COMMENTARY

FIXED INCOME

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Fourth Quarter 2020

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MARKET REVIEW

Our expectations of volatility in the capital markets has materialized, and the yield curve has begun to steepen, as we wrote about last quarter. With the short end of the yield curve anchored at historically low levels, the move in the curve from 7 years and out is just as has happened over past economic cycles. Historically we see an inverted yield curve, followed by a dramatic flattening, and eventually a steepening as the economy recovers. Our tactical shift in longer duration accounts certainly drove a majority of total return for the quarter and the year.

INDEX RETURNS FOR THE PERIOD ENDING DECEMBER 31, 2020

	Q4 2020	YTD
BB Aggregate	0.67%	7.51%
Corporate	3.05%	9.89%
Treasuries	-0.83%	8.00%
ABS	0.36%	4.52%
Mortgages	0.25%	3.87%
High Yield	6.45%	7.11%
Municipal	1.82%	5.21%
2-year Treasury	0.04%	3.07%
10-year Treasury	-1.91%	10.61%
30-year Treasury	-4.18%	18.72%

Source: Bloomberg

SECTOR HIGHLIGHTS

Credit

- Corporate Spreads were tighter by 36 basis points in the fourth quarter.
- Longer dated securities outperformed shorter dated securities and BBB rated securities outperformed A rated securities.

Mortgage-Backed Securities

- Mortgages returned only 25 basis points for the 4th Quarter making Agency MBS the worst performer within structured products.
- Year to date, Agency MBS excess return was negative 17 basis points.
- The rate rally throughout the year made it difficult for mortgages to outperform, as low interest rates drove massive refinancing within the sector.
- Lower coupons outperformed as did 15 year versus 30 year paper.
- The Fed as well as banks continue to support current coupon purchases which lends technical support to the market.
- We prefer story paper like low loan balance bonds that offer better convexity and carry than current coupon bonds.

Asset-Backed Securities

- ABS posted another strong quarter of returns with 36 bps of total return.
- Supply picked up over the quarter, but on a year-over-year basis overall ABS supply was down nearly 20%.
- Any supply throughout the quarter was easily met by institutional demand trying to garner any extra yield in the current rate environment.
- We continue to maintain our ABS positions as a yield pick up to short treasury holdings.

Commercial Mortgage-Backed Securities

- CMBS returned 62 basis points of total return for the quarter.
- Senior AAA LCF CMBS paper outperformed with spreads tightening 15 basis points heading into year-end.
- We continue to maintain our ABS positions as a yield pick up to short treasury holdings.

Treasuries

- Treasuries had a rather volatile fourth quarter, returning a negative 83 basis points. The 10 year treasury yield started the quarter at 0.68% and ended at 0.91%, approaching that psychologically important 1% mark.
- Rates increased on the long end as the bond market saw stronger future growth from a clear Biden/Harris presidential victory, COVID vaccines being distributed, and prospects of more stimulus payments.
- The most noticeable move for yields in the quarter across the entire curve happened in the 7 to 30 year tenor where rates increased about 17 to 20 basis points.

Municipals

- The AAA muni curve shifted lower over the past quarter, in stark contrast to the treasury curve. Rates were lower by anywhere from 10 to 20 basis points in the 5 to 30 year part of the curve, making munis rich to taxables.
- Returns for the quarter were positive in all Muni composites. The 1-10 year index returned 0.98% for the quarter, and 4.23% for the year, while the 3-15 year index returned a positive 1.46% and 5.04% for 2020. The 1-5 year index numbers were also positive, coming in with 0.44% for the quarter and 3.15% for 2020.
- Continued demand and decreasing relative supply drove rates lower, as investors may expect to see higher tax rates from a new democratic presence in the White House.

GLA FIXED INCOME PRELIMINARY RETURNS[1]

	Q4	YTD
Core	0.74%	8.81%
BB Agg	0.67%	7.51%
Intermediate G/C	0.81%	7.68%
BB Int G/C	0.48%	6.43%
Short Term	0.73%	4.33%
BB Gov/Credit 1-3	0.21%	3.33%
Municipal	1.24%	4.53%
BB Muni 1-10	0.98%	4.23%

CORE FIXED

- We outperformed by 7 basis points versus the index for the quarter.
- Our overweight to Corporates added about 20 basis points, however our selection detracted 22 basis points, as we held less longer-dated corporate bonds versus the benchmark, specifically in the energy sector.
- Our underweight to Mortgages added 4 basis points.
- Treasuries added 4 basis points, and our ABS exposure had little effect on return for the period.

INTERMEDIATE FIXED

- Intermediate portfolios outperformed by 33 basis points for the fourth quarter of 2020.
- Our allocation to spread product was the main driver of performance as we out-yielded and carried better than the benchmark.
- Longer corporates (7-10 years) outperformed shorter corporates.
- The portfolio overweight to the financial sector added 25 basis points.
- Our MBS and Agency CMBS provided positive performance for the quarter.
- We continue to overweight spread product going onto the new year.

SHORT-TERM FIXED

- We outperformed the index by 52 basis points.
- ABS added 3 basis points, and MBS added 1 basis point.
- Our overweight to Corporates added 20 basis points, and our underweight to Treasuries added 8 basis points.
- Our selection within Corporates added 19 basis points with Financials adding the most alpha.

MARKET OUTLOOK

Looking ahead, we are content to maintain our posture of underweighting all-in duration and increasing exposure in credit in the five year area. The specter of rising long-term rates and an expected increase in inflation suggests that we should be well positioned over the near-term. Although we believe we will see higher rates in 2021, especially on the long-end, Federal Reserve actions could suppress higher rates if they decide to issue longer-dated treasuries when borrowing over $1 trillion in just the first quarter of 2021. Also, there are some fears that a more contagious strain of COVID-19 could spread across the U.S., stalling any chance of improving upon the economic recovery. Indeed, in the near-term we will need to keep a close eye on The Fed's actions, results of the Georgia Senate election, and any further increase in the spread of the COVID-19 virus.

1. Returns are preliminary and from a representative account.

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