment Grade - Corp.	2.51	5.14	5.14	4.94	3.63
Agg. High Yield - Corp.	0.94	7.26	7.26	5.93	6.43
Agg. Securitized (ABS, MBS, CMBS)	1.46	2.22	2.22	4.48	3.07
Agg. Investment Grade - Muni.	1.58	2.90	2.90	5.38	2.32
Agg. Emerging Markets	1.37	5.43	5.43	4.38	5.31
Data as of 3/31/2019					

RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return
AGG (U.S. Aggregate)	2.12	2.94	2.94	4.57
GOVT (Agg. Treasury)	1.99	2.76	2.76	4.34
LQD (Agg. Investment Grade - Corp)	2.93	6.18	6.18	5.21
HYG (Agg. High Yield - Corp.)	1.29	7.59	7.59	6.53
MBB (Agg. Securitized (ABS, MBS, CMBS)	1.45	2.19	2.19	4.46
MUB (Agg. Investment Grade - Muni.)	1.48	2.42	2.42	4.69
EMB (Agg. Emerging Markets)	1.51	6.79	6.79	3.28
Data as of 3/31/2019				

For March, risk markets stalled slightly after the big run in the prior two months. Although posting returns of nearly 1%, high yield was the worst performer while investment grade was the best.

The contrast in performance between high-quality and low-quality bonds may be telling. In what could be a related issue, interest rate volatility in the U.S. Treasury market as measured by the MOVE Index spiked higher mid-month and had implications for the credit markets.



As shown in the tables below, only the BBB spread tightened slightly with all others widening by 1-3 basis points. Putting it together, despite solid total returns for the month, the spread widening tells us that corporate credit did not keep pace with falling Treasury yields in March, particularly at the end of the month.

Investment Grade

March Spread Change

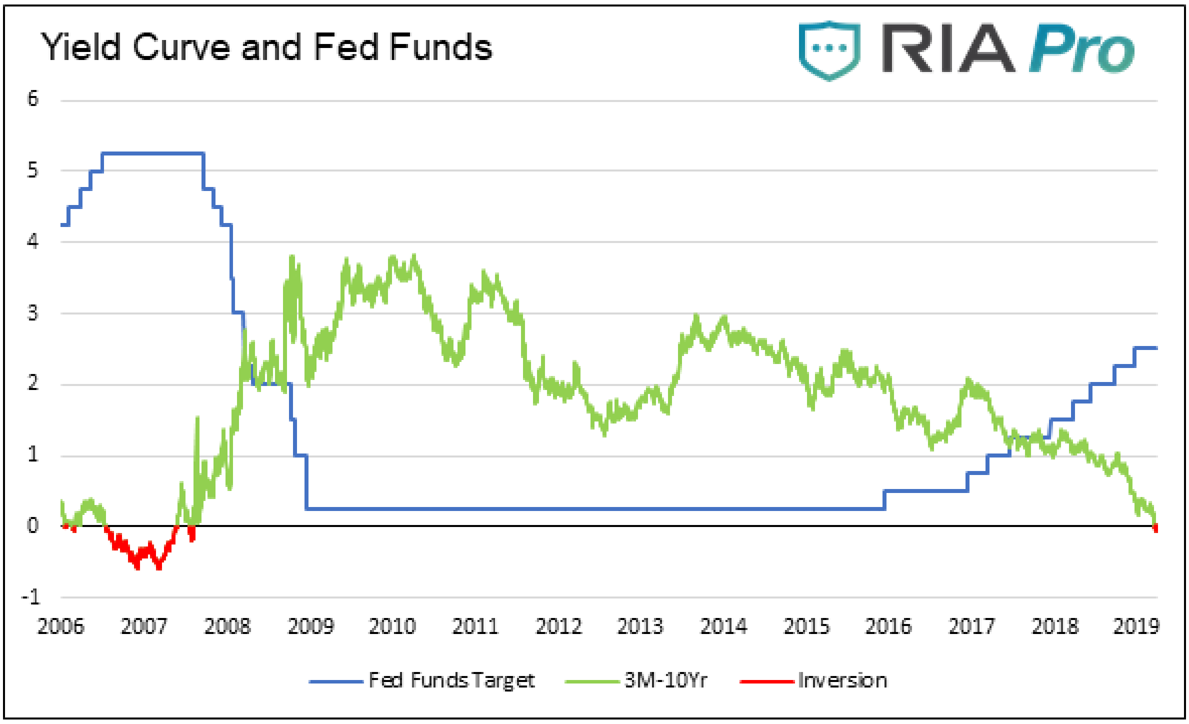
	AAA	AA	A	BBB
March	0.641	0.602	0.910	1.534
February	0.632	0.588	0.905	1.563
Diff	0.009	0.014	0.005	-0.029

High Yield

March Spread Change

	BB	B	CCC	CC-D
March	2.346	3.875	8.025	26.792
February	2.245	3.763	7.800	25.410
Diff	0.101	0.111	0.224	1.382

From a macro perspective, the changes in Treasury yields and the yield curve raise broad concerns. Namely, are we nearing the end of the current expansion? As discussed in far more detail in our prior article, Yesterday?s Perfect Recession Warning May Be Failing You, the yield curve has a durable track record of signaling major changes in the economic cycle especially when it inverts (longer-term interest rates drop below short-term rates). When an inverted curve is considered with the end of a Fed rate hike cycle, the evidence becomes even more compelling. The Fed abruptly altered their outlook for monetary policy in March putting to rest any concern for further hikes. The market is now pricing for 1 or 2 rate *cuts* in 2019.



RIA Pro	12/31/2018	3/31/2019	Change
2 Year Treasury Yield	2.480	2.270	-0.210
3 Year Treasury Yield	2.460	2.210	-0.250
5 Year Treasury Yield	2.510	2.230	-0.280
10 Year Treasury Yield	2.690	2.410	-0.280
2-3 UST Curve	-0.020	-0.060	-0.040
2-5 UST Curve	0.030	-0.040	-0.070
2-10 UST Curve	0.210	0.140	-0.070
5-10 UST Curve	0.180	0.180	0.000
Data as of 3/31/2019			

The last time we observed this combination of circumstances, an inverted curve and a market implying fed funds rate cuts, was ominously in late 2006. In October of last year, when the yield curve spread was decidedly positive, most economists including National Economic Council director Larry Kudlow pointed to this barometer and said we were nowhere near recession. The current market narrative now claims we should not pay too much attention to this important historical precedent. As opposed to trying to shape the narrative to suit our interests, we prefer instead to heed history. The odds are that this time is not different.

Time will tell.

All data sourced from Bloomberg and Barclays