Intermediate Duration Corporate Fixed Income

Fourth Quarter 2020

The fourth quarter saw decelerating to stalling trends in the economic recovery with activity still at levels below those seen prior to the COVID-19 pandemic. Capital markets shrugged off this information due to the belief that greater government support will be forthcoming and will support the economy until the newly developed vaccines allow a return to normal activity. This belief drove a modest rise in longer rates, surging equity prices and a continued grind tighter in credit spreads. The benefit of tightening spreads was much greater than the negative price impact of rate increases, and this led to another strong quarter of corporate bond performance.

The portfolio's more conservative credit risk positioning was a negative for relative performance during the fourth quarter. Lower-rated bonds saw more credit spread tightening during the fourth quarter, and so the portfolio's high-quality bias resulted in less price appreciation due to corporate credit spread tightening. Also, the portfolio's yield was lower due to the more conservative credit risk positioning. Credit selection in higher-rated financials was a negative for relative performance during the fourth quarter.

2021 will see strong forces working both for and against a strong economic recovery. Widespread rollout of vaccines that prove effective would support the recovery, and fiscal stimulus will likely provide at least a short-term boost. If vaccination efforts do not work to quickly quell the pandemic, or if the Biden administration seeks to significantly ramp up taxes and regulation, these items would work against continued growth. Many corporate borrowers will need to see a strong and sustained recovery from current economic activity levels in order to maintain solvency, and the current levels of credit spreads indicate market assumptions that this recovery will be forthcoming. Given this level of uncertainty and the current levels of compensation for assuming credit risk, a conservative credit risk posture remains appropriate in the corporate bond market.

Adherence to our conservative style of fixed income investing has been, and will always be, the hallmark of Reinhart Partners.