

April 2020

**First Quarter Fixed Income Letter to Clients**

Global financial markets sold off aggressively in March as investors reacted to the Coronavirus pandemic and the expected economic impact of the crisis. Typically, high quality assets such as investment grade municipal bonds perform relatively well during an extreme market selloff.

However, the S&P Municipal Bond Index fell more than 10% in just a few days but recovered just as quickly after the Federal Reserve & US Treasury announced policy to support municipal bonds. Municipal Bonds ended the month of March down -3.34%, adjusting year-to-date total returns to -.058%.

Municipal bonds delivered strong results in 2019 and impressive demand continued to be strong in 2020 before the onset of this overnight crisis. A streak of 60 consecutive weeks of funds flowing into municipal bonds, quickly shifted to record outflows in March. Investors moved into cash or reallocated into cheaper asset classes as volatility spiked.

A week after the initial panic, investor sentiment improved as a variety of stimulus measures were implemented, including liquidity facilities from the Fed and the CARES Act, which provided funding to municipal entities and allows Fed loans to and investments in municipalities.

The municipal market is a high-quality asset class with a majority of its bonds rated AA or better. Most states and municipalities were in strong fiscal health before the crisis. The concern for the municipal market going forward is if a prolonged recession were to occur and sales tax collections, fees, along with tolls and other use charges were to reduce materially, then some defaults may occur. That said, we maintain a slightly defensive posture in municipal bond portfolio allocations where diversification among 100% investment grade bonds is critical. In addition, portfolios should maintain some cash in order to take advantage of opportunities that often present themselves during periods of market turmoil.

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