

Third Quarter 2019 Bond Market Commentary

Interest rates continued to fall during the third quarter, producing strong performance across the fixed income markets. Most notable, long-term U.S. Treasury bonds achieved double-digit returns year to date of +21.7%, according to Bloomberg. Additionally, lower-quality credit benefited from tightening credit spreads, reversing the damage that was inflicted in late 2018. Demand for yield globally directs most of the world to the U.S. as negative interest rates in Germany and Japan are causing dislocations.

Central banks around the globe are saturating the world with money. This easing, in turn, is causing interest rates to fall, and in some cases become negative. The concept of lending someone money, and you must pay them to hold it, is innovative, but not without potential unintended consequences. How this monetary experiment gets unwound is yet to be determined.

At the beginning of the year, expectations were for the Fed to raise interest rates throughout 2019. Following the Fed pivot, we have experienced unexpected double-digit total returns from bonds as interest rates dropped. This shift in rates has impacted corporations and their appetite for debt. Major corporations have been borrowing at record pace. Bloomberg reports that the total value of U.S. investment-grade corporate bonds is near a record \$5.8 trillion, more than triple the amount in October 2008.

While the higher-rated corporations have actively borrowed to fund acquisitions and stock buy backs to improve earnings, junk-rated companies have struggled to borrow. High-yield companies are facing downgrades at the fastest pace relative to upgrades since 2009, according to Bloomberg data. With chances of a recession occurring in the next two years rising, we are prudently addressing our corporate bond exposures and upgrading the quality of our holdings.

Demand for tax-free income has also impacted the municipal bond market. Tax-free yields as a percentage of U.S. Treasury notes fell to very low levels earlier this year. Recently, this has reversed, and though overall municipal interest rates remain very low, they are back in line with the historical average as a percentage of U.S. Treasuries. As with our corporate bond allocation, we are prudently upgrading our municipal bond quality.

Index Returns As of 9/30/19	Performance Period		
	3 Month	YTD	1 Year
Bloomberg Barclays U.S. Treasury Intermediate	+1.18%	+5.22%	+7.58%
Bloomberg Barclays Govt/Credit Intermediate	+1.37%	+6.41%	+8.17%
Bloomberg Barclays Intermediate Aggregate	+1.38%	+6.18%	+8.08%
Bloomberg Barclays U.S. Treasury	+2.40%	+7.71%	+10.48%
Bloomberg Barclays Govt/Credit	+2.64%	+9.72%	+11.32%
Bloomberg Barclays Aggregate	+2.27%	+8.52%	+10.30%
Bloomberg Barclays U.S. Treasury 20+ Year	+8.15%	+20.20%	+25.21%
Bloomberg Barclays Corporate	+3.05%	+13.20%	+13.00%
Bloomberg Barclays Corporate Intermediate	+1.74%	+8.94%	+9.57%
Bloomberg Barclays Corporate High Yield	+1.33%	+11.41%	+6.36%
Bloomberg Barclays Credit AAA	+1.77%	+6.88%	+8.86%
Bloomberg Barclays Credit AA	+2.84%	+10.32%	+11.76%
Bloomberg Barclays Credit A	+2.93%	+12.18%	+12.58%
Bloomberg Barclays Credit BAA	+3.26%	14.52%	+13.49%
Bloomberg Barclays MBS	+1.37%	+5.60%	+7.80%
Bloomberg Barclays TIPS	+1.35%	+7.58%	+7.13%
Bloomberg Barclays Inter-Short Muni	+0.67%	+4.31%	+5.92%

Source: Bloomberg Barclays

Daily Generic Municipal Bond Yields as of 9/30/19

Term	Maturity	AAA	AA	A	BAA1
1 Yr	2020	1.25	1.36	1.45	1.80
2 Yr	2021	1.25	1.38	1.47	1.83
3 Yr	2022	1.25	1.39	1.50	1.86
4 Yr	2023	1.25	1.40	1.53	1.89
5 Yr	2024	1.25	1.41	1.56	1.91
7 Yr	2026	1.31	1.46	1.65	1.98
9 Yr	2028	1.41	1.59	1.79	2.11
10 Yr	2029	1.46	1.65	1.85	2.17
12 Yr	2031	1.56	1.77	1.97	2.30
14 Yr	2033	1.64	1.89	2.08	2.42
15 Yr	2034	1.67	1.94	2.13	2.47
17 Yr	2036	1.74	2.02	2.19	2.55
19 Yr	2038	1.81	2.07	2.23	2.62
20 Yr	2309	1.84	2.09	2.26	2.66
25 Yr	2044	1.98	2.24	2.39	2.85
30 Yr	2049	2.03	2.30	2.43	2.92

Source: Bloomberg



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Index Descriptions:

Bloomberg Barclays U.S. Intermediate Treasury Index: Unmanaged index includes all publicly issued, U.S. Treasury securities that have a remaining maturity of greater than or equal to 1 year and less than 10 years, are rated investment grade, and have \$250 million or more of outstanding face value.

Bloomberg Barclays Intermediate Government/Credit Index: Unmanaged index based on all publicly issued intermediate government and corporate debt securities with maturities of 1-10 years. This index represents asset types that are subject to risk, including loss of principal.

Bloomberg Barclays U.S. Treasury Bond Index: Part of Bloomberg Barclays global family of government bonds indices. The index measures the performance of the U.S. Treasury bond market, using market capitalization weighting and a standard rule based inclusion methodology.

Bloomberg Barclays Government/Credit Bond Index: Unmanaged index that tracks the performance of U.S. Government and corporate bonds rated investment grade or better, with maturities of at least one year.

Bloomberg Barclays Intermediate Aggregate Index: Unmanaged index that consists of 1-10 year Governments, 1-10 year Corporates, all Mortgages, and all Asset-Backed securities within the Aggregate Index (i.e., the Aggregate Index less the Long Government/Corporate Index).

Bloomberg Barclays U.S. Aggregate Bond Index: Unmanaged index composed of securities from the Bloomberg Barclays Government/Corporate Bond Index, Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization.

Bloomberg Barclays U.S. Credit Index: Composed of all publicly issued, fixed-rate, nonconvertible, investment-grade corporate debt. Issues are rated at least Baa by Moody's Investors Service or BBB by Standard & Poor's, if unrated by Moody's. Collateralized Mortgage Obligations (CMOs) are not included. Total return comprises price appreciation/depreciation and income as a percentage of the original investment.

Bloomberg Barclays U.S. Intermediate Credit Index: Measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. The index only includes securities with maturity between 1 and 10 years. It is composed of the Bloomberg Barclays U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals, and local authorities.

Bloomberg Barclays U.S. Corporate High Yield Index: Unmanaged index comprised of issues that meet the following criteria: at least \$150 million par value outstanding, maximum credit rating of Ba1 (including defaulted issues), and at least one year to maturity.

Bloomberg Barclays U.S. Mortgage-Backed Securities Index: Unmanaged index that tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by GNMA, FNMA, and FHLM.

Bloomberg Barclays U.S. Treasury Inflation-Protected Securities (TIPS) Index: Represents securities that protect against adverse inflation and provide a minimum level of real return. To be included in this index, bonds must have cash flows linked to an inflation index, be sovereign issues denominated in U.S. currency, and have more than one year to maturity, and, as a portion of the index, total a minimum amount outstanding of 100 million U.S. dollars. An individual cannot invest directly in an index.

Bloomberg Barclays Municipal Bond Inter-Short 1-10 Year Index: Unmanaged index of municipal bonds traded in the U.S. with maturities ranging from 1-10 years.

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