# Taxable Fixed Income Strategies

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**Brian Meaney, CFA**
Vice President, Taxable Fixed Income Strategist

It was a banner quarter for financial assets, with stocks posting double digit returns and bonds showing continued strength. The recession worries at the end of last year are proving unfounded as economic data has improved. Central banks responded to market volatility by indicating continued easy monetary policy, which lowered global bond yields.

The Federal Reserve dramatically revised their outlook after the market sell-off at the end of the year. After 4 hikes in 2018, the best way to describe their stance is "patient". Rate projections call for no further hikes this year (down from 2 at their December meeting), while the Fed assesses global growth and waits for inflation to return to its 2% target. The balance sheet unwind will stop later this year as well.

Economic data, which had been trending lower since last summer has started to stabilize. Although retail sales, jobs figures, and manufacturing surveys indicate a slowing in the economy, the US household segment is quite strong – as indicated by housing and labor market data. China is taking steps to reflate by cutting taxes and interest rates, which is an important development considering China's economy is nearly equal in size to the United States. There is also the possibility that a major US/China trade agreement is within reach, which would remove a source of business uncertainty.

Dovish moves from the Fed, China policymakers, and other central banks have improved financial conditions. Stocks have rallied since December lows, corporate debt (especially high yield) has outperformed, and bank lending surveys are easy. We believe with the Fed in patient mode this is likely to continue and supports asset classes tied to global growth.

The Treasury market's reaction to the Fed's dovish shift has been lower yields and a flatter curve. This makes sense as investors are worried about growth risks and low inflation. Short maturity Treasuries are priced for the Fed to cut rates this year rather than stay patient. If inflation surprises to the upside, bond yields are likely to reprice higher. Wage growth and higher commodity prices point to inflationary pressure.

We will be watching the Fed's upcoming research conference on its inflation target. If the Fed formally adopts a more flexible approach such as an inflation range, this could have large implications for the bond market. If the Fed is comfortable allowing the economy to overheat, then rate hikes are likely to occur later in the cycle and may end higher than if the current framework stays in place.

**Market and Strategy Returns***

| | | 1Q2019 |
|---|---|---|
| **HGST** | **Gross** | **1.17%** |
| | Net | 1.13% |
| BBC US Gov/Cred 1-3Y | | 1.21% |
| Ex BBB | | 1.10% |
| **HGCI** | **Gross** | **2.45%** |
| | Net | 2.37% |
| BBC Int. Agg | | 2.28% |
| Ex. BBB/CMBS/ABS | | 2.01% |
| **Int Gov** | **Gross** | **1.88%** |
| | Net | 1.81% |
| BBC Int Gov | | 1.58% |
| **Corp 1-5** | **Gross** | **2.59%** |
| | Net | 2.56% |
| BBC 1-5 Corp | | 2.61% |
| | | |
| BBC Int. Treasury | | 2.11% |
| BBC TIPS 1-10Y | | 2.57% |
| BBC U.S. MBS | | 2.17% |
| BBC Int. Corp | | 3.82% |
| Industrials | | 3.88% |
| Financials | | 3.85% |
| BBC Muni 5 Year | | 2.11% |
| ML High Yield | | 7.38% |
| S&P 500 | | 13.65% |

*Please see important disclosures at the end of this commentary for strategy and market definitions.
Sources: Bloomberg Barclays (BBC), Bloomberg 3/31/19.

**Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.**

## High Grade Portfolio Positioning

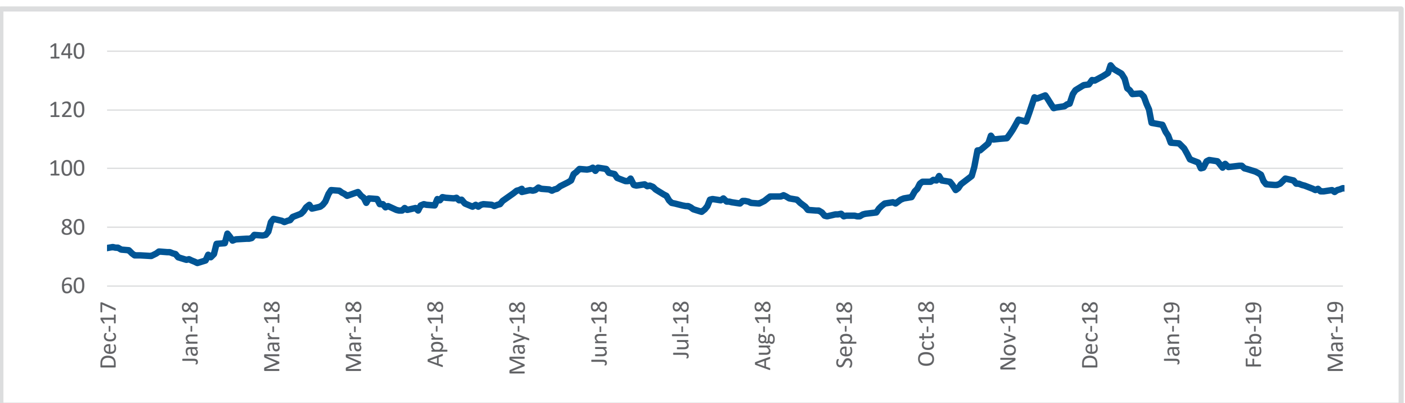
We believe the sector most likely to outperform on higher inflation expectations is Treasury Inflation Protected Securities (TIPS). This out of benchmark allocation in our portfolios is used when we believe the market is underpricing the annualized rate of inflation over the life of the security. At present, the market is only priced for 1.8% inflation versus the Fed target of 2%. The combination of a dovish Fed, strong US labor market, and easing from China should push inflation expectations higher.

The corporate allocation increased during the quarter. Our positive view of the US economy's fundamentals meant that spread widening was an opportunity to add to our position. Corporate performance has shifted from a headwind to tailwind for overall portfolio performance as recession fears have dimmed.

While we believe there is further potential for corporate to generate healthy returns for the near term, we are cognizant of risk factors. In order to fully understand company risks beyond its balance sheet, Fiera has integrated Environmental Social and Governance (ESG) scoring within our investment process.

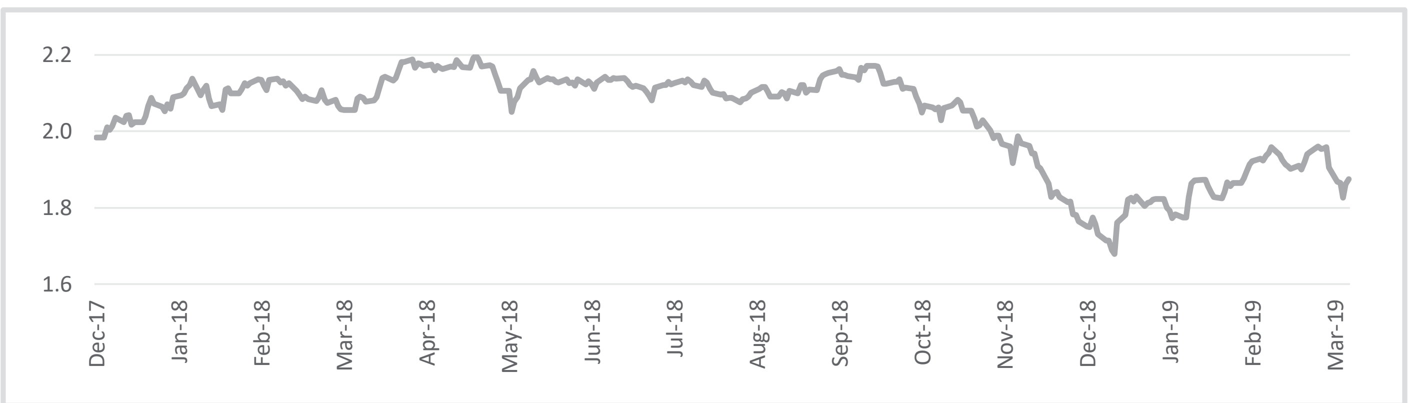
Tax-exempt municipals were reduced as valuations are becoming stretched. This sector has benefited from low supply and strong demand. We observe that the reduction in state and local tax deductions makes municipals an attractive place for investors seeking tax advantaged income. Municipals are likely to be reduced further and rotate to more growth friendly sectors TIPS and corporates.

**A-Rated Corporate Spreads (OAS)**




Source: Bloomberg Barclays Capital as of 3/31/19.

**10-year Tips Breakevens**




Source: Bloomberg as of 3/31/19.

**IMPORTANT DISCLOSURES**

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Allocations presented herein are as of the date noted and subject to change. Returns reflect the reinvestment of income and other investment proceeds.

**Composite Definitions:**

Fees: Gross performance results do not reflect the deduction of management fees or other expenses. Net performance results, when shown, are calculated using the highest total fees and expenses currently charged to any account, fund, or other investment vehicle using this strategy, including management fees and all other expenses, but excluding custody fees.

- High Grade Short Term (HGST): The High Grade Government/Credit Short Term Composite was created April 30, 2012. The Composite consists of all fully discretionary, fee paying separately managed accounts in the High Grade Government/Credit Short Term style. The strategy is a relative return focused mandate appropriate for investors with an 1-3 year investment horizon, seeking to maximize return with a lower degree of principal volatility than typical aggregate market strategies. The minimum account size for this composite is $2.5 million.
- Intermediate Government (Int Gov): The Intermediate Government (IG) Composite was created January 1, 2014. The Composite consists of all fully discretionary, fee paying separately managed accounts in the Intermediate Government style. The strategy is a relative return focused mandate appropriate for investors with an indefinite investment horizon desiring exposure to government supported credits. Benchmark: Barclays Intermediate Government Index. The minimum account size for this composite is $500,000.00
- High Grade Core Intermediate (HGCI): The High Grade Core Intermediate Composite was created September 30, 2005. The Composite consists of all fully discretionary, fee paying separately managed accounts in the High Grade Core Intermediate style. The High Grade Core Intermediate strategy is a relative return focused mandate appropriate for investors with an indefinite investment horizon, seeking to maximize return with a lower degree of principal volatility than typical aggregate market strategies. The minimum account size for this composite is $2.5 million.
- Corporate Index Replication (Corp 1-5): The High Grade Core Intermediate Composite was created September 30, 2005. The Composite consists of all fully discretionary, fee paying separately managed accounts in the High Grade Core Intermediate style. The High Grade Core Intermediate strategy is a relative return focused mandate appropriate for investors with an indefinite investment horizon, seeking to maximize return with a lower degree of principal volatility than typical aggregate market strategies. The minimum account size for this composite is $2.5 million.

**Index Definitions:**

It is not possible to invest directly in an index. Investors pursuing a strategy similar to an index may experience higher or lower returns and will bear the cost of fees and expenses that will reduce returns.

**Bloomberg Barclays 1-3 Yr Gov/Credit** is the 1-3 Yr component of the U.S. Government/Credit Index. The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes Treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government). The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. **Bloomberg Barclays 1-3 Yr Gov/Credit Ex BBB** is the same index as previous but excludes BBB securities. **Bloomberg Barclays Intermediate Aggregate Index** is the intermediate component of the US Aggregate Index. The Bloomberg Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. **The Bloomberg Barclays Intermediate Aggregate ex CMBS/ABS/BBB Index** is the same index as previous but excludes commercial mortgage backed securities (CMBS), asset backed securities (ABS), and BBB rated bonds. **Bloomberg Barclays Intermediate Government Index** includes Treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government) between 1-10 years maturity. **Bloomberg Barclays U.S. Corporate Investment Grade Index** is a rules-based and market value weighted index of publicly issued U.S. corporate bonds. To be included in the index, bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. Bonds in the Index must have at least one year to final maturity regardless of call features and have at least $250 million par amount outstanding. Bonds in the Index must be fixed rate, although it can carry a coupon that steps up or changes according to a predetermined schedule, must be dollar-denominated and non-convertible and must be publicly issued. **The Bloomberg Barclays 1-5 Corporate Index** is the 1-5 year component of the Corporate Index. **The Bloomberg Barclays Intermediate Corporate Index** is the Intermediate component of the Corporate Index.