

COMMENTARY

FIXED INCOME



GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

MANAGER COMMENTARY

Second Quarter 2021

Patrick Morrissey
Head of Fixed Income

Nancy Studenroth
Senior Portfolio Manager

Brian Schuster, CFA®
Senior Portfolio Manager

Richard Rokus, CFA®
Senior Portfolio Manager

David Kopp
Portfolio Manager

MARKET REVIEW

The bond market is wrestling with two main dynamics. First, whether inflation is transitory or not, and second, when will the Fed start to taper their QE program and possibly even raise interest rates. Looking at the second point, economic data was very strong in Q2, the ISM was above 60, ISM Services reached an all-time high of 64, and GDP increased to 6.4 quarter over quarter. However, the jobs market has been weaker than expected, which is likely due to a combination of the continued unemployment insurance payments and lack of child care during the summer months. We anticipate a strong jobs recovery in the 2nd half of this year as schools return to full in-person learning and the unemployment insurance runs out. Therefore, with solid economic data and the possibility of a better labor market, the question becomes will the Fed start to taper their QE program and raise interest rates sooner than expected? In regards to the first point, in Q2 the market started to believe inflation would be transitory with PCE possibly peaking around 3.9% year over year. Prices should flatten out and inflation should fall as global supply issues start to resolve themselves. We are seeing this in the breakeven numbers with the 2yr, 5yr, and 10yr numbers down from their peak in mid-May, ending Q2 at 2.7%, 2.5%, and 2.3%, respectively.

INDEX RETURNS FOR THE PERIOD ENDING JUNE 30, 2021

	QTD	YTD
BB Aggregate	1.83%	-1.60%
Corporate	3.55%	-1.27%
Treasuries	1.75%	-2.58%
ABS	0.34%	0.18%
Mortgages	0.33%	-0.77%
CMBS	1.87%	-0.50%
High Yield	2.74%	3.62%
Municipal	1.42%	1.06%
2-year Treasury	-0.09%	-0.13%
10-year Treasury	3.06%	-4.17%
30-year Treasury	7.83%	-9.25%

Source: Bloomberg

SECTOR HIGHLIGHTS

Credit

- Corporate Spreads were tighter by 5 basis points in the second 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 0.33% on a total rate of return basis for Q2 2021, bringing YTD performance to -0.77%.
- Mortgage spreads have remained range bound through most of the quarter as Fed buying and bank purchases have lent support to spreads.



- Refi activity has dropped sharply for lower coupon mortgages, but still remains healthy in the higher coupons.
- Performance has been tight around all coupons, conventionals versus GNMA and 15 year versus 30 year.
- 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 0.34% for Q2 and 0.18% year-to-date on a total rate of return basis.
- The new issue market picked up in the quarter with nearly \$125 billion issued to date.
- Consumer credit continues to improve as more of the economy comes online.
- We continue to maintain our ABS positions as a yield pick up to short treasury and corporate holdings.

Commercial Mortgage-Backed Securities

- CMBS returned 1.87% of total return for Q2 and -0.50% year-to-date on a total rate of return basis.
- AAA LCF CMBS only tightened 5 basis points year to date. The down in credit trade has driven CMBS performance. BBB CMBS tightened as much as 90 basis points this year.
- We continue to hold AAA CMBS as well as Agency CMBS paper as a yield pick-up vehicle versus treasuries.

Treasuries

- Treasuries returned 1.75% in the second quarter of 2021.
- The 2yr, 10yr, and 30yr parts of the curve returned -0.09%, 3.06%, and 7.83%, respectively.
- The curve flattened in Q2 with the pivot point at the 5yr tenor. The 2yr/5yr flattened 14 basis points, 2yr/10yr flattened 36 basis points, and the 2yr/30yr flattened 41 basis points in Q2.
- The treasury curve did unexpectedly flatten in Q2 with the prospects that inflation will be transitory, a weaker than expected labor market, and the possibility that we have reached peak economic growth.

Municipals

- With continued inflows into tax-exempt funds, muni rates dropped throughout the period to end up about 25 basis points lower at the quarter end.
- Once again, continued demand and decreasing relative supply drove rates lower, 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 JUNE 30, 2021¹

	QTD	YTD
Core	1.79%	-1.28%
BB Agg	1.83%	-1.60%
Intermediate G/C	1.11%	-0.67%
BB Int G/C	0.98%	-0.90%
Short Term	0.34%	0.18%
BB Gov/Credit 1-3	0.04%	0.00%
Municipal	1.12%	1.05%
BB Muni 1-10	0.62%	0.36%

CORE FIXED

- We underperformed by 4 basis points versus the index for the quarter.
- Our duration call hurt us during the quarter as longer-dated duration assets outperformed. We are underweight the longer part of the treasury curve which experienced larger gains. The duration positioning detracted 38 basis points.
- On an asset class basis, our overweight to Corporates added about 16 basis points with spreads tightening for the quarter. Most of this return was derived by our overweight.
- Our underweight to Mortgages added 7 basis points as the asset class underperformed the index.
- Our overweight to ABS detracted 10 basis points as the asset class underperformed the index.
- Treasuries detracted 15 basis points as we are underweight and Treasuries performed in line with the index.

INTERMEDIATE FIXED

- Intermediate Gov/Credit outperformed its benchmark by 13 basis points for Q2 2021.
- Portfolio allocation was the lead performer for the quarter. Portfolio duration, curve exposure, and selection all deterred from overall performance.
- Curve flattening over the quarter was the main culprit for performance give up as the portfolios continue to be short duration via the 10 year.
- Intermediate securities outperformed in the portfolio.
- Our mortgage allocation contributed roughly 5 basis points for the quarter.



- 7-10 year corporates also provided solid performance.

SHORT-TERM FIXED

- We outperformed the index by 30 basis points for the quarter.
- Duration in the front of the curve was significantly less volatile than last quarter, and this added 3 basis points to the returns for the quarter. The two year underperformed for the quarter which benefited us. We continue to have a barbell position with an overweight to 4 year names, and an overweight to less than one year securities.
- ABS added 18 basis points for the quarter, which are short-dated assets with relatively wider yields than corporates.
- Corporates added 9 basis points for the quarter, with both selection and our allocation contributing equally.

MARKET OUTLOOK

For the remainder of 2021, we are content to maintain our posture of underweighting all-in duration and increasing exposure in credit in the five year area despite rates seeming to want to grind lower. 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, albeit a painful position to take at times. Although we believe we will see higher rates later in 2021, we also anticipate volatility as the Fed moves toward an actual rate hike. Again, we have continued concerns that the Delta variant of COVID could spread across the U.S. and may stall chances of more economic recovery.

1. Returns are preliminary and from a representative account as of June 30, 2021.

Great Lakes Advisors, LLC ("Great Lakes" or "GLA") is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. Established in 1981, Great Lakes is a subsidiary of Wintrust Financial Corporation and a part of the Wintrust Wealth Management family of companies. On October 1, 2013, majority owned subsidiary Advanced Investment Partners, LLC ("AIP") became fully-owned and integrated into Great Lakes. Great Lakes is a distinct business unit with distinct investment processes and procedures relating to the management and/or trading of investment portfolios for its clients.

Great Lakes Advisors, LLC claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. A list of composite descriptions is available upon request. Great Lakes Advisors, LLC's fees are available upon request and may be found in our Form ADV Part 2A. Performance data quoted herein represents past performance. Past performance does not guarantee or indicate future results. Returns and net asset value will fluctuate.

Manager commentary represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice. To determine if this strategy is appropriate for you, carefully consider the investment objectives, risk factors, and expenses before investing. The holdings, industry sectors, and asset allocation are presented to illustrate examples of the securities bought and the diversity of areas in which we may invest, and may not be representative of current or future investments. Portfolio holdings subject to change and should not be considered investment advice. The specific securities identified and described do not represent all of the securities purchased, sold or recommended for advisory clients and it should not be assumed that investments in the securities identified and discussed were or will be profitable. To obtain a list of all securities recommended during the past year, contact Great Lakes Advisors (GLA) at 312.553.3700. Actual clients' portfolios may or may not hold the same securities depending on the guidelines, restrictions and other factors of the specific portfolios.

The index performance figures are calculated in U.S. dollars and reported on a gross basis. The index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income. Fees, including but not limited to the advisory fee, transaction and custody charges, would reduce the return. Investors cannot invest directly in an index. These indexes are not managed or sold by Great Lakes Advisors. Past performance is not indicative of future results. 21-6-0086