

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.

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.

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

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	-	-

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	↑
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

© 2020 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC.
© 2020 Raymond James Financial Services, Inc., member FINRA/SIPC. All rights reserved.
Raymond James® is a registered trademark of Raymond James Financial, Inc.
M20-2936036 until 2/4/23

The author of this material is a Trader in the Fixed Income Department of Raymond James & Associates (RJA), and is not an Analyst. Any opinions expressed may differ from opinions expressed by other departments of RJA, including our Equity Research Department, and are subject to change without notice. The data and information contained herein was obtained from sources considered to be reliable, but RJA does not guarantee its accuracy and/or completeness. Neither the information nor any opinions expressed constitute a solicitation for the purchase or sale of any security referred to herein. This material may include analysis of sectors, securities and/or derivatives that RJA may have positions, long or short, held proprietarily. RJA or its affiliates may execute transactions which may not be consistent with the report's conclusions. RJA may also have performed investment banking services for the issuers of such securities. Investors should discuss the risks inherent in bonds with their Raymond James Financial Advisor. Risks include, but are not limited to, changes in interest rates, liquidity, credit quality, volatility, and duration. Past performance is no assurance of future results.

Investment products are: not deposits, not FDIC/NCUA insured, not insured by any government agency, not bank guaranteed, subject to risk and may lose value.

To learn more about the risks and rewards of investing in fixed income, please access the Securities Industry and Financial Markets Association's "Learn More" section of investinginbonds.com, FINRA's "Smart Bond Investing" section of finra.org, and the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access System (EMMA) "Education Center" section emma.msrb.org.
