# Fixed Income Commentary

March 4, 2020

KEY TAKEAWAYS

Bond yields plummeted in February as investors were looking for safe havens in response to the equity market sell-off due to the COVID-19 virus. Going forward, investors will be assessing the global economic impact caused by the COVID-19 virus and evaluate the duration and magnitude of the impact. Meanwhile, spreads moved wider in all sectors due to the rapidly deteriorating fundamental back-drop.

| Key Rates (%) | Feb 29 2020 | Jan 31 2020 | Dec 31 2019 |
|---|---|---|---|
| **Treasury Yields** | | | |
| 2 Year | 0.93 | 1.31 | 1.57 |
| 5 Year | 0.94 | 1.31 | 1.69 |
| 10 Year | 1.15 | 1.51 | 1.92 |
| 30 Year | 1.68 | 2.00 | 2.39 |
| **Credit Yields** | | | |
| BBB Industrial 10 Year | 2.41 | 2.72 | 3.10 |
| **Muni Yields** | | | |
| AAA 10 Year | 0.98 | 1.18 | 1.48 |
| **Mortgage Backed Securities** | | | |
| 30 Year FNMA Current Coupon | 2.18 | 2.38 | 2.71 |

FEBRUARY IN REVIEW

- The 10- year Treasury yield finished the month with a yield of 1.15%, down 36 bps month over month.
- Treasuries were the strongest performing sector, up 2.65% for the month.
- The high yield index was down 1.41%.

## Skating on Thin Ice

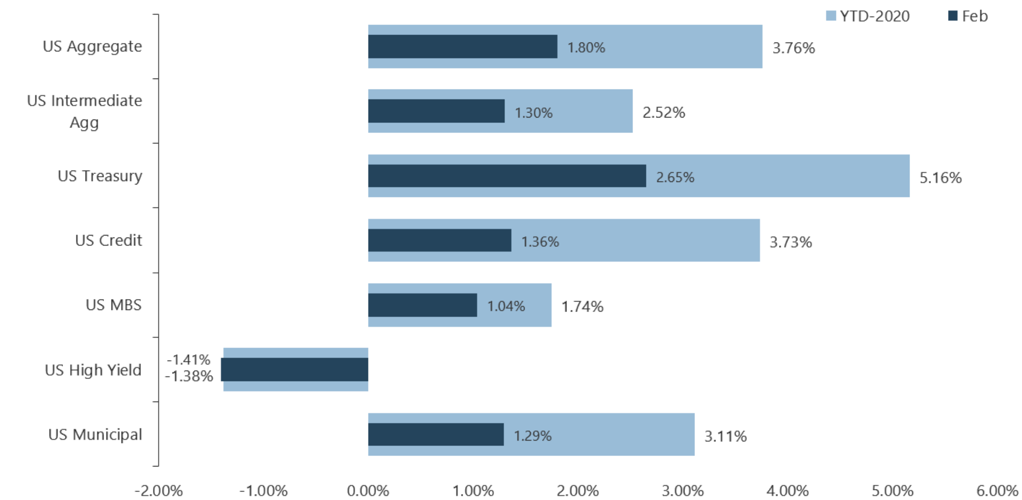

**Skating on thin ice was a real danger in parts of Vermont** in February due to unseasonably warm weather. The phrase is also an apt metaphor for the current economic outlook following two significant developments last month: after hitting all-time record highs, equity market indices fell sharply and swiftly, and the COVID-19 virus suddenly presented a significant threat to global growth. In response, bond yields plummeted, with yields on some maturities hitting new lows. Yields on Treasuries were down 30 to 40 basis points in February and the ten-year Treasury ended the month yielding just 1.15%, well below the low of 1.36% seen in 2016. In a world where prevailing interest rates in many countries are negative, this move is significant.

**In response to this sudden change in financial conditions**, the FOMC cut the target range for the fed funds rate on March 3 by 50 basis points to 1.00-1.25%. This surprise intra-meeting cut may be part of a coordinated move among other central banks to instill confidence in the markets, but it also may backfire by demonstrating how worried policymakers are about the economic fall-out from the COVID-19 virus. It's not clear a reduction in short term rates will have much affect on an economy that has been enjoying low rates for the last decade. We believe the low growth rates across developed economies reflect key structural problems such as demographic factors, fiscal profligacy, aging populations, and excess supply. Rate cuts at this juncture limit the Fed's options when the economy is truly in need of stimulus, and the concern that US rates may follow Europe and Japan into negative territory is rapidly gaining momentum. Regrettably, we believe this sudden policy shift is a mistake and a reflection of a Fed that has become too politicized.

**One of the chief reasons for the equity market slide was the COVID-19 virus** which has now killed more than 3,000 people around the world and could become a global pandemic before long. The efforts to contain the virus have resulted in factory closures, travel bans, and drastically reduced public activity, all in an attempt to limit the spread of this new deadly strain. This abrupt decline in economic activity by such a large population center in

China has many multinational companies regretting their sourcing strategies. While likely temporary, impacts to earnings from these closures will affect a broad cross-section of companies, and some will not be able to recoup the loss of sales. As the virus spreads globally, the fear is that similar measures may be implemented more broadly to protect the public, or that consumers will simply refrain from many of their normal public activities out of fear.

**EXHIBIT 1: FIXED INCOME MARKET TOTAL RETURNS**




Source: *Recession Readiness*, PFM Group Consulting LLC, January 2020

**This threat to the economy comes at a vulnerable time since most economists were projecting slower growth this year,** both in the US as well as China, and the manufacturing sector was already in decline due to last year's trade war. An exogenous event such as the COVID-19 virus could be the catalyst for this longest economic recovery on record to finally run out of steam. When coupled with a hit to equity values and a corresponding decline in consumer and business confidence measures, the outlook is not encouraging.

**As global risk assets sold off last week, spreads on corporate bonds, municipal bonds, and mortgage-backed securities moved wider,** not surprising given the deteriorating fundamental backdrop. We have opined repeatedly in this space that spreads were more likely to widen and it was challenging to find value, so this is a welcome development for new money being put to work. The steady decline in Treasury yields has also kept call activity elevated, and mortgage prepayment activity is also moving higher as homeowners look to refinance their higher-coupon mortgages yet again.

**Going forward, it seems likely the markets will experience more volatility, particularly equities.** With the election looming, each of the candidates' platforms will come in to focus which could result in some investors altering certain industry outlooks. Bond yields are vulnerable to a back-up should the COVID-19 panic begin to fade, but a further decline is also possible if the virus does produce enduring changes in consumer behavior. We continue to find good value in taxable municipal bonds and will look to add more opportunistically.

**Thank you for your continued confidence in Maple Capital Management.**



535 Stone Cutters Way, Montpelier, VT 05602 •
Tel: 802.229.2838 • Toll Free: 800.255.9946 Fax: 802.229.2837
533-D Johnson Ferry Rd • Suite 350 • Marietta, GA 30068 •
Tel: 770.693.7690 • Fax: 770.512.5176

MAPLE CAPITAL
MANAGEMENT