Annotated version by MDR team. Refer to the following pages for notes & comments.

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Monthly Report

September 1, 2020

Investors Increase Credit Risk Exposure & Inflation Expectations Tick Up in August

Listen to Monthly Insights

Main Points

August 2020's credit market performance confirmed investor's risk-on sentiment. Convertible bonds outperformed for the fifth consecutive month, while 10Y and 30Y treasuries both underperformed. On the corporate front, HY outperformed IG by +1.8%. The Federal Reserve's accommodative monetary policy and low interest rates are pushing investors toward riskier credits in order to earn higher yields. We believe this will continue to occur. As a result, we remain OW riskier assets, such as HY and EM Sovereign, to generate higher yields and benefit from tightening credit spreads. The risk to this position is a second infection wave, deteriorating investor sentiment, and weak economic growth. In the end, we think the Federal Reserve's stimulus programs will support the credit markets.

Inflation expectations ticked higher again in August. Investors appear to associate surging money supply with inflationary pressure. The Federal Reserve's recent move to allow inflation to overshoot 2% during certain periods also likely increased expectations. However, we believe the market's inflation expectations are too high for multiple reasons. While increasing money supply is a key inflationary ingredient, the Bank of Japan's recent monetary policy showed central banks alone cannot create inflationary pressures. There must be additional policies and economic activity to create inflation. In Japan's case, the consumption tax increase and other regulatory requirements pressured economic growth, thereby contradicting the money supply increase. Looking at the present-day U.S., the unemployment rate remains elevated, enhanced unemployment benefits expired at the end of July 2020, and the ongoing recovery remains gradual and fragile. We believe those thematic drivers will act to contain inflation. This is not to say deflation is imminent, only that inflation could remain weak in the coming months.

Credit Roundup

- **EM Sovereign:** Maintain OW due to spread vs 10Y Trsy rate (**Figure 3**) & strong global central bank stimulus measures
- **TIPs:** Inflation expectations continue to rise (**Figure 19**), but we believe inflationary pressures remain weak (see above)
- **Convertibles:** Top performing credit segment for fifth consecutive month (**Figure 7**); Vulnerable to equity market sell-off
- **HY Corp:** Maintain OW vs IG due to potential for HY outperformance over next 12-months (**Figure 42**); Expect spreads to tighten further
- **Municipals:** Position in BBB to capture tightening spread (**Figure 49**) -- Refer to 7/17/2020 Friday Strategist
- **CMBS:** We believe the commercial real estate market remains too risky, especially lower rated debt; Remain UW for now

Table of Contents

Global Credit Ratings

12-18 Month Investment Horizon

Credit Market	Our View	Last Chg
EM Sovereign	OW	May-20
High Yield	OW	May-20
Preferreds	OW	May-20
U.S. Treasuries	N	May-20
Cash (3-Mo Trsy)	N	May-20
Investment Grade	N	May-20
Municipals	N	May-20
Convertibles	N	May-20
MBS	N	May-20
TIPS	UW	May-20
CMBS	UW	May-20

Source: MarketDesk Research

Research Portal →

MarketDesk Research

U.S. Credit Strategy

We maintain our OW position on EM Sovereign and HY. The Fed and global central banks are overly accommodative currently, and we continue to take their cue to own risk assets.

Monthly Report

September 1, 2020

MarketDesk Credit Ratings: The goal of this report is to simplify credit investing by focusing on the key drivers of risk and return. Below is a summary of our credit allocation views for the next 12 months. Up / down arrows indicate a positive (▲) or negative (▼) change in view since the prior monthly report.

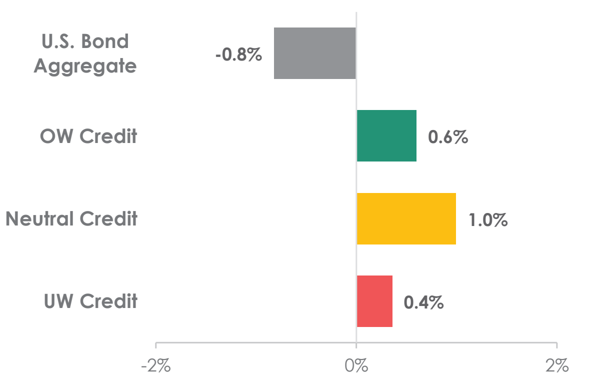
● Underweight (UW) ● Neutral (N) ● Overweight (OW)

Credit Markets	Allocation View				Current Drivers of Allocation Views	Rationale
	Chg	UW	N	OW		
U.S. Government & International Sovereigns						
EM Sovereign (Local)		•	•	●	Yield Spread vs U.S. Treasuries	Spread vs 10-year Trsy remains elevated; USD weakness = Potential catalyst; Use to generate higher yields
U.S. Treasuries		•	●	•	Fed Demand; Low Yields	Steady purchase demand from Fed; Yields are too low to generate income = Use to fortify portfolio against equity market sell-off
U.S. Credit						
High Yield		•	•	●	Credit Spread	Spreads likely to continue tightening vs both U.S. treasuries and corporate IG bonds due to Fed stimulus; Use to generate income
Preferreds		•	•	●	Yield; Low Beta	Offers attractive yield amid low interest rates; Risk of limited upside in market rally, which could continue given stimulus measures
Cash (3-Month Treasury)		•	●	•	More Attractive Opportunities	Cash yields collapsed; Higher yield opportunities exist elsewhere in credit markets
Investment Grade		•	●	•	High Duration	Increasing duration risk in IG bonds as firms increase issuance at low rates; Rising BBB exposure = downgrade risk
Municipals		•	●	•	Default Risk	Spreads to corporate credit with identical ratings indicate higher tax adjusted yields; Default risk elevated due to shutdown orders
Convertibles		•	●	•	Potential Equity Sell-Off	Offers yield plus equity like exposure in a low interest rate environment; Concerns about equity sell-off justify a neutral rating
MBS		•	●	•	Fed Purchases; Prepayment Risk	Concerned about forbearances turning into defaults; Risk of prepayment elevated due to low interest rate environment
TIPS		●	•	•	Low Inflation Expectations	Inflation expectations increased again during August; However, we expect inflation to remain weak through the end of 2020
CMBS		●	•	•	Remote Work Movement	Uncertain when offices will reopen; Increasing concerns about tenants either asking for lower rents or terminating leases
U.S. Credit Factors						
Quality		•	•	●	Default Risk	Corporate health was already weakening before the coronavirus outbreak; Credit default risk elevated over the next 12 months
Duration		●	•	•	Fed Policy	We expect more of credit's total return to come from coupon yield than duration; Fed more likely to purchase bonds than cut rates

__Bond Duration__ is a measure of the sensitivity of the price of a bond to a change in interest rates and is measured by years. As an example, if a bond has a duration of five years and interest rates increase 1%, the bond's price will drop by approximately 5% (1% X 5 years). __Credit Quality__ is the measure of a company's creditworthiness or risk of default.

Figure 1: Performance of MDR Ratings — August 2020

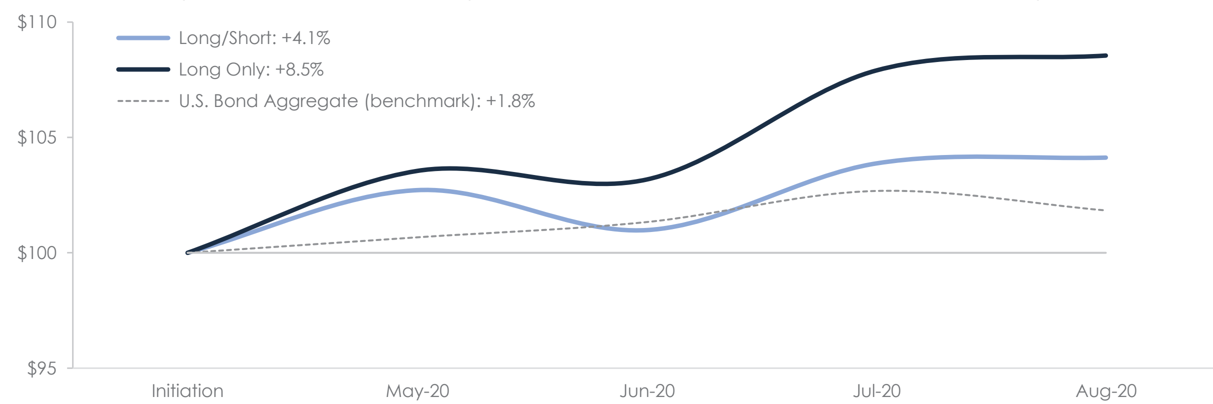
Average monthly performance across credit by ratings.



Source: MarketDesk Research

Figure 2: Model Portfolios Performance

Based on equal weight total return data. Assumes long OW credit and short UW sectors. Returns do not include borrowing costs.



Source: MarketDesk Research. __Note:__ MDR Credit Ratings began on 4/30/2020.

The asset flows column highlights two credit market trends: (1) investors are taking on more credit risk (e.g. EM Sovereign and HY net inflows in August vs 30Yr Trsy net outflows) and (2) inflation expectations are firming with TIPs continuing to experience net inflows. Figure 6 is another way of looking at Figure 3. Investors are willing to take on increased credit risk and moving away from the safety trade, which is indicated by the 30Y Trsy (negative 1-month return & flows). Inflation expectations are firming (TIPs outsized net inflows vs positive 1-month return).

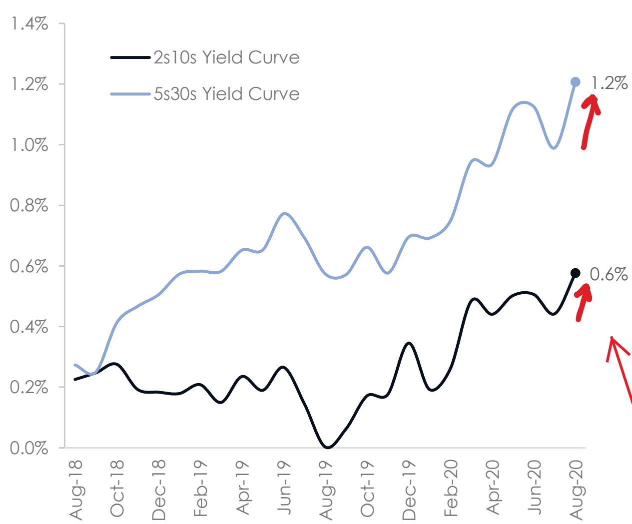
Figure 3: Credit Market Metrics

Credit Markets	Total Returns (%)			Asset Flows (%)			Spread vs 10Y UST			Yield to Maturity	Yield to Worst	Yield to Call	Duration (Years)	Duration Spread	Option Adj Spread	Current Yield to Maturity vs 20-Year Average
	1M	6M	1Y	1M	6M	1Y	1M	6M	1Y							
U.S. Government & International Sovereigns																-3std +3std
2-Year Treasuries	0.0	1.5	3.3	-0.5	31.2	32.2	-0.4	-0.3	0.0	0.13%	0.13%	0.13%	-	-	-	-1.2
10-Year Treasuries	-1.0	4.3	8.1	-3.5	-7.4	2.5	0.0	0.0	0.0	0.70%	0.70%	0.70%	-	-	-	-2.1
30-Year Treasuries	-5.0	5.3	12.0	-6.0	-14.3	-1.0	0.7	0.5	0.5	1.46%	1.46%	1.46%	-	-	-	-2.2
EM Sovereign (Local)	-0.1	-0.5	0.8	0.4	-21.0	-7.7	2.9	2.7	2.6	3.64%	3.64%	3.64%	6.93	6.87	-1	-2.4
U.S. Credit																
Cash (3-Month Treasury)	0.0	0.2	1.0	-6.7	11.3	1.9	-1.4	-1.1	-0.4	0.11%	0.11%	0.11%	-	-	-	-0.8
Investment Grade	-1.8	4.0	8.4	1.7	35.8	40.9	0.2	0.4	0.5	1.65%	1.60%	1.60%	8.53	8.38	97	-1.7
High Yield	0.0	1.3	2.4	3.1	77.6	72.6	3.5	4.1	4.3	4.96%	4.37%	4.41%	4.83	3.50	405	-1.3
TIPS	0.9	6.2	8.9	6.0	10.0	18.2	-2.6	-2.2	-1.9	-1.14%	-1.14%	-1.14%	8.63	4.89	0	-1.9
Municipals	-0.6	0.5	2.9	1.2	10.4	29.3	1.1	1.3	0.9	2.55%	1.41%	1.66%	9.67	5.81	48	-1.9
Convertibles	9.2	29.4	37.6	2.7	5.3	16.4	-	-	-	-	-	-	-	-	-	
Preferreds	1.9	3.9	3.4	2.7	0.7	12.7	3.0	3.4	3.4	4.43%	2.23%	2.45%	11.11	6.39	153	-1.3
MBS	0.1	2.3	4.4	2.8	-1.8	27.0	0.0	0.2	0.2	1.47%	1.47%	1.47%	4.09	4.37	80	-1.5
CMBS	-0.2	2.7	5.1	0.0	0.5	16.1	0.5	0.8	0.3	1.98%	1.98%	1.98%	4.78	4.77	164	-1.2

Source: MarketDesk Research. ***Asset Flows*** *= 5 largest ETFs for each category. Total net flows are divided by total beginning of period assets.*

Figure 4: Treasuries — Long vs Short-End Yield Curve

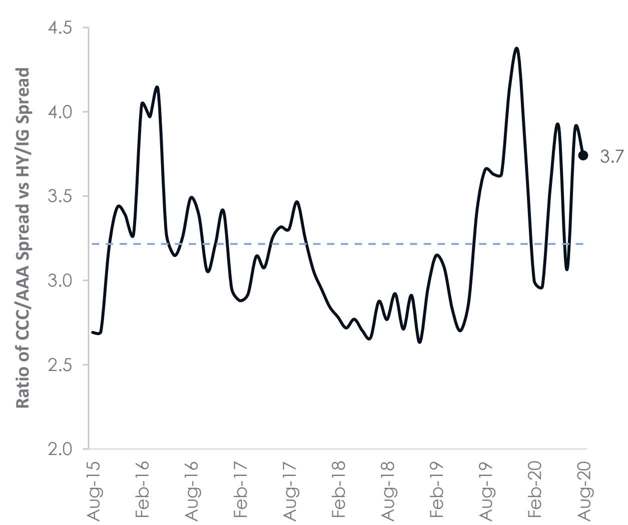
The analysis below highlights steepening and/or flattening yields at the long (5s30s) and short (2s10s) end of the yield curve.



Source: MarketDesk Research, St. Louis Federal Reserve

Figure 5: Corporates — Extremes vs Rating Groups

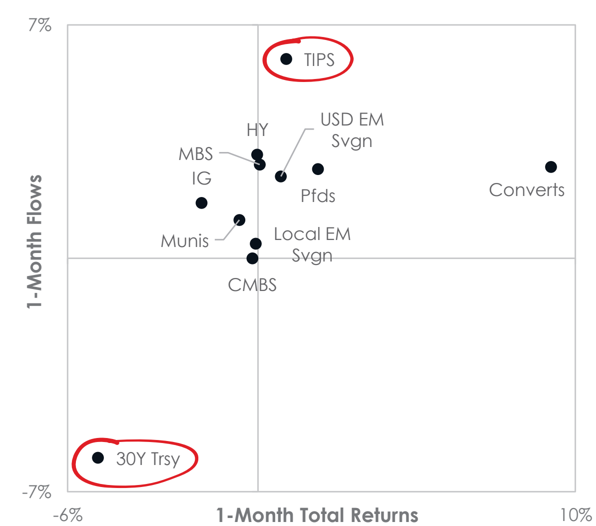
Net Difference between CCC/AAA spread and the broad HY/IG spread to highlight movements at the extremes.



Source: MarketDesk Research

Figure 6: Returns vs Flows (m/m%)

The scatter plot below highlights areas where investors are adding (or removing) capital based on recent returns.



Source: MarketDesk Research

The 2s10s and 5s30s curves both steepened in August. A steepening yield curve indicates investors expect stronger economic growth and/or higher inflation. The risk is investors are overly optimistic about economic growth and projecting too high inflation.

The risk on credit rally continued in August. Convertibles outperformed due to their hybrid bond/equity exposure, while the safety trade (e.g. 30yr Trsy, 10yr Trsy, & Corp IG) underperformed. The Fed is driving investors toward riskier credits by keeping interest rates low.

Figure 7: Credit Market Total Returns

Monthly total returns over the past year by credit type.

	September 2019	October 2019	November 2019	December 2019	January 2020	February 2020	March 2020	April 2020	May 2020	June 2020	July 2020	August 2020	YTD	1-Year
Best	Local EM Svgn 0.8%	Local EM Svgn 3.2%	Convertibles 2.9%	Local EM Svgn 3.6%	Trsy (30Y) 7.7%	Trsy (30Y) 6.6%	Trsy (30Y) 6.4%	Convertibles 11.5%	Convertibles 6.9%	Convertibles 6.6%	Convertibles 7.4%	Convertibles 9.2%	Convertibles 28.7%	Convertibles 37.6%
	Preferreds 0.7%	Convertibles 1.7%	Corp HY 0.6%	USD EM Svgn 2.9%	Trsy (10Y) 3.5%	Trsy (10Y) 3.0%	Trsy (10Y) 3.7%	Preferreds 9.4%	USD EM Svgn 6.2%	USD EM Svgn 3.0%	Corp HY 5.0%	Preferreds 1.9%	Trsy (30Y) 20.8%	Trsy (30Y) 12.0%
	Corp HY 0.4%	USD EM Svgn 0.6%	Corp IG 0.5%	Convertibles 2.9%	Convertibles 3.1%	Corp IG 1.1%	Trsy (2Y) 1.2%	Corp HY 4.9%	Local EM Svgn 5.8%	Corp IG 2.1%	Preferreds 4.9%	TIPS 0.9%	Trsy (10Y) 11.1%	TIPS 8.9%
	Cash 0.2%	Corp IG 0.4%	TIPS 0.3%	Preferreds 1.9%	CMBS 2.7%	Municipals 1.0%	MBS 1.1%	Corp IG 4.8%	Municipals 3.8%	CMBS 1.7%	Trsy (30Y) 4.4%	USD EM Svgn 0.7%	TIPS 9.4%	Corp IG 8.4%
	MBS 0.1%	Preferreds 0.4%	CMBS 0.2%	Corp HY 1.9%	Corp IG 2.4%	TIPS 0.9%	Cash 0.2%	USD EM Svgn 4.4%	Corp HY 2.9%	TIPS 1.0%	USD EM Svgn 3.8%	MBS 0.1%	Corp IG 7.7%	Trsy (10Y) 8.1%
	Trsy (2Y) -0.1%	MBS 0.3%	Cash 0.1%	Corp IG 0.5%	TIPS 2.1%	Trsy (2Y) 0.9%	CMBS -1.2%	TIPS 3.0%	Corp IG 2.5%	Local EM Svgn 0.4%	Local EM Svgn 3.8%	Cash 0.0%	CMBS 6.1%	CMBS 5.1%
	Convertibles -0.3%	Trsy (2Y) 0.3%	Municipals 0.1%	TIPS 0.3%	Municipals 1.7%	MBS 0.8%	TIPS -1.8%	Local EM Svgn 2.5%	Preferreds 1.9%	Municipals 0.4%	Corp IG 3.1%	Trsy (2Y) 0.0%	MBS 3.9%	MBS 4.4%
	CMBS -0.6%	Municipals 0.3%	MBS 0.0%	Municipals 0.3%	Preferreds 1.5%	CMBS 0.6%	Municipals -3.0%	Trsy (30Y) 1.2%	CMBS 1.0%	Trsy (30Y) 0.3%	TIPS 2.3%	Corp HY 0.0%	Municipals 3.1%	Preferreds 3.4%
	Corp IG -0.8%	Trsy (10Y) 0.2%	Trsy (2Y) 0.0%	MBS 0.2%	USD EM Svgn 1.2%	Cash 0.1%	Corp IG -6.3%	MBS 0.8%	TIPS 0.6%	Trsy (10Y) 0.0%	Municipals 1.4%	Local EM Svgn -0.1%	Trsy (2Y) 3.0%	Trsy (2Y) 3.3%
	Municipals -0.8%	Cash 0.2%	Trsy (30Y) -0.4%	Trsy (2Y) 0.2%	MBS 0.7%	USD EM Svgn -1.2%	Corp HY -10.0%	Trsy (10Y) 0.3%	Trsy (10Y) 0.3%	Trsy (2Y) 0.0%	CMBS 1.1%	CMBS -0.2%	USD EM Svgn 1.4%	Municipals 2.9%
	USD EM Svgn -1.1%	Corp HY 0.0%	Preferreds -0.4%	Cash 0.1%	Trsy (2Y) 0.6%	Corp HY -1.3%	Preferreds -11.8%	Trsy (2Y) 0.3%	MBS 0.2%	Cash 0.0%	Trsy (10Y) 0.9%	Municipals -0.6%	Preferreds 0.7%	USD EM Svgn 2.8%
	TIPS -1.1%	TIPS 0.0%	Trsy (10Y) -0.7%	CMBS -0.3%	Cash 0.1%	Local EM Svgn -2.4%	Local EM Svgn -11.9%	CMBS 0.2%	Cash 0.0%	MBS -0.2%	MBS 0.3%	Trsy (10Y) -1.0%	Cash 0.4%	Corp HY 2.4%
	Trsy (10Y) -1.2%	CMBS -0.2%	USD EM Svgn -0.9%	Trsy (10Y) -0.9%	Corp HY -0.5%	Convertibles -3.5%	Convertibles -13.1%	Cash 0.0%	Trsy (2Y) -0.1%	Corp HY -0.6%	Trsy (2Y) 0.1%	Corp IG -1.8%	Corp HY -0.5%	Cash 1.0%
Worst	Trsy (30Y) -2.7%	Trsy (30Y) -1.1%	Local EM Svgn -3.1%	Trsy (30Y) -3.2%	Local EM Svgn -0.8%	Preferreds -4.4%	USD EM Svgn -14.9%	Municipals -1.4%	Trsy (30Y) -1.8%	Preferreds -0.9%	Cash 0.0%	Trsy (30Y) -5.0%	Local EM Svgn -3.6%	Local EM Svgn 0.8%

Source: MarketDesk Research

One item to keep in mind -- its not just the Fed pushing interest rates lower. Central banks around the globe are cutting interest rates (see Figure 9). We believe this will cause risk assets, such as equities, and assets with strong growth profiles to trade at valuation premiums as investors struggle to generate returns. Moving forward, investing will become more about finding relative value (attractive asset at a slight discount) than absolute value (the cheapest asset overall).

Central Bank Monitor

Monetary Policy Actions

Figure 8: Key Metrics — International Policy Rates

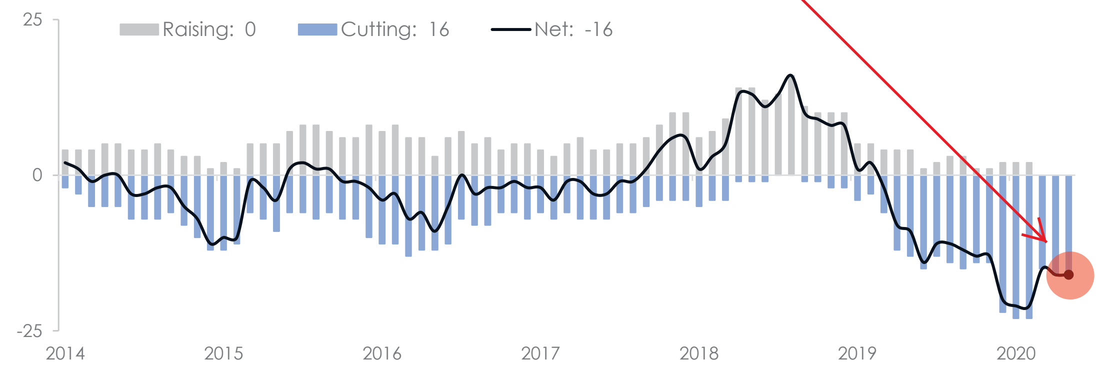
Global central banks have the ability to create enormous changes in the bond markets. Below we track the past, current and future rate targets of several countries

Country	2-Year Trend	Current Policy Rate	LTM Chg (bps)	NTM Chg (bps)	Target Rate
North America					
United States		0.25%	▼ -200		0.25%
Canada		0.25%	▼ -150		0.25%
Europe					
Denmark		0.05%		▼ -65	-0.60%
Eurozone		0.00%			0.00%
Norway		0.00%	▼ -125		0.00%
Poland		0.10%	▼ -140		0.10%
Russia		4.25%	▼ -300	▼ -12	4.13%
Sweden		0.00%	▲ 25		0.00%
Iceland		1.00%	▼ -250		
Turkey		8.25%	▼ -1150		8.25%
Ukraine		6.00%	▼ -1100	▼ -50	5.50%
United Kingdom		0.10%	▼ -65		0.10%
Asia Pacific					
Australia		0.25%	▼ -75		0.25%
China		3.85%	▼ -40	▼ -10	3.75%
Hong Kong		0.50%	▼ -200		0.50%
India		4.00%	▼ -140	▼ -12	3.88%
Indonesia		4.00%	▼ -150		4.00%
Japan		-0.10%			-0.10%
Philippines		2.25%	▼ -200	▼ -12	2.13%
South Korea		0.50%	▼ -100		0.50%
Taiwan		1.13%	▼ -25	▼ -13	1.00%
Latin America					
Argentina		38.00%	▼ -4526	▼ -75	37.25%
Brazil		2.00%	▼ -400		2.00%
Chile		0.50%	▼ -200	▼ -12	0.38%
Colombia		2.25%	▼ -200	▼ -25	2.00%
Mexico		4.50%	▼ -350		4.50%
Middle East & Africa					
Israel		0.10%	▼ -15		
Qatar		2.50%	▼ -225		
Saudi Arabia		1.00%	▼ -175		
South Africa		3.50%	▼ -300		3.50%
UAE		1.50%	▼ -100		

Source: MarketDesk Research, Various global central banks

Figure 9: Global Central Banks Raising vs Cutting Interest Rates

Tracking the direction of policy changes to highlight easing (rate cuts) or tightening (rate increases) monetary policy.



Source: MarketDesk Research

Figure 10: U.S. Federal Reserve Balance Sheet

Snapshot of the size and directional trends of the U.S. Federal Reserve's balance sheet.

The Fed is increasing money supply to protect the economy, not generate a return. Treasury valuations are not a factor in bond purchases, which means the Fed will compete aggressively and likely overbid for Treasuries. The size of the Fed's operations pushes investors to other areas of the markets, which increases competition in those market segments. The process repeats itself, which results in natural upward pressure on asset valuations across the markets. This is why we believe asset valuations will run elevated over the next few years.

Source: MarketDesk Research, St. Louis Federal Reserve

Figure 11: Upcoming Central Bank Meetings

Summary of future meeting dates at the three most watched global central banks.

	U.S. Federal Reserve	ECB	BOJ
Sept	15-16	10	16-17
Oct		29	28-29
Nov	4-5		
Dec	15-16	10	17-18
Jan	26-27	21	20-21
Feb			
Mar	16-17	11	18-19

Source: MarketDesk Research, U.S. Federal Reserve, European Central Bank (ECB), Bank of Japan (BOJ)

U.S. Corporate Health
Overview

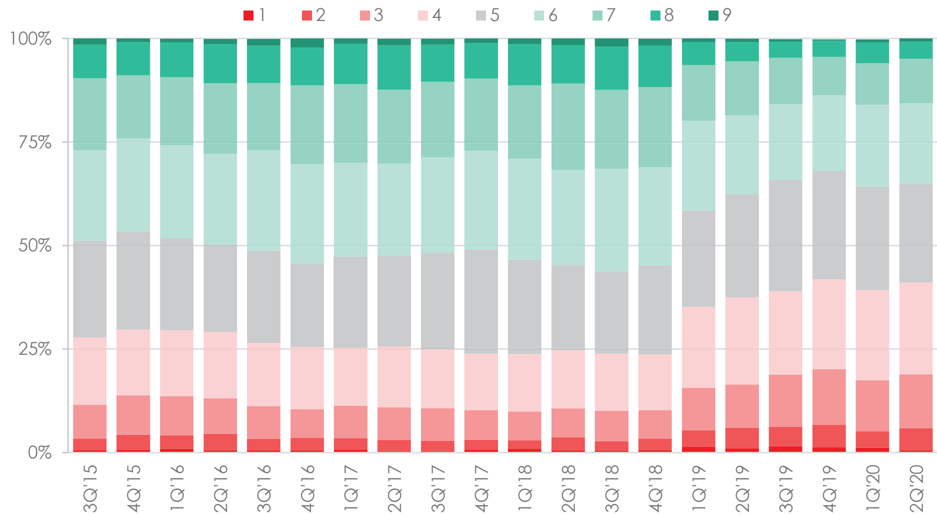
Corporate profit margins are back below 9%, which last occurred in 2013. The current health pandemic has now erased the 2017 tax cut boost. If Joe Biden wins the presidency and Democrats control Congress, Biden could push through a tax rate increase to 28%. The result would be a further decline in profit margins …

Monthly Report

September 1, 2020

Figure 12: U.S. Companies Financial Health — Piotroski F-Score

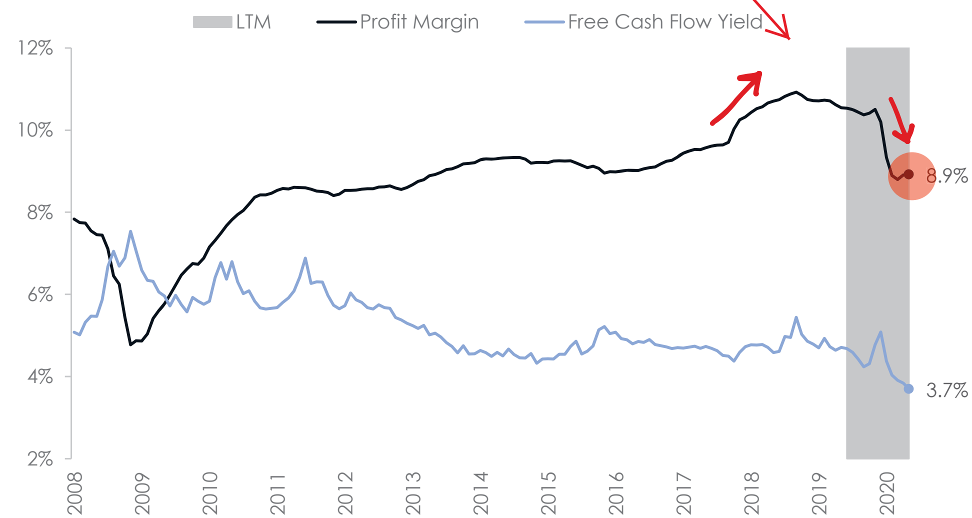
Piotroski F-Score is a gauge of corporate financial health taking into consideration a company's income statement and balance sheet. F-Scores 6 to 9 (1 to 4) are consider financially strong (weak).



Source: MarketDesk Research

Figure 13: U.S. Profit Margins & Free Cash Flow Yields

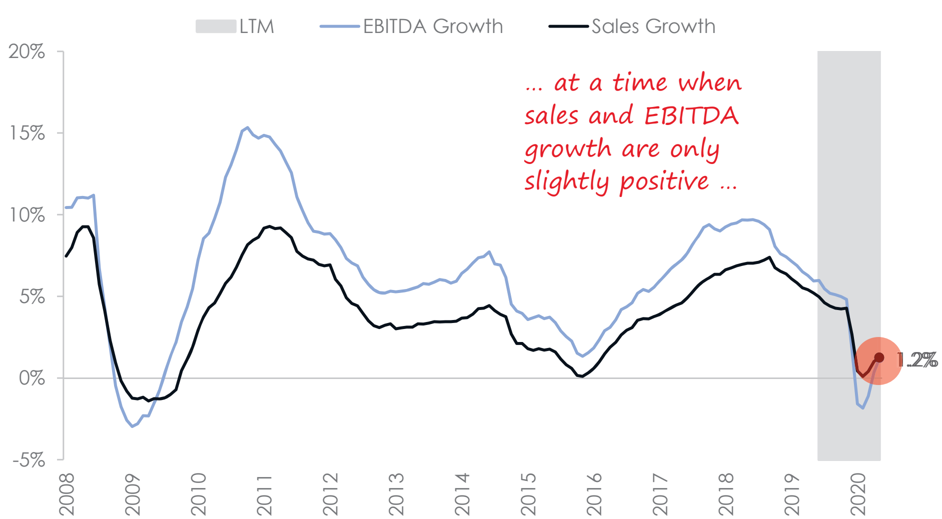
Investors pay close attention to income statement margins and cash flow generation to gauge financial health. The analysis below uses the market cap weighted Russell 3000 universe.



Source: MarketDesk Research

Figure 14: EBITDA & Sales Growth (y/y%)

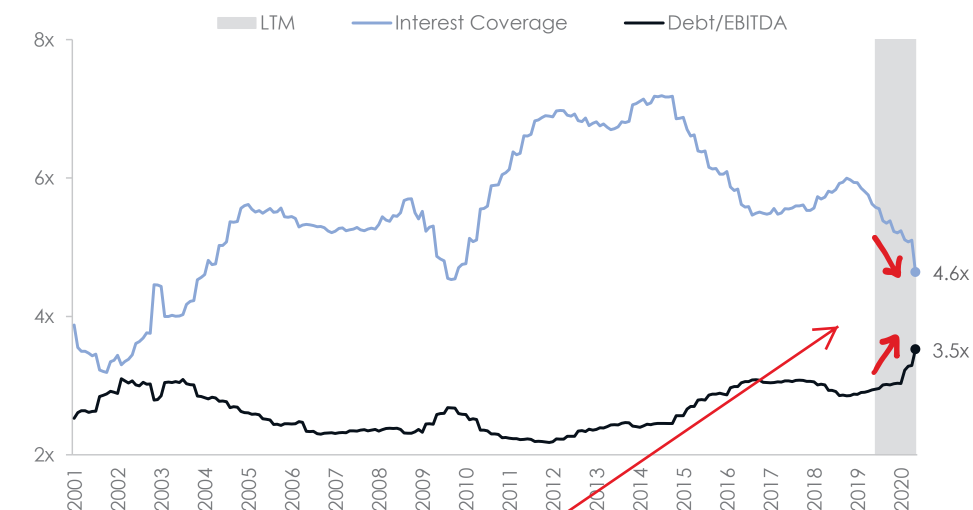
Top line sales and EBITDA growth are key indicators to highlight if companies are growing or shrinking their business. The analysis below uses the market cap weighted Russell 3000 universe.



Source: MarketDesk Research

Figure 15: Interest Coverage & Debt/EBITDA Ratio

Two key credit ratios followed by investors are: Interest Coverage (EBIT / Interest Expense) and Debt / EBITDA. The analysis below uses the market cap weighted Russell 3000 universe.



Source: MarketDesk Research

… and interest coverage is approaching decades lows with Debt/EBITDA hitting 20-year highs. The prevailing trend is toward weaker U.S. corporate health. The Fed is trying to prevent this weak corporate health from infecting the broader economy.

U.S. Treasuries & TIPS

Overview

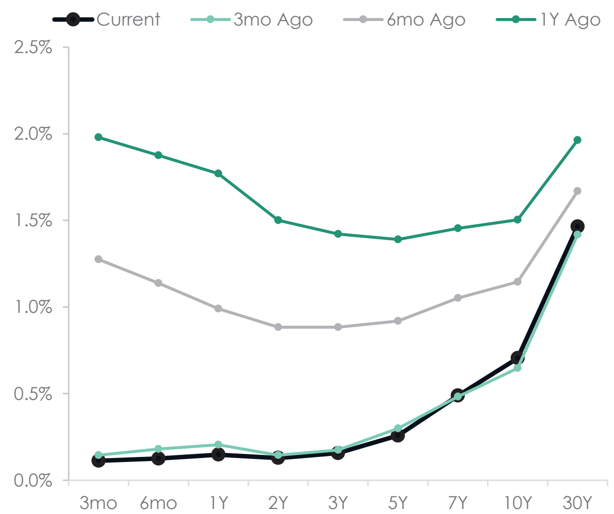
Short maturities outperformance in Figure 17 is overdramatized due to the 30Y Trsy's strong August 2019 performance rolling off. It is difficult to see either short maturity or long maturity treasuries materially outperforming in the months ahead. We believe rates at the short end of the curve will struggle to move lower, while rates at the long end of the curve will be capped by increasing market risks and demand for portfolio protection. Overall, we would favor longer maturity treasuries.

Monthly Report

September 1, 2020

Figure 16: U.S. Treasury Yield Curve

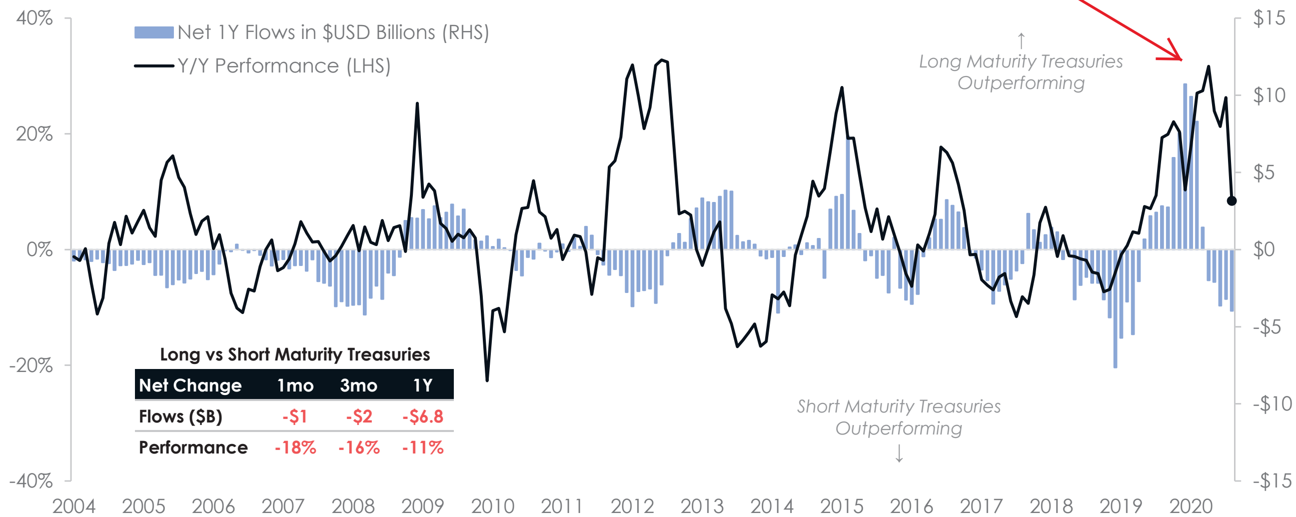
Highlighting recent shifts in the U.S. Treasury yield curve.



Source: MarketDesk Research

Figure 17: Flows & Performance — Long vs Short Maturity Treasuries

Rolling LTM return and net flows into long (TLT +20Y bond ETF) vs short (SHY 1-3Y bond ETF) maturity U.S. Treasuries.



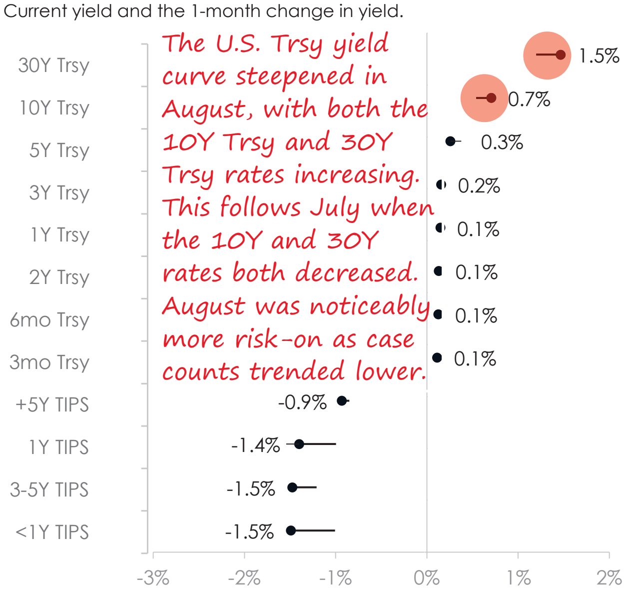
Long vs Short Maturity Treasuries

Net Change	1mo	3mo	1Y
Flows ($B)	-$1	-$2	-$6.8
Performance	-18%	-16%	-11%

Source: MarketDesk Research

Figure 18: Current Yield & 1-Month Change in Yield

Current yield and the 1-month change in yield.

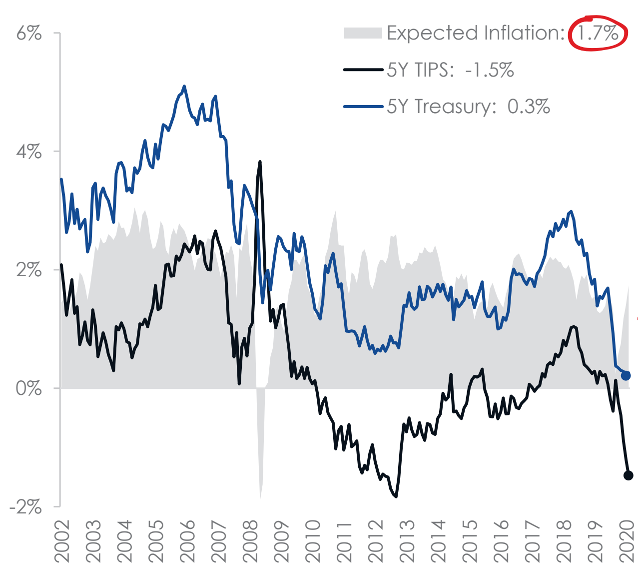


The U.S. Trsy yield curve steepened in August, with both the 10Y Trsy and 30Y Trsy rates increasing. This follows July when the 10Y and 30Y rates both decreased. August was noticeably more risk-on as case counts trended lower.

Source: MarketDesk Research

Figure 19: Expected Inflation — 5Y Treasury vs 5Y TIPS

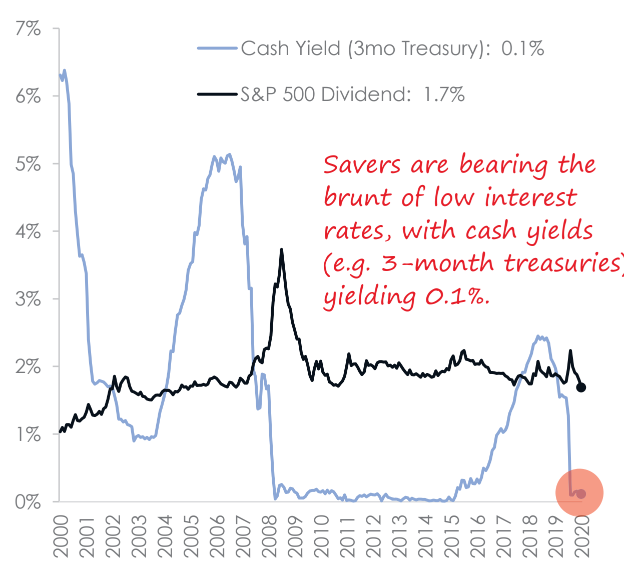
Expected inflation rate = 5Y Treasury yield minus 5Y TIPS yield.



Source: MarketDesk Research

Figure 20: S&P 500 Dividend Yield vs Cash Yield

Comparative yield of holding cash vs investing in equities.



Savers are bearing the brunt of low interest rates, with cash yields (e.g. 3-month treasuries) yielding 0.1%.

Source: MarketDesk Research

Inflation expectations moved up from 1.4% to 1.7% last month. We continue to believe investors' inflation projections are too high. Japan's recent history indicates central banks alone are not powerful enough to spur inflation.

Two important items to note in Figure 21. The 10Y Trsy rate is higher than the 10Y yield across the majority of developed market countries. This can be seen in the 10Y U.S. Trsy spread column. The higher U.S. 10Y Trsy yield could prevent USD from weakening dramatically. (continued below)

Figure 21: Key Metrics — Sovereign Bonds

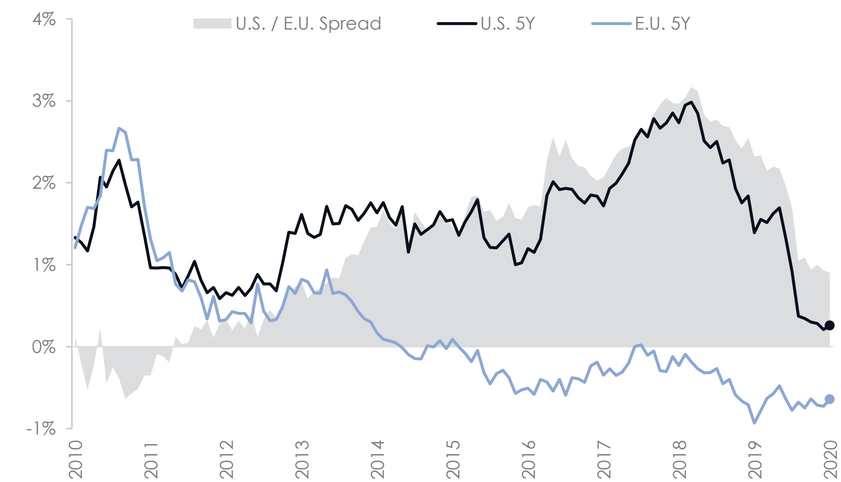
This figure tracks key credit market metrics across developed and emerging market sovereign bonds. We use the 10-year bond as a broad proxy for each country and compare it to the U.S. 10-year Treasury bond.

Country	S&P Rating	10Y Yield (%)	30 Day Chg (bps)	10Y CDS (bps)	10Y / 2Y Spread	10Y U.S. Trsy Spread (bps)	U.S. Trsy Spread (1Y History)
United States	**AA+**	**0.70%**	**▲ 17**	**27**	**58**	**-**	**-**
Developed Markets							
Italy	BBB	1.07%	▲ 5	189	116	37	
Australia	AAA	0.98%	▲ 17	28	73	28	
Hong Kong	AA+	0.46%	▲ 16	77	29	-25	
Spain	A	0.40%	▲ 7	98	87	-30	
U.K.	AA	0.31%	▲ 22	35	38	-39	
Japan	A+	0.04%	▲ 4	29	17	-66	
Sweden	AAA	0.03%	▲ 12	20	38	-68	
France	AA	-0.10%	▲ 10	38	50	-81	
Denmark	AAA	-0.29%	▲ 11	18	30	-100	
Netherlands	AAA	-0.29%	▲ 11	23	33	-100	
Germany	AAA	-0.40%	▲ 13	24	26	-111	
Switzerland	AAA	-0.41%	▲ 14	14	40	-111	
Emerging Markets							
South Africa	BB	9.75%	▲ 47	369	517	904	
Brazil	BB-	7.29%	▲ 57	289	363	659	
Indonesia	BBB	6.83%	▼ -24	183	250	613	
India	BBB-	6.12%	▲ 28	137	165	541	
Mexico	BBB+	6.07%	▲ 12	207	156	537	
Russia	BBB	6.00%	▲ 10	161	155	530	
Colombia	BBB	5.66%	▼ -26	193	296	496	
China	A+	3.07%	▼ -1	79	33	236	
Philippines	BBB+	2.72%	▼ -97	98	71	201	
Malaysia	A	2.61%	▲ 5	103	88	190	
South Korea	AA	1.53%	▲ 24	44	68	82	
Thailand	A-	1.42%	▲ 19	76	88	72	
Greece	BB-	1.09%	▲ 1	215	-	39	
Singapore	-	0.92%	▲ 14	-	69	21	
Taiwan	-	0.42%	▲ 1	-	27	-29	

Source: MarketDesk Research

Figure 22: 5-Year Bond Yields — U.S. vs E.U.

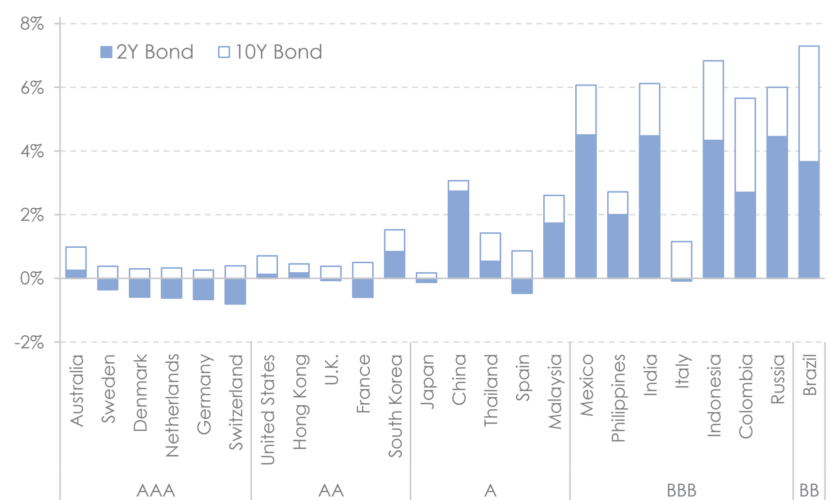
Comparing the yield investors earn holding a 5-year U.S. Treasury bond versus a 5-year European Union bond. The analysis does not account for currency differences.



Source: MarketDesk Research

Figure 23: Sovereign Yields across Rating Levels & Regions

A comparison of country yields across regions and similarly rated countries. The yield spread (10-year minus 2-year) for each country is shown in the white box.



Source: MarketDesk Research

(continued from above) In addition, the U.S. 10Y/2Y spread is also steeper than the 10Y/2Y spread in the majority of developed markets. This can be seen in the 10Y/2Y spread column. The steeper yield curve tells us investors expect a combination of stronger economic growth and/or higher inflation in the U.S.

U.S. Corporates
Overview

After IG outperformed HY from 4Q18 through 1Q20, the HY-IG performance gap is now reversing. The setup looks similar to mid-2016 when HY started a strong performance run vs IG into 1Q17. We believe HY can continue to close the performance gap vs IG.

Figure 24: Key Metrics Across Corporate Bond Ratings

Analysis	Investment Grade				High Yield		
	AAA	AA	A	BBB	BB	B	CCC
Yield / Spread (%)							
Yield To Maturity	1.64	1.50	1.67	2.44	4.35	6.07	12.47
Yield To Worst	1.60	1.47	1.63	2.38	3.94	5.52	11.94
Yield To Call	1.60	1.47	1.62	2.38	3.96	5.54	11.95
Option Adj Spread	0.74	0.81	1.00	1.76	3.54	5.21	11.71
Bond Duration							
Duration (Years)	12.3	9.2	8.3	8.0	5.4	4.5	3.8
Duration Spread	12.0	9.0	8.1	7.9	4.3	2.9	2.7
Returns							
1-Month	-3.3%	-2.6%	-1.8%	-1.3%	0.2%	0.7%	6.3%
3-Month	-3.5%	0.8%	1.8%	3.9%	5.6%	5.7%	27.2%
6-Month	-1.2%	1.8%	1.6%	1.6%	2.0%	1.6%	4.1%
1-Year	1.9%	3.7%	3.8%	3.6%	0.7%	1.9%	3.0%

Source: MarketDesk Research

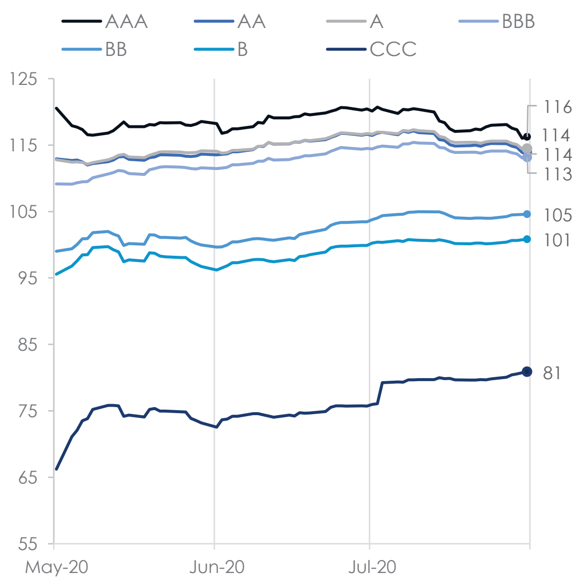
Figure 25: Y/Y Performance — HY vs IG

Rolling LTM price returns of high yield vs investment grade bonds.

Source: MarketDesk Research

Figure 26: Index Prices Over The Past 3-Months

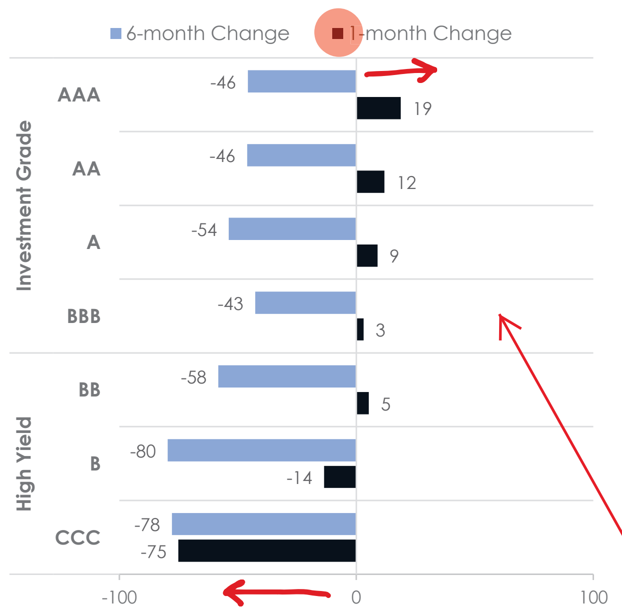
Price movement across corporate bonds by rating levels.



Source: MarketDesk Research

Figure 27: YTW Across Ratings - 1mo & 6mo Change

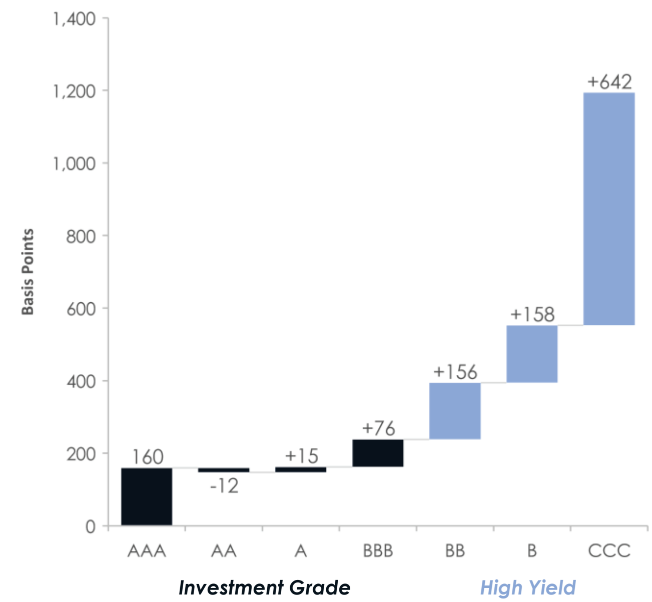
Trends in yield to worst (YTW) across corporate bond ratings.



Source: MarketDesk Research

Figure 28: Incremental Corporate Yield by Rating Levels

Additional yield for owning one lower rating (using YTW).



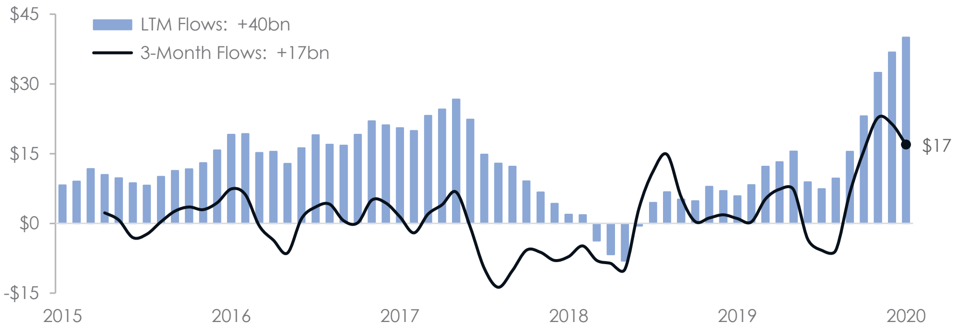
Source: MarketDesk Research

Yields on the lowest quality credits decreased further in August, while yields on the highest quality credit increased. Savers continue to search for yield, even as the economic backdrop remains uncertain. We believe a search for yield and the spread compression that results will continue to define the credit market.

The BBB-AAA spread moved further below the 5Y average last month. The 5Y low is ~0.6% vs today's 0.8%. The 0.6% low was before the Fed's stimulus measures, which suggests the BBB-AAA spread could tighten further.

Figure 29: IG Asset Flows ($USD Billions)

Trends in asset flows across investment grade bond ETFs.



Source: MarketDesk Research

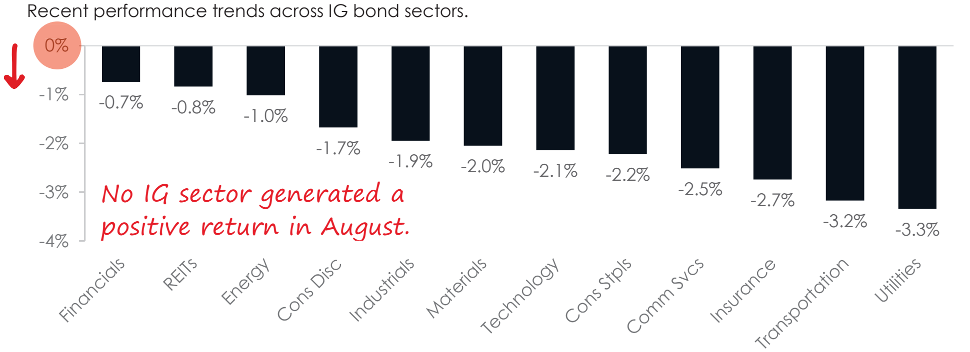
Figure 30: Y/Y Performance — IG Corporate Bonds vs 10Y U.S. Treasury

Rolling LTM price return of investment grade bonds vs 10-year U.S. Treasury bonds.

Source: MarketDesk Research

Figure 31: 1-month Price Return by IG Sector

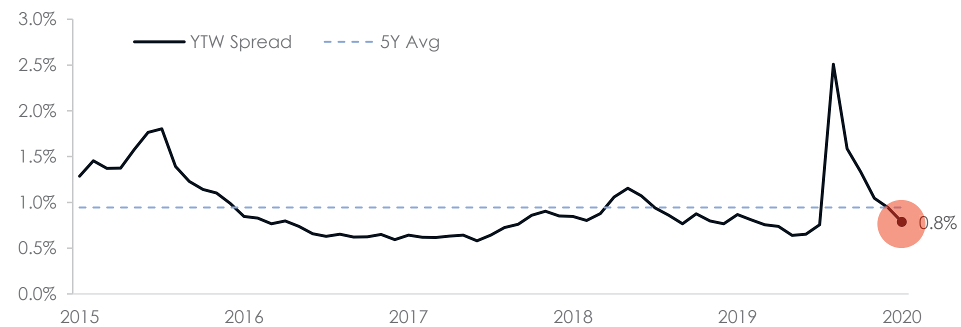
Recent performance trends across IG bond sectors.



Source: MarketDesk Research

Figure 32: YTW Spread — BBB vs AAA

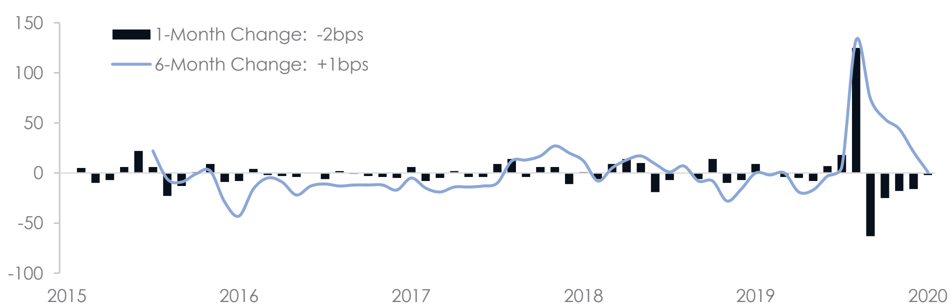
Yield to worst (YTW) difference between the lowest (BBB) and the highest (AAA) rated IG bonds.



Source: MarketDesk Research

Figure 33: IG OAS Change (basis points)

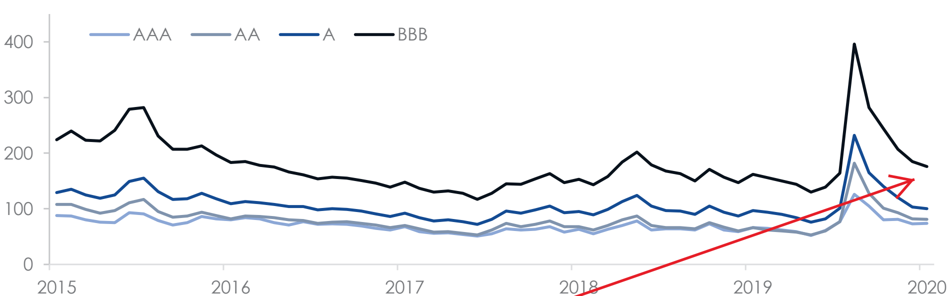
Change in option adjusted spread for a broad investment grade index measured in basis points (1bp = 0.01%).



Source: MarketDesk Research

Figure 34: OAS Across IG Ratings (basis points)

Option adjusted spread by investment grade rating level measured in basis points (1bp = 0.01%).



Source: MarketDesk Research

Yield starved institutions could be the catalyst to push BBB yields lower. However, BBB credit is more stressed from a financial health perspective today than in recent years. This increases the BBB credit downgrade risk, which investors will need to accept in order to earn the 0.8% incremental yield.

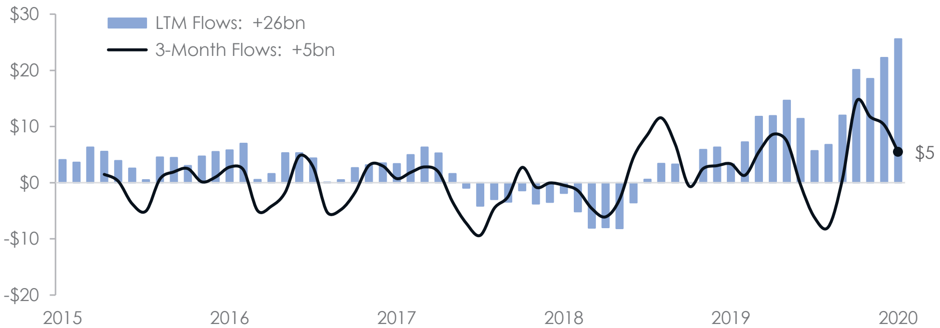
U.S. Corporates

High Yield (HY)

In contrast to IG's BBB-AAA spread, HY's CCC-BB credit spread remains above the 5Y average. This suggest investors are still wary of holding the lowest quality HY credit despite unprecedented stimulus measures. We would prefer to position at the higher quality end of the HY spectrum.

Figure 35: HY Asset Flows ($USD Billions)

Trends in asset flows across high yield bond ETFs.



Source: MarketDesk Research

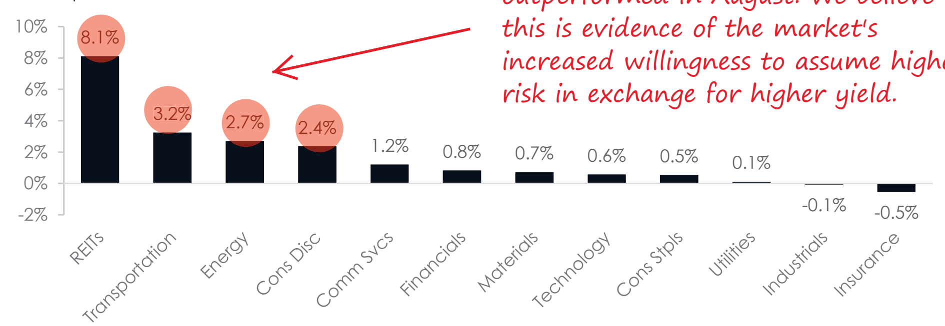
Figure 36: Y/Y Performance — Short-term HY vs Broad HY Corporate Bonds

Rolling LTM price return of short-term high yield corporate bonds vs broad high yield corporate bonds.

Source: MarketDesk Research

Figure 37: 1-month Price Return by HY Sector

Recent performance trends across HY bond sectors.

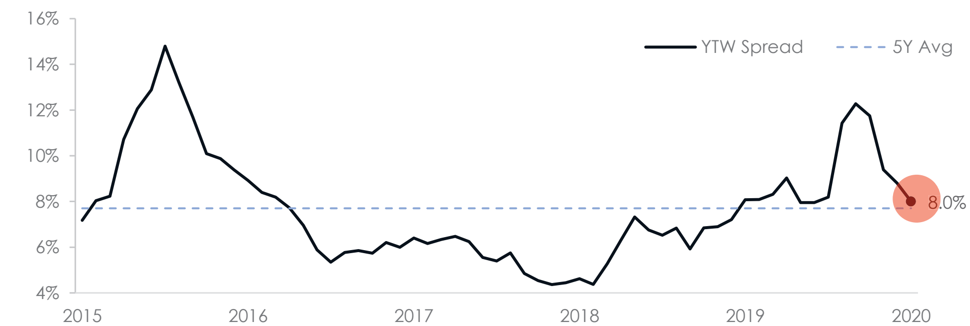


Source: MarketDesk Research

The hardest hit HY sectors (REITs, transportation, energy, & cons disc) outperformed in August. We believe this is evidence of the market's increased willingness to assume higher risk in exchange for higher yield.

Figure 38: YTW Spread — CCC vs BB

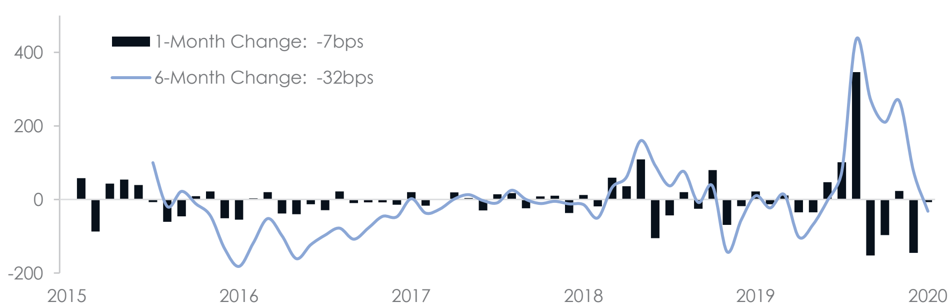
Yield to worst (YTW) difference between the lowest (CCC) and the highest (BB) rated HY bonds.



Source: MarketDesk Research

Figure 39: HY OAS Change (basis points)

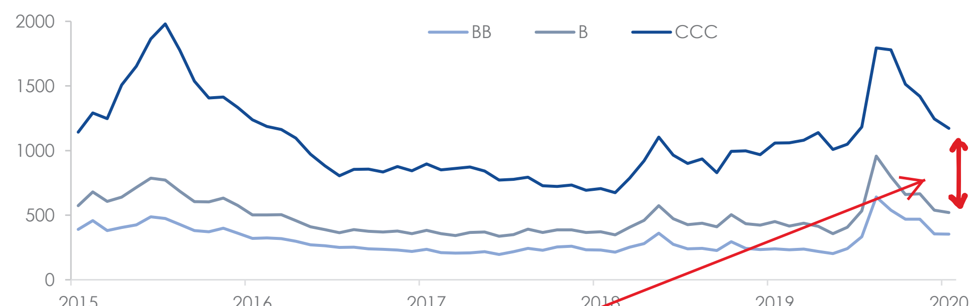
Change in the option adjusted spread for a broad high yield index measured in basis points (1bp = 0.01%).



Source: MarketDesk Research

Figure 40: OAS Across HY Ratings (basis points)

Option adjusted spread by high yield rating level measured in basis points (1bp = 0.01%).



Source: MarketDesk Research

CCC OAS remains significantly elevated. In our view, it remains too risky to venture down to the bottom of the HY spectrum. Consider fallen angel ETFs, such as FALN and ANGL, to capture the BBB-BB credit spread and catch BBB downgrades.

U.S. Corporates
HY vs IG

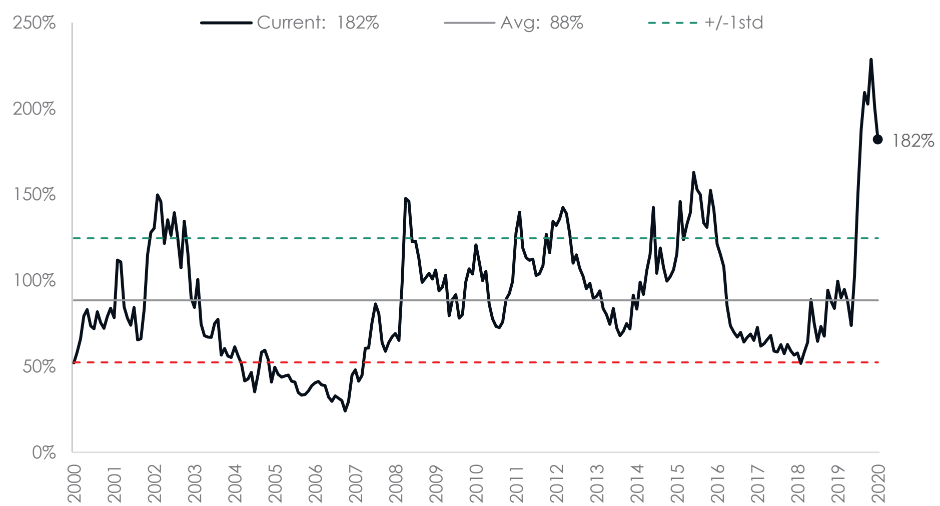
The HY-IG LTM return gap sits at 0% currently, which is an indication of how impactful the Fed's stimulus measures are to the market. Historical periods of HY underperformance tend to lead to periods of HY outperformance. The cycle is fairly consistent, which is why we continue to prefer HY over IG due to the stronger near-term HY return potential.

Monthly Report

September 1, 2020

Figure 41: Incremental HY Yield as % of IG Yield

The additional yield earned by investors owning high yield bonds (measured as % of the IG yield).



Source: MarketDesk Research

Figure 42: Y/Y Price Return — HY vs IG

Rolling LTM price return of high yield bonds vs investment grade bonds.

Source: MarketDesk Research

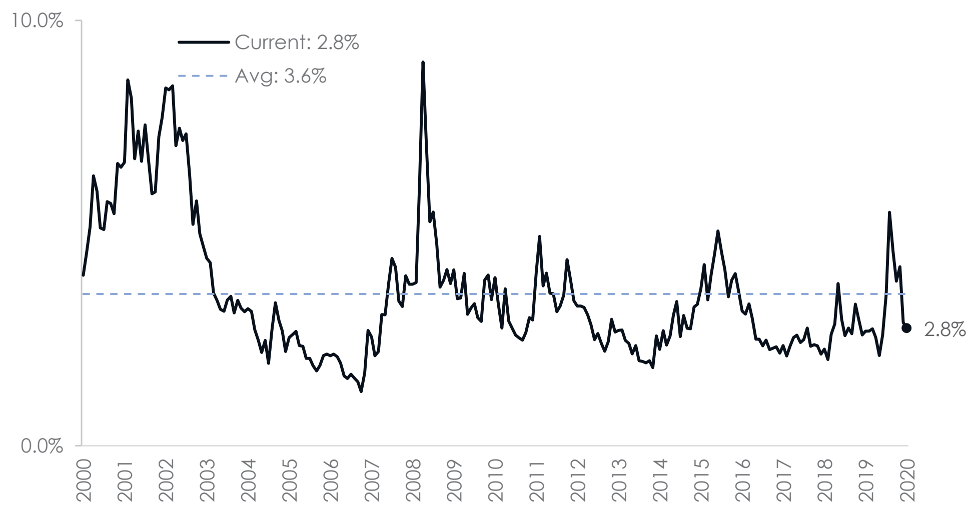
Figure 43: Credit Divide YTW Spread — BBB vs BB

Incremental yield earned owning the highest rated HY bond (BB) vs lowest rated IG bond (BBB).

Source: MarketDesk Research

Figure 44: YTW Spread — HY vs IG

Yield to worst spread between high yield bonds and investment grade bonds.



Source: MarketDesk Research

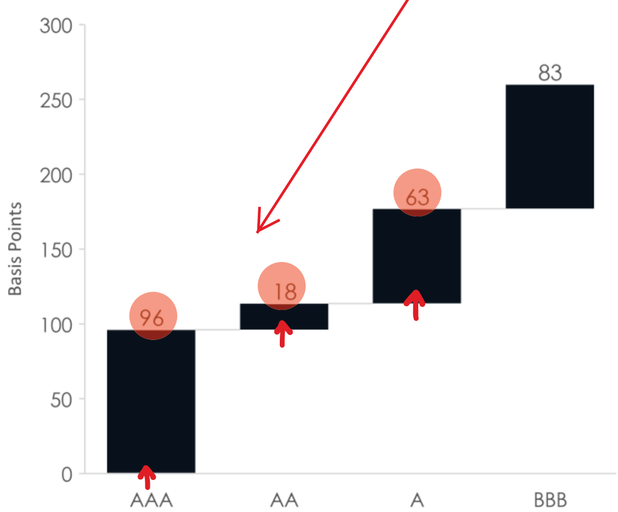
The BBB-BB credit divide spread sits at the 5Y average. We would prefer to own BB and earn the 1.6% additional yield. BBB was already stressed entering 2020, and COVID-19 related shutdowns stressed all companies. As a result, we believe the actual credit risk gap between BBB and BB credits is smaller than historical standards.

Municipals
Overview

AAA, AA, and A rated yields increased in August 2020 as federal aid for states and cities was held hostage during congressional negotiations. The stalled negotiations …

Figure 45: Incremental Muni Yield by Ratings Level

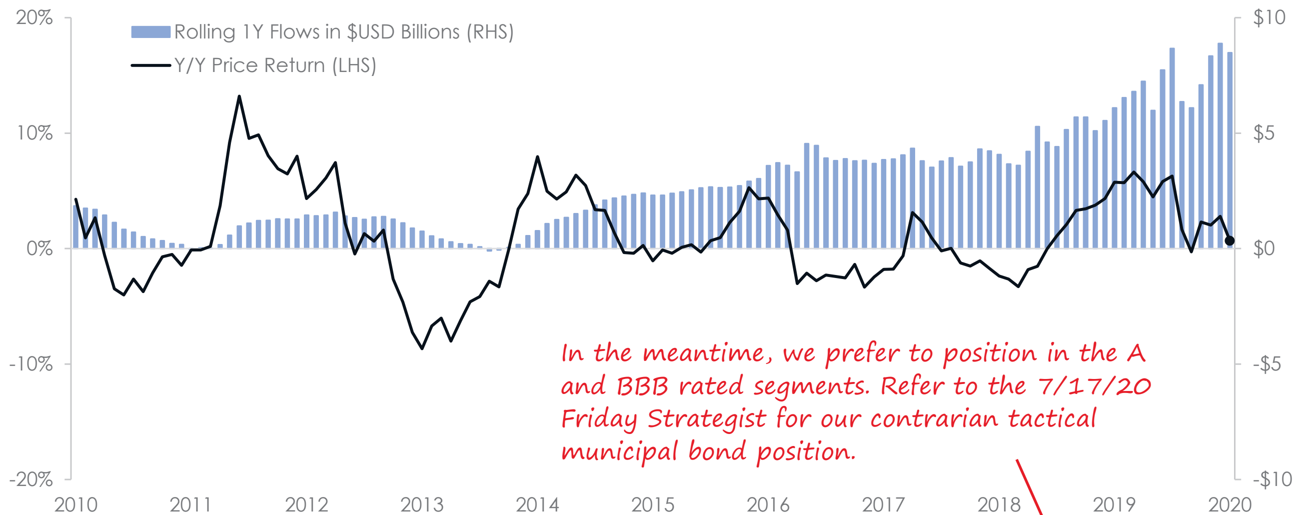
Additional muni yield earned owning one rating level lower.



Source: MarketDesk Research

Figure 46: Municipal Bonds — Flows & Performance

Rolling LTM return and net flows into municipal bond ETFs. This analysis highlights shifts in investor preference for municipal bonds.

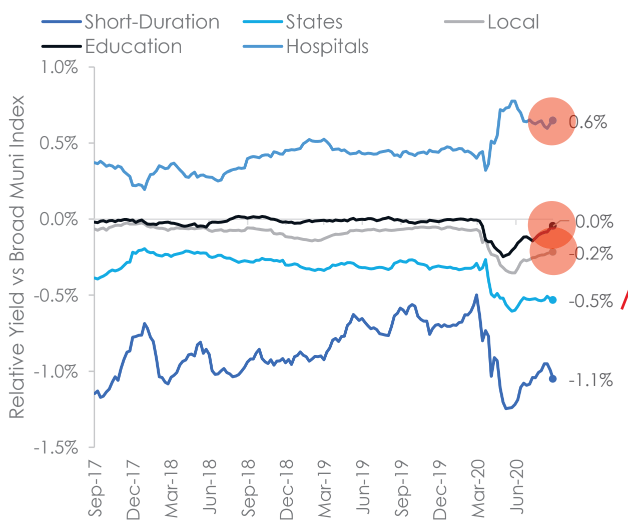


In the meantime, we prefer to position in the A and BBB rated segments. Refer to the 7/17/20 Friday Strategist for our contrarian tactical municipal bond position.

Source: MarketDesk Research

Figure 47: Relative Yields across Muni Bond Types

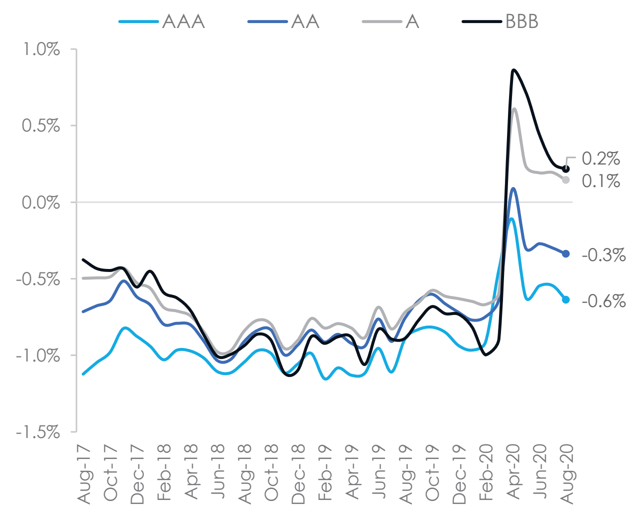
Yield of muni bond types vs diversified muni bond index.



Source: MarketDesk Research

Figure 48: Muni Yields Relative to Corp Bonds by Rating

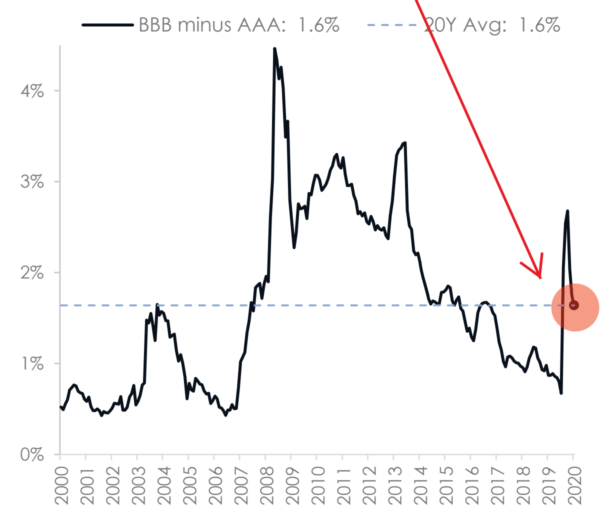
Comparative yield owning the same quality muni vs corp bonds.



Source: MarketDesk Research

Figure 49: Muni Bond Spread — BBB vs AAA

Yield spread between high (AAA) vs low (BBB) rated munis.



Source: MarketDesk Research

… caused state, education, and local municipal bonds yields to each increase relative to the broad municipal bond index. We do expect states and cities to receive aid, but municipal bonds could become caught in the negotiation process until a deal is reached.

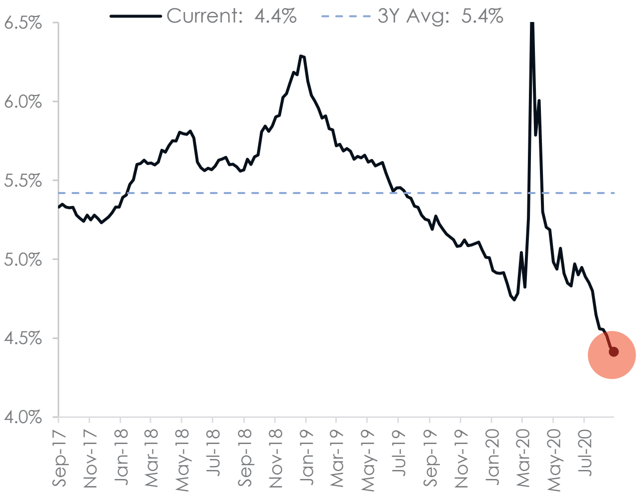
Preferred Stocks & Convertible Bonds

Overview

Preferreds' yield is 1% below the 3-year average. We believe this indicates two things: (1) savers' hunt for yield is picking up pace and (2) investors are willing to give up equity market upside in exchange for a higher yield.

Figure 50: Preferred Stocks Yield vs 3-Year Average

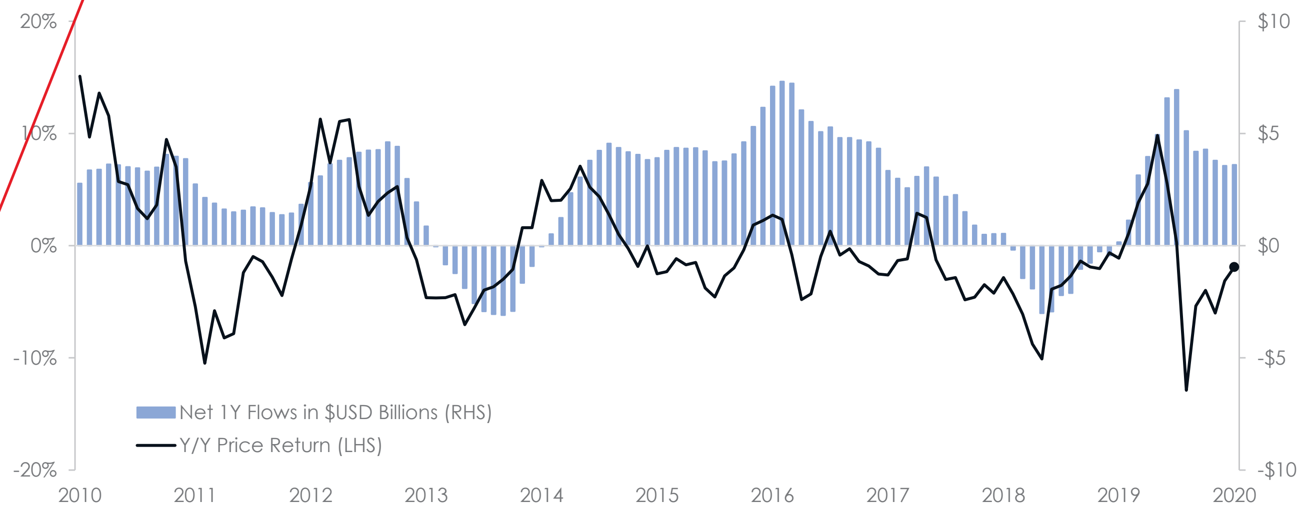
Historical yield earned owning preferred stocks.



Source: MarketDesk Research

Figure 51: Preferred Stocks — Flows & Performance

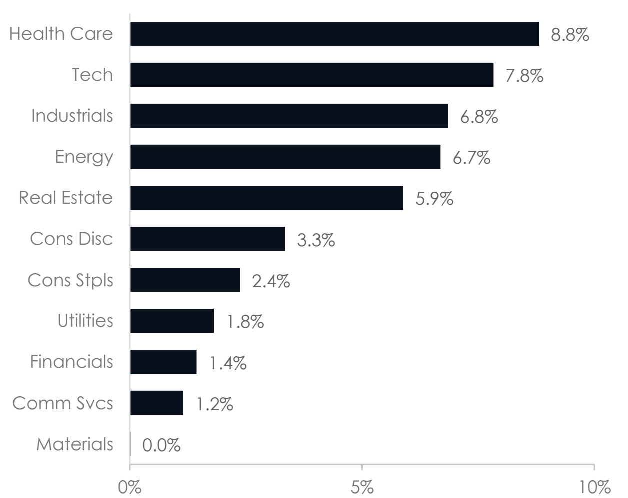
Rolling LTM return and net flows into preferred stock ETFs. This analysis highlights shifts in investor preference for preferred stocks.



Source: MarketDesk Research

Figure 52: 1-Month Returns — Convertible Bonds by Sector

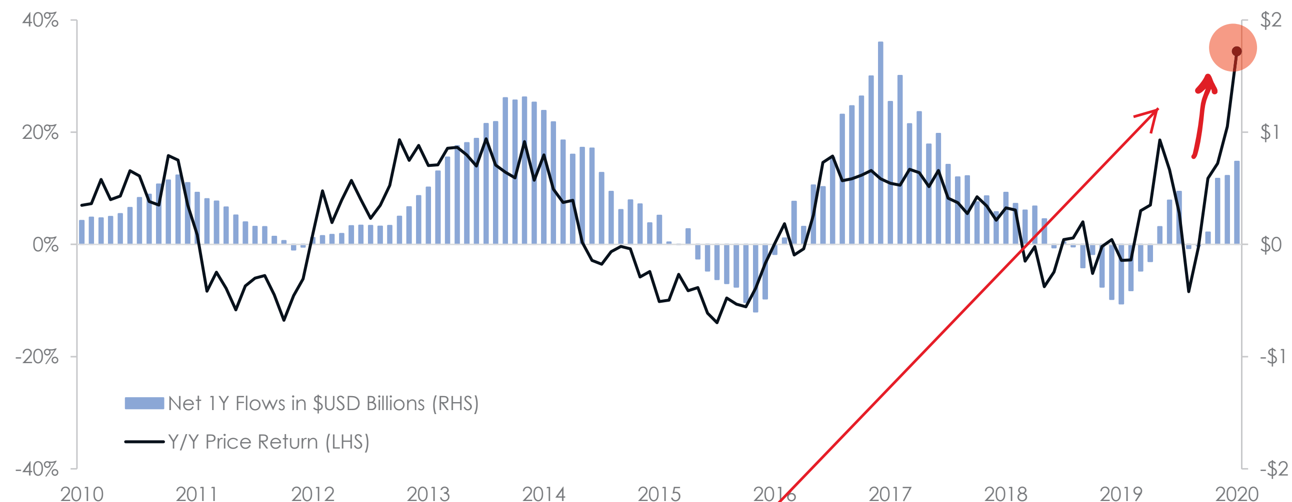
Trends in convertible bond performance by U.S. sector.



Source: MarketDesk Research

Figure 53: Convertible Bonds — Flows & Performance

Rolling LTM return and net flows into convertible bond ETFs. This analysis highlights shifts in investor preference for convertible bonds.

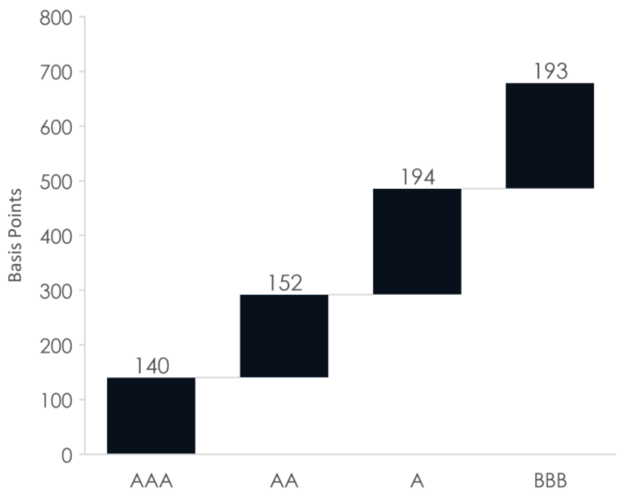


Source: MarketDesk Research

Convertible bonds' +37.6% y/y return is the highest over the past decade. The surging equity market makes convertibles' hybrid bond/equity exposure more attractive. However, the strong LTM returns leave convertibles at risk of underperformance and vulnerable to an equity market selloff.

Figure 54: Incremental CMBS Yield by Ratings Level

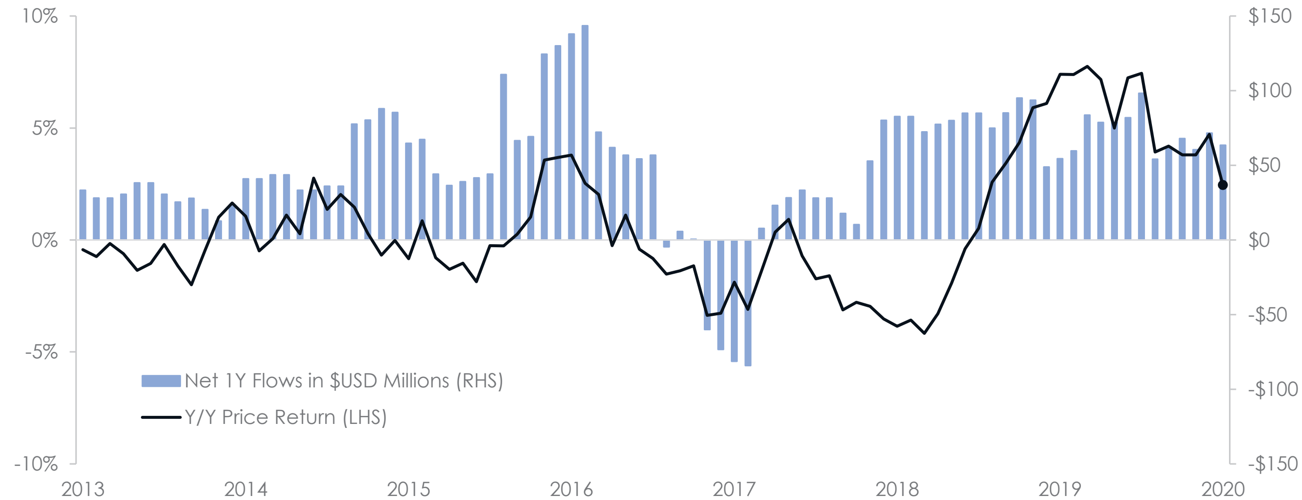
Additional CMBS yield earned owning one rating level lower.



Source: MarketDesk Research

Figure 55: CMBS — Flows & Performance

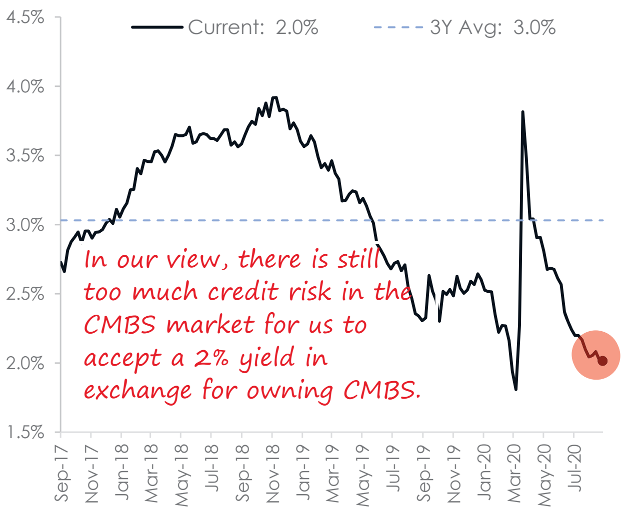
Rolling LTM return and net flows into CMBS ETFs. This analysis highlights shifts in investor preference for CMBS.



Source: MarketDesk Research

Figure 56: CMBS Yield & 3-Year Average

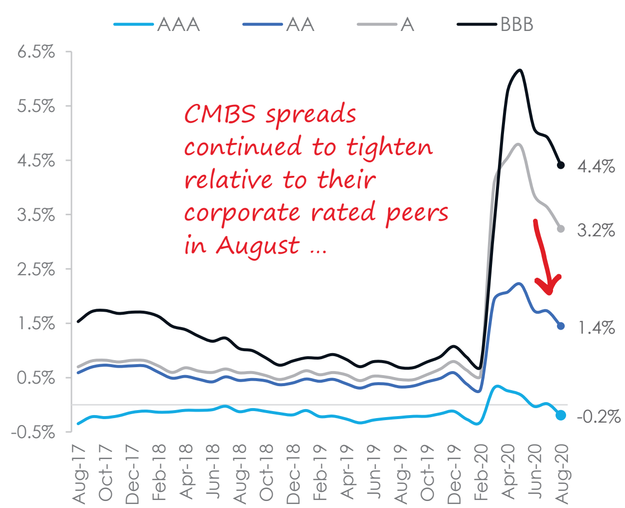
Historical yield earned owning CMBS.



Source: MarketDesk Research

Figure 57: Relative Yields — CMBS vs Corporate Bonds

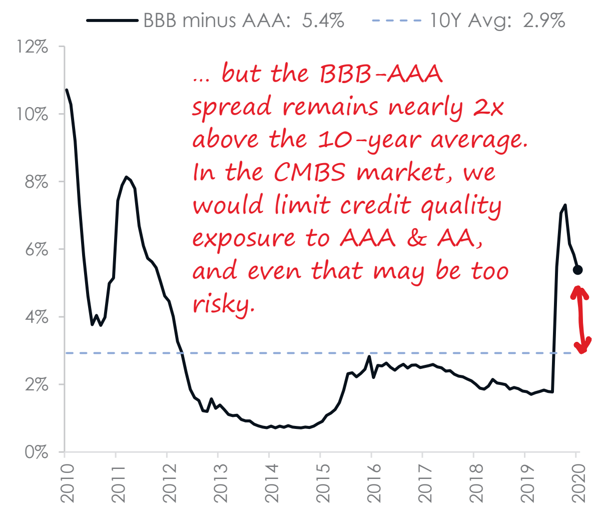
Comparative yield owning the same quality CMBS vs corp bonds.



Source: MarketDesk Research

Figure 58: CMBS Spread — BBB vs AAA

Yield spread between high (AAA) vs low (BBB) rated CMBS.



Source: MarketDesk Research

MDR Website

www.MarketDeskResearch.com

Sales Team

+1 (646) 787-0394

Sales@MarketDeskResearch.com

Client Support

+1 (646) 787-0394

Support@MarketDeskResearch.com

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