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January 2021

Fourth Quarter Fixed Income Letter to Clients

The US Bond Market closed the year on a strong note from the year's start on January 2, 2020. The US Treasury 10-year bond began the year at a yield of 1.88%, and ended the year at 0.93%, similarly at the long end of the curve, the US Treasury 30-year bond, started the year at 2.33% and closed the year at 1.65%. Although the pandemic brought about the sharpest and most severe selloff of modern history, the S&P Municipal Bond Index ended 2020 with a gain of 4.95% as robust demand for tax-exempt bonds broadly outpaced supply. And given the key macro highlights heading into 2021, which are the uncertainties surrounding the spread of COVID, the success of newly developed vaccines in conjunction with the rollout of inoculations, the timing of the shutdown sectors of the economy reopening, the country's politically polarized environment spilling over into unlawfulness, and government stimulus, we believe that volatility will be the primary investment theme for 2021. That said, our outlook is based on prudent risk management, flexibility, and expertise to navigate the diverse fixed income marketplace.

The consensus view regarding interest rates among economist surveys for 2021 reveal boosted expectations for inflation. We believe that early 2021 will be pivotal in determining whether the emerging US reflation expectation can really gather steam in 2021. And if inflation does continue to show itself on both the service and the goods sides of the economy, then the question will quickly become, "to what extent will inflation grow?"

Despite greater volatility in interest rates, we expect demand for municipal bonds to remain firm and continue to outpace supply in 2021. Our primary focus in managing fixed income portfolios will be to assess the risk of, and the corresponding magnitude of, reflation. We believe that the fixed income market will continue to offer attractive opportunities in the year ahead.

Our portfolio structuring strategy is to slowly add bond positions to fixed income portfolios while maintaining a bit more cash than usual to take advantage of a possible more volatile interest rate environment to find opportunities where we can trade into bonds at higher yields.

Evan Slater
Fixed Income Portfolio Manager