Weekly Bond Market Commentary

Fixed Income Solutions

A Small Window of Opportunity in a World of Considerable Uncertainty

DOUG DRABIK
Managing Director, Fixed Income Strategist

Your fixed income allocation is meant to be the portfolio's more stable and predictable assets. Many of our investors design their fixed income allocation with the intent of holding these line items to maturity, thus reducing the risks associated with market volatility while knowing the income, cash flow and designated date that the face value will be returned.

The current interest rate environment renders near historic lows across the curve. In addition, the Fed is telling us that they have no intent of raising short-term interest rates at least through 2022. In a world environment abundant with uncertainty, this information provides a window of transparency and perhaps a small but meaningful means to exploit the knowledge.

The vigorous demand for short-term high-quality bonds inside of 2 years coordinates with the nearly 2.5 years the Fed has pledged to keep short-term rates low. Aggressive pricing for these short-term assets can provide an offset to income sacrificed by selling before maturity in the form of an immediate profit gained. By taking the proceeds and reinvesting in very moderate maturities, an investor may be able to pick up an additional 50bp-80bp in yield over the next 12-30 months. Although this doesn't seem like a "home-run", keep in mind that the 10 year Treasury bond is yielding only 0.60%. This can be a substantial benefit on a percent basis.

This is an extension swap; however, with a high degree of certainty that the Fed is keeping short-term interest rates low for the next 2.5 years, moving into the 5 year part of the curve adds a very calculated, and educated look at a moderate amount of market risk.

Below is an example of what the numbers could look like. The market value was held constant at roughly $186k. For comparison, the cash flow was designed to stay roughly the same also. In this example, the client booked an $8,137 gain.

Sample Portfolio For Demonstration Purposes Only. Actual Results Could Vary. Sources: TradeWeb Direct, Raymond James.

	Proposed Sells	Proposed Buys	Change
Original Face	$175,000.00	$165,000.00	-$10,000.00
Current Face	$175,000.00	$165,000.00	-$10,000.00
Market Principal	$186,247.75	$186,111.45	-$136.30
Accrued Interest	$1,200.80	$1,527.39	$326.59
Market Value	$187,448.55	$187,638.84	$190.29
Next 12mo Cpn Cash Flow	$6,735.75	$6,256.25	-$479.50
Generic Annual Cpn Cash Flow	$6,735.75	$6,256.25	-$479.50
Gain/(Loss)	$8,137.00	-	-

	Proposed Sells	Proposed Buys	Change
Coupon	3.849%	3.792%	-5.7 bp
Maturity	1.69 yrs	5.18 yrs	3.49 yrs
Original Maturity	1.69 yrs	5.18 yrs	3.49 yrs
Price	106.427	112.795	6.368
Yield to Worst	0.382%	1.177%	79.5 bp
Yield to Maturity	0.542%	1.245%	70.3 bp
Modified Duration	1.55	4.58	3.03
Convexity	0.036	0.251	0.215
After Tax YTW**	0.237%	0.741%	50.4 bp
Tax Equivalent YTW**	0.381%	1.176%	79.5 bp
After Tax YTM**	0.338%	0.784%	44.6 bp
Tax Equivalent YTM**	0.542%	1.244%	70.2 bp
Avg Moody's Rating	Baa1 A3	Baa1 A3	↑
Avg S&P Rating	BBB+ A-	BBB+	↓

The trade-off is clear. By moving the aggressively bid holdings with an average 1.69 years-to-maturity out to 5.1 years, this portfolio would earn an extra 70bp on $186k over the 1.69 years. Since there is a strong possibility that short-term interest rates will not likely be any higher 1.69 years from now, choosing to reinvest the bonds today delivers extra income over this time period with the understood risk of whether rates would or would not be higher should they hold until maturity.

A small window of opportunity in a world of considerable uncertainty!

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863 // RAYMONDJAMES.COM