PARAMETRIC

Corporate Bond Markets Look to Stabilize amid Unprecedented Volatility in March

IMPORTANT NOTICE

The following material is provided by a third-party strategist unaffiliated with AssetMark. The strategist is solely responsible for its content. Please read the risks and disclosures section for additional important information. AssetMark has not verified the accuracy of the information contained in this material.

For financial advisor use only.

C20-16012 | 05/2020 | EXP 05/31/2021

PARAMETRIC™

Corporate Bond Market Insight | April 2020

Corporate Bond Markets Look to Stabilize amid Unprecedented Volatility in March

Key takeaways

» Market disruptions stemming from COVID-19 led to the second-worst month in history for investment-grade corporate credit performance.

» Markets were greatly affected by:

- COVID-19's disruption of global supply chains
- Extreme demand shock from efforts to curb the spread of COVID-19
- Ongoing disagreements in the Organization of the Petroleum Exporting Countries (OPEC) that led to a collapse in crude oil prices reverberating through global energy markets

» The accelerated spread of this crisis has convinced us that it's worse than the 2008–2009 financial crisis in many ways.

» As the month drew to a close, the Fed's unprecedented policy initiatives and fiscal stimulus began to stabilize the markets.

Parametric
800 Fifth Avenue
Suite 2800
Seattle, WA 98104
T 206 694 5575
F 206 694 5581
www.parametricportfolio.com

©2020 Parametric Portfolio Associates® LLC

Market disruptions trigger federal aid for corporates

March 2020 was a historic month by many measures. As disruptions related to COVID-19 ravaged markets and the economy, investment-grade corporate credit suffered the second-worst month in index history, trailing only September 2008. Credit spreads exploded, going from roughly 100 basis points (bps) to over 400 bps in a matter of 16 trading days. Not surprisingly the only comparable period was that which followed Lehman's bankruptcy (September–October 2008). However, as March drew to a close, unprecedented monetary and fiscal stimulus began to stabilize the markets.

While credit spreads recovered at the end of the month, they widened by 200 bps and were somewhat offset by a decline of 43 bps in 10-year Treasury yields. This leaves investment-grade corporate bond yields about 1.57% higher over the month, suggesting an extreme imbalance between cash-raising sellers and willing buyers. As a result of the imbalance, the ICE BofAML Merrill Lynch 1–10 Year US Corporate Index returned -5.75% in March, bringing the total return to -3.43% in 2020.

	March 5	March 23	March 31
1–10 BBB index (C5A0) yield to maturity (YTM)	1.90%	4.63%	3.48%
1–10 BBB index (C5A0) option-adjusted spread (in bps)	+110 bps	+413 bps	+306 bps
1–10 BBB index (C5A0) month-to-date return	+0.82%	-9.95%	-5.75%

Sources: ICE BofAML US Corporate Index, Bloomberg, 3/31/2020. Not a recommendation to buy or sell any security.

Markets were buffeted by multiple shocks. In the early stages COVID-19 disrupted global supply chains, creating a dramatic and negative supply shock. As the pandemic spread, millions of employees were laid off and populations began social distancing, creating an extreme and negative demand shock. In early March ongoing OPEC talks broke down after Saudi Arabia announced a significant increase in oil production as a negotiating ploy aimed at Russia. The subsequent breakdown in crude oil prices created a crisis in the global energy markets. In response to these events, credit and equity markets quickly began pricing a precipitous business interruption across large sectors of the economy. Some estimates suggested that GDP might contract as much as 30%.

Not surprisingly, the Fed, Congress, and the administration all reacted quickly and decisively to address the economic fallout. The Fed reacted first with an emergency rate cut of 50 bps in early March and followed up 12 days later with a second cut of 100 bps. It also announced a new round of quantitative easing. What began as a limited program was quickly expanded to become open ended and to include several new asset types and credit facilities. Importantly for corporate bond investors, in an effort to ease the liquidity crisis in credit markets, it created programs designed to support both primary and secondary corporate bond markets. Additionally Congress and the administration passed an impressive package of legislation intended to bolster the health care system, support cash-strapped corporations, and provide support to millions left unemployed.

As for the yield curve, we usually focus on US Treasuries to judge both changes in rates and the shape of the curve. With spreads moving so violently during March, corporate yields moved in the opposite direction from Treasuries. The Treasury curve fell and steepened from two years to 10 years. Investment-grade corporate yields, however, did the opposite. They rose and flattened as credit spreads widened more in short maturities than in long. Though industrials were dragged down by energy and autos, utilities trailed—followed by industrials—which in turn lagged banks. As expected given the wider spreads, BBB-rated issuers lagged considerably versus A to AAA, while high-yield issuers fell further behind BBBs.

Notes from the trading desk

As the crisis unfolded this month, the ability to execute at anticipated levels disappeared. Market visibility vanished, and bid-ask spreads—our measure of trading costs—ballooned. Bids were elusive in the face of forced selling, and offers we considered to be fair value were also difficult to source. Uncertainty related to the crisis created a market of sellers far outnumbering buyers, while many of our trading counterparts quickly became unable or unwilling to provide liquidity.

While illiquidity spread throughout the bond markets—including Treasuries—our trading team ultimately managed through the associated challenges by employing new and innovative approaches to generate liquidity in dysfunctional markets. Given the accelerated spread of the crisis, we quickly realized that the unpredictable price action, lack of dealer participation, and poor visibility were worse than what we experienced during the 2008–2009 financial crisis in many ways.

©2020 Parametric Portfolio Associates® LLC

Since the Fed outlined its plans to support both the primary and secondary investment-grade corporate markets last week, trading has stabilized and credit spreads have narrowed. One important sign of improving market dynamics has been the bid for recent new-issue corporates. New issuance in March was by far the largest on record—and demand for these issues was strong. This suggests that institutional buyers are interested in issuers who can access the market to raise cash—even though secondary trading is by no means normal.

Looking ahead

There are many questions surrounding the path of COVID-19 and its ultimate impact on the economy. Despite the unknown challenges that may lie ahead, policymakers during the 2008 crisis learned that unprecedented times call for decisive and forceful responses to restore investor confidence and to stabilize financial markets. In that context we view the March weakness as a rare opportunity for ladder investors to establish new positions at attractive yields and the widest spreads since the financial crisis. Additionally, the lack of liquidity makes any portfolio repositioning more costly than normal.

We suggest being patient and not letting volatility dictate financial decisions. This crisis is likely to continue presenting opportunities to make portfolio adjustments and new implementations. BBB issuers look historically cheap compared to issuers rated A or better, and the spread differential between BBs and BBBs is even greater. We suggest sticking to a one-to-10-year maturity to take full advantage of a potential future recovery.

PARAMETRIC™
An Eaton Vance Company

About

Parametric Portfolio Associates LLC (Parametric), headquartered in Seattle, is registered as an investment advisor with the Securities and Exchange Commission under the Investment Advisers Act of 1940. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed-income, alternative, and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay, and centralized portfolio management. Parametric is a wholly owned subsidiary of Eaton Vance Corp. and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York City, and Westport, Connecticut.

Disclosures

This material may not be reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

This information is intended solely to report on investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Past performance is not indicative of future results. The views and strategies described may not be suitable for all investors. Investing entails risks, and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Parametric does not provide legal, tax, or accounting advice or services. Clients should consult with their own tax or legal advisor prior to entering into any transaction or strategy described herein.

Charts, graphs, and other visual presentations and text information were derived from internal, proprietary, and/or service vendor technology sources and/or may have been extracted from other firm databases. As a result, the tabulation of certain reports may not precisely match other published data. Data may have originated from various sources, including, but not limited to, Bloomberg, MSCI/Barra, FactSet, and/or other systems and programs. Parametric makes no representation or endorsement concerning the accuracy or propriety of information received from any third party.

The views expressed in this report are those of portfolio managers and are current only through the date stated at the top of this page. These views are subject to change at any time based on market or other conditions, and Parametric disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions are based on many factors, may not be relied on as an indication of trading intent on behalf of any Parametric strategy. This commentary may contain statements that are not historical facts, referred to as "forward-looking statements." The strategy's actual future results may differ significantly from those stated in any forward-looking statement, depending on factors such as changes in securities or financial markets or general economic conditions.

An imbalance in supply and demand in the income market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads, and a lack of price transparency in the market. As interest rates rise, the value of certain income investments is likely to decline. Mortgage-backed securities are subject to prepayment risk. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. While certain US government–sponsored agencies may be chartered or sponsored by acts of Congress, their securities are neither issued nor guaranteed by the US Treasury. Mortgage- and asset-backed securities are subject to credit, interest rate, prepayment, and extension risk. Derivative instruments can be used to take both long and short positions, be highly volatile, result in economic leverage (which can magnify losses), and involve risks in addition to the risks of the underlying instrument on which the derivative is based, such as counterparty, correlation, and liquidity risk. Diversification does not guarantee profit or eliminate the risk of loss.

All contents ©2020 Parametric Portfolio Associates® LLC. All rights reserved. Parametric Portfolio Associates® and Parametric® are trademarks registered in the US Patent and Trademark Office and certain foreign jurisdictions.

Parametric is headquartered at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies or to request a copy of Parametric's Form ADV, please contact us at 206 694 5575 or visit www.parametricportfolio.com.

27494 | 04.08.2020