January 2020

Fourth Quarter Fixed Income Letter to Clients

The United States bond markets experienced relatively sideways price action with interest rates moving slightly higher in the fourth quarter of 2019 in response to continued progress with US-China trade negotiations. The 10-year US Treasury bond yield remained below 2.00%, ending the quarter at 1.92%. Tax-Free Municipal Bonds broadly outperformed Treasuries. The iShares National Municipal Bond Index returned 0.59% for the quarter, bringing the 2019 one-year total return to 7.28%. Longer maturities and low-rated investment grade municipal bonds were the strongest performers for the year.

Bond investors have enjoyed strong returns in 2019. The large drop in yields and declining credit spreads combined to boost returns in a wide range of fixed income asset classes. In 2020, we expect returns to be more subdued. From current levels, yields are likely to move modestly higher, while there isn't room for credit spreads to fall further. Therefore, we expect returns to be in line with the current income offered on bonds, while price gains are likely to be limited.

In 2020, the lagged impact of the Fed's interest rate cuts, signs of stabilization in the global economy, and a modest uptick in inflation expectations should provide a boost to bond yields. We don't expect a large rise in economic growth, but even at a GDP (Gross Domestic Product) growth rate of about 2.00%, there is still room for bond yields to move modestly higher.

Our strategy for Fixed Income investors is to own a diversified portfolio of high-quality, investment grade bonds maturing in one to ten years, with the possibility of allocating up to 20% of capital to 25-30-year bond maturities depending on the client's circumstances. Our client's portfolios are designed to earn optimal after-tax returns while maintaining a relatively defensive portfolio structure given today's interest rate environment. Of course, each client has a unique set of circumstances that we focus on in order to customize the portfolio towards meeting their goals and investment objectives. Tax-free income, preservation of principal and targeted duration management is what makes a municipal bond portfolio an attractive investment for clients in a high tax bracket.

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