COMMENTARY

FIXED INCOME

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

First Quarter 2021

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MARKET REVIEW

Our expectations of volatility in the capital markets has indeed materialized, and the yield curve continues to steepen, as we wrote about last quarter. With the short end of the yield curve still anchored at historically low levels, the move in the curve from 5 years and out is almost right on cue, just as has happened over past economic cycles. Over the past quarter, the curve is higher by 58 bps in the 5 year, about 85 bps in the 10 and 20 year, and 77 bps on the long end. The long end volatility is highlighted in the chart below. Junk Bonds were the sole positive for the period. 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 MARCH 31, 2021

	QTD/YTD
BB Aggregate	-3.37%
Corporate	-4.65%
Treasuries	-4.25%
ABS	-0.16%
Mortgages	-1.10%
CMBS	-2.32%
High Yield	0.85%
Municipal	-0.35%
2-year Treasury	-0.04%
10-year Treasury	-7.02%
30-year Treasury	-15.84%

Source: Bloomberg

SECTOR HIGHLIGHTS

Credit

- Corporate Spreads were tighter by 5 basis points in the first quarter moving from 96 to 91.
- Shorter dated securities outperformed longer dated securities and BBB rated securities outperformed A rated securities.

Mortgage-Backed Securities

- Mortgages returned -1.10% on a total rate of return basis for Q1 2021.
- On a duration adjusted basis mortgages could not outperform their treasury counterparts.
- Fed and bank support could not bolster mortgage performance over the quarter.
- Across the coupon stack, performance was a mixed bag.
- The 1.5% coupon was removed from Fed purchase program causing the coupon to underperform.
- We have not changed our mortgage strategy and continue to prefer story paper like low loan balance bonds that offer better convexity and carry than current coupon bonds.

Asset-Backed Securities

- ABS returned -0.16% basis points for the quarter.
- Supply slowed down over the quarter, however demand did not – this allowed for strong secondary trading and kept spreads in-line.
- We continue to maintain our ABS positions as a yield pick up to short treasury and corporate holdings.

Commercial Mortgage-Backed Securities

- CMBS returned -2.32% of total return for Q1 2021.
- AAA CMBS, like MBS, could not outperform duration neutral treasuries, while lower in the coupon stack spreads were mixed as investors reached for yield.
- The Fed announced it would drop ACMBS from the purchase program. Spreads, however, remain firm as supply/demand dynamics persist.
- We continue to hold AAA CMBS as well as Agency CMBS paper as a yield pick-up vehicle versus treasuries.

Treasuries

- Treasuries returned -4.25% in the first quarter of 2021.
- The 2yr, 10yr, and 30yr parts of the curve returned -0.04%, -7.02%, and -15.84%, respectively.
- The curve steepened significantly in the first quarter of 2021. The 2yr/10yr and 2yr/30yr parts of the curve steepened 78 basis points and 72 basis points, respectively.
- With the Fed's desire for the inflation rate to be sustained above 2% and expectations for strong growth in 2021 on the back of increased vaccinations and the $2T stimulus package, longer-term rates should continue to move higher. However, short-term treasury rates should be anchored near zero as the Fed plans to keep the fed funds rate at zero for the foreseeable future, possibly until 2023.

Municipals

- Despite continued inflows into tax-exempt funds, muni rates rose mid-February to end up about 35 basis points cheaper at the quarter end.
- Returns for the quarter were negative in all Muni composites except for the short indices. The 1-10 yr. Index returned -0.26% for the quarter, while the 3-15 year Index returned -0.38%. The 1-5 yr Index numbers were flat, coming in with .00% for the quarter.
- Continued demand and decreasing relative supply drove rates lower until rates in general moved higher in other fixed classes, as investors assume higher tax rates from a new Democratic presence in the White House to pay for stimulus funding.

GLA FIXED INCOME PRELIMINARY RETURNS AS OF MAR 31, 2021[1]

	QTD/YTD
Core	-3.01%
BB Agg	-3.37%
Intermediate G/C	-1.76%
BB Int G/C	-1.86%
Short Term	-0.15%
BB Gov/Credit 1-3	-0.04%
Municipal	-0.07%
BB Muni 1-10	-0.26%

CORE FIXED

- We outperformed by 36 basis points versus the index for the quarter.
- Our duration call was the primary driver of these returns, we were underweight the longer part of the treasury curve which experienced larger losses. The duration positioning added 62 basis points.
- Our overweight to Corporates added about 5 basis points.
- Our underweight to Mortgages added 35 basis points which underperformed as rates rose.
- Treasuries detracted 7 basis points, and our ABS were not significant contributors or detractors.

INTERMEDIATE FIXED

- Intermediate Gov/Credit outperformed its benchmark by 10 basis points for Q1 2021.
- Duration and curve exposure led performance for the quarter.
- Portfolios are short duration versus the benchmark at 90%. We are short via 10 year treasuries which had been positive for performance.
- Also, our overweight to spread product versus treasuries provided approximately 8 basis points but selection was poor.
- Short corporates and mortgage securities outperformed for the quarter.
- Mortgages and our allocation to the technology sector were positive as well.

SHORT-TERM FIXED

- We underperformed the index by 11 basis points.
- Our duration call was the primary driver of these returns. We were overweight the longer part of the treasury curve which experienced larger losses as a way to enhance yield, but overall short the shorter part of the curve, with a net short duration call. The duration positioning detracted 15 basis points.
- ABS added 2 basis points which are short dated assets, and MBS added 1 basis point.
- Treasuries detracted 2 basis points.
- Our overweight to Corporates detracted 12 basis points primarily because of how we are positioned on the curve.

MARKET OUTLOOK

For the year 2021, we are content to maintain our posture of underweighting all-in duration and increasing exposure in credit in the five year area. The continued 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 throughout 2021, especially on the long-end, the Federal Reserve could begin to suppress higher rates if they decide to issue longer-dated treasuries when borrowing over $1 trillion in just the first quarter of 2021. At some point in late 2021 we may see some buyer finding the long-end duration, just NOT YET. Also, continued fears that this variant strain of COVID could spread across the U.S. may stall chances of improving upon the economic recovery. The vaccination process has yielded a positive outlook by the rapid rate of people being inoculated. Indeed, in the near-term we will need to continue to keep a watchful eye on The Fed’s actions, government spending, and any further increased spread of the COVID virus.

1. Returns are preliminary and from a representative account as of March 31, 2021.

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