

MARCH 2021

Observations in Fixed Income

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The Fixed Income Landscape

Themes for 2021

Current Environment

Fiscal Stimulus	Central Bank Balance Sheets	Inflation
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Market Developments

Interest Rates	Credit Spreads
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Fixed Income Themes for 2021

Sources of Potential Volatility for the Bond Market

STIMULUS

Global economies were propped up by monetary and fiscal stimulus through much of 2020. This improved the wealth effect for households and boosted market liquidity. Despite unemployment remaining below target, gauges of wealth continue to make historical highs, and the fourth quarter saw 70% of companies beat earnings estimates.

The Biden administration wasted no time proposing, and ultimately passing, a massive \$1.9T stimulus plan for COVID relief. The package provides much needed assistance to areas of the economy such as state and local governments but its effects on the bond market were immediate and severe as rates spiked during the first quarter of the year.

INFLATION

In the U.S., market sentiment has changed quickly as the monthly PCE prints have been well above the Fed's mandate and depict real price pressures. This coincides with strong signals from both commodity prices and Treasury break-evens which work to corroborate the story. None of this has put a damper on Biden's plan for an additional \$1.9T in stimulus or his trust in the Fed's ability to fight inflation.

The same inflationary pressures are becoming apparent outside the U.S. where measures, such as the CPI, are more weighted towards staple goods which limits the substitution effect that may obscure the situation being felt by consumers.

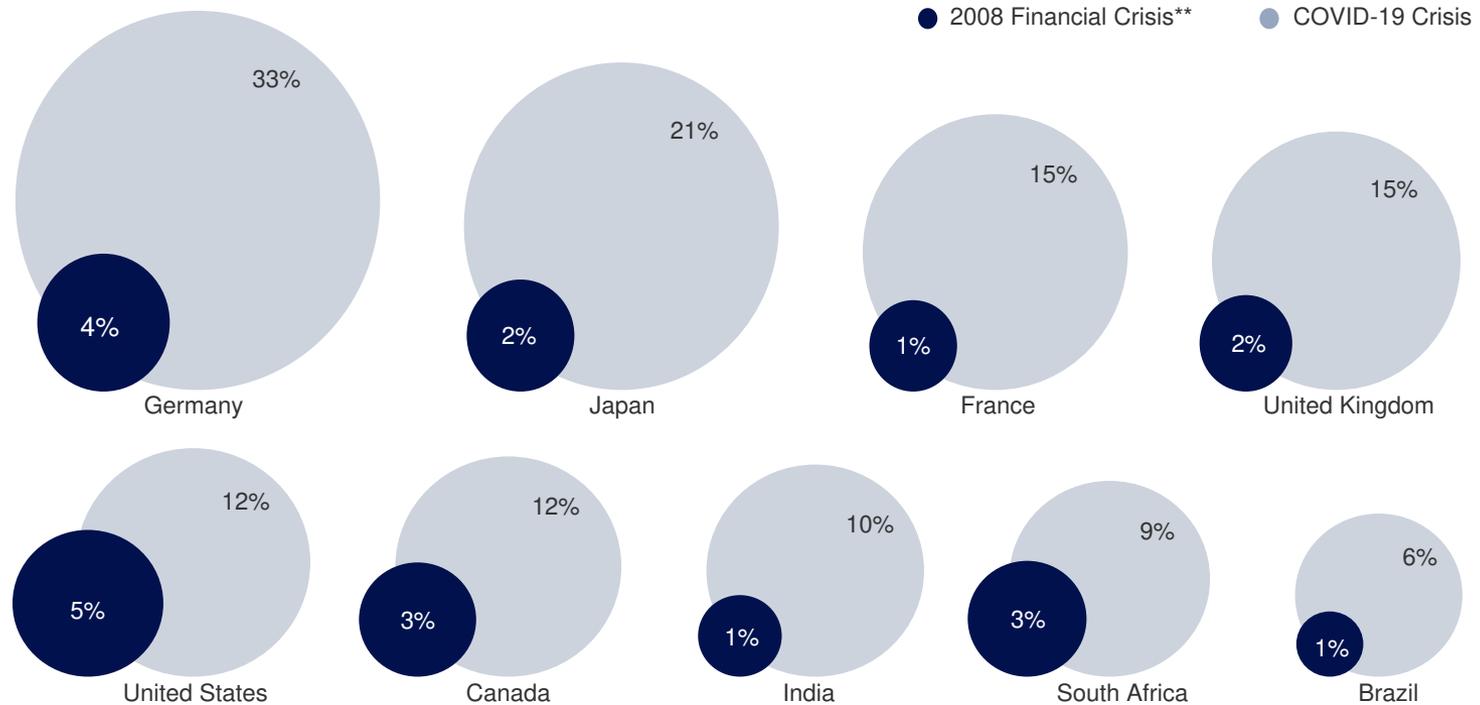
YIELDS

The first quarter of 2021 saw government bond yields rise across many economies. However, the rise in nominal yields has not been enough to lift real yields into positive territory for many G20 countries. The subsequent loss of purchasing power has forced investors out the risk spectrum in terms of both credit and duration.

This rise in yields is especially problematic for the U.S. because of its ballooning budget deficit, highly indebted corporations and a recovery driven in part by a healthy consumer and red-hot housing market. Every incentive is in place to keep rates low to avoid stifling the recovery or smothering borrowers with rising debt service costs.

Global Stimulus Exceeds That of GFC

Economic Stimulus Crisis Response, % of GDP*



Source: *Global economic policies and prospects*, International Monetary Fund (IMF), March 2009, imf.org; government sources; IHS Markit; IMF; press search; *The state of public finances; Outlook and medium-term policies after the 2008 crisis*, IMF, March 2009, imf.org

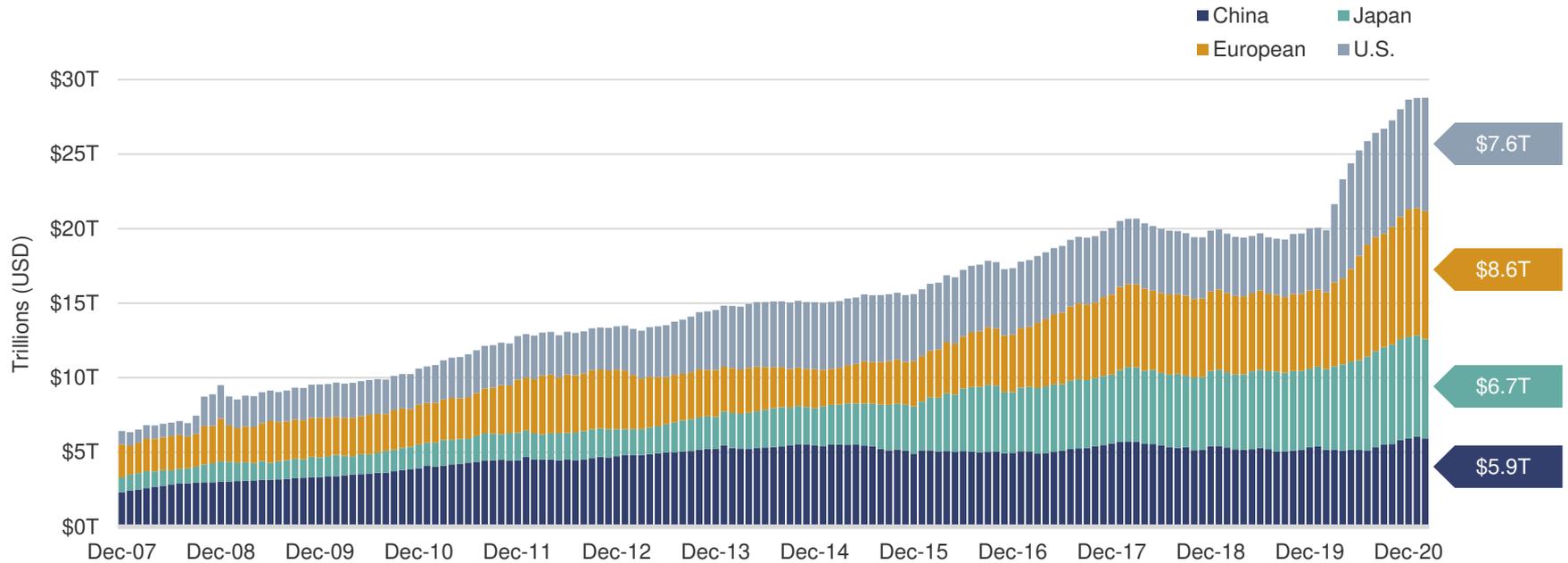
*2019 GDP taken into account for values related to COVID-19 crisis.

**Data published by International Monetary Fund in March 2009; includes discretionary measures announced for 2008-10.

Central Bank Balance Sheets Continue to Grow

Central Bank Balance Sheets

26 FEBRUARY 2021



Source: Bloomberg, Thornburg



Real Rates Show Investors' Concern More about near-Term Inflation

5- and 10-Year Real Yields

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Run-Up in Nominal Yields Offset by Inflation Expectations – Despite the spike in nominal yields that occurred in January and February, real yields remain decidedly negative. Inflation concerns in the near-term combined with the short-end being pegged to zero has short-term oriented, risk-averse investors in a precarious situation.



Past performance does not guarantee future results.

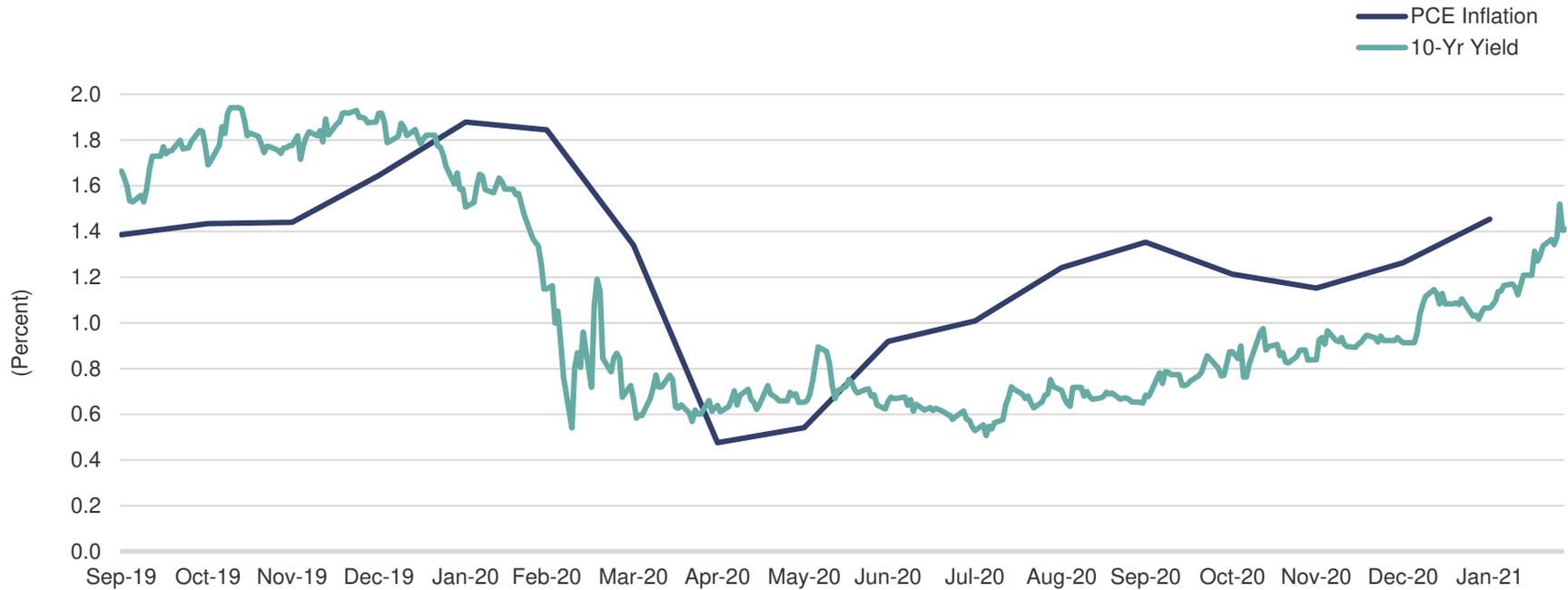
Source: Bloomberg



Inflation & Yields below Pre-Pandemic Levels

U.S. Personal Consumption Expenditures Index (PCE) & 10-Year Treasury

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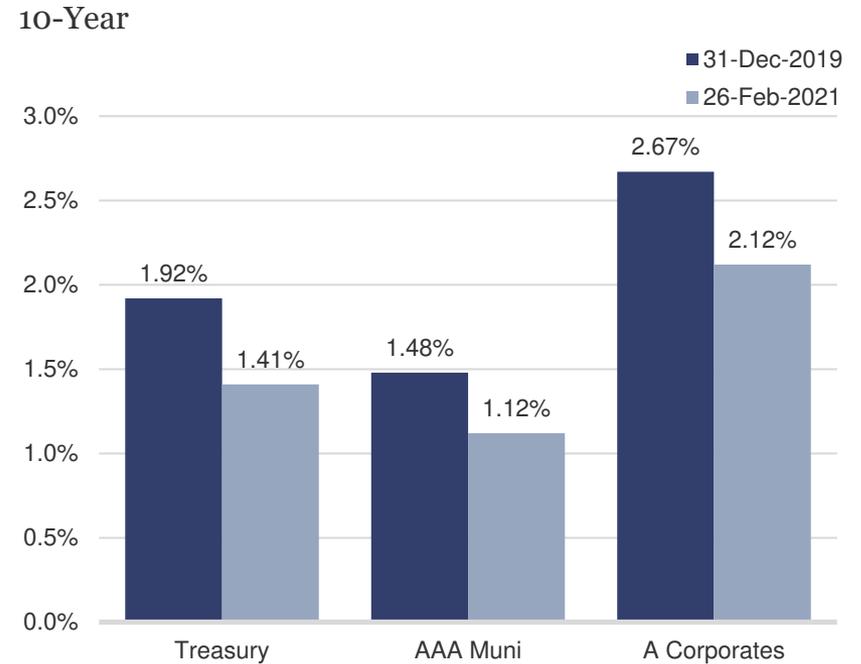
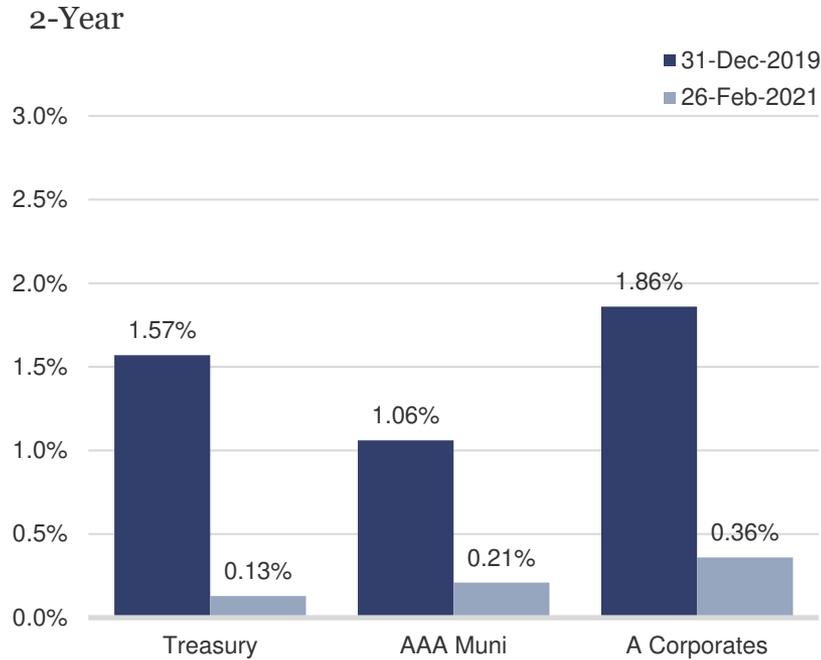
Past performance does not guarantee future results.

Source: Bloomberg, U.S. Department of Commerce



Yield Curve Has Steepened after Run-up in Rate

Treasury, Corporate and Municipal Bond Yields



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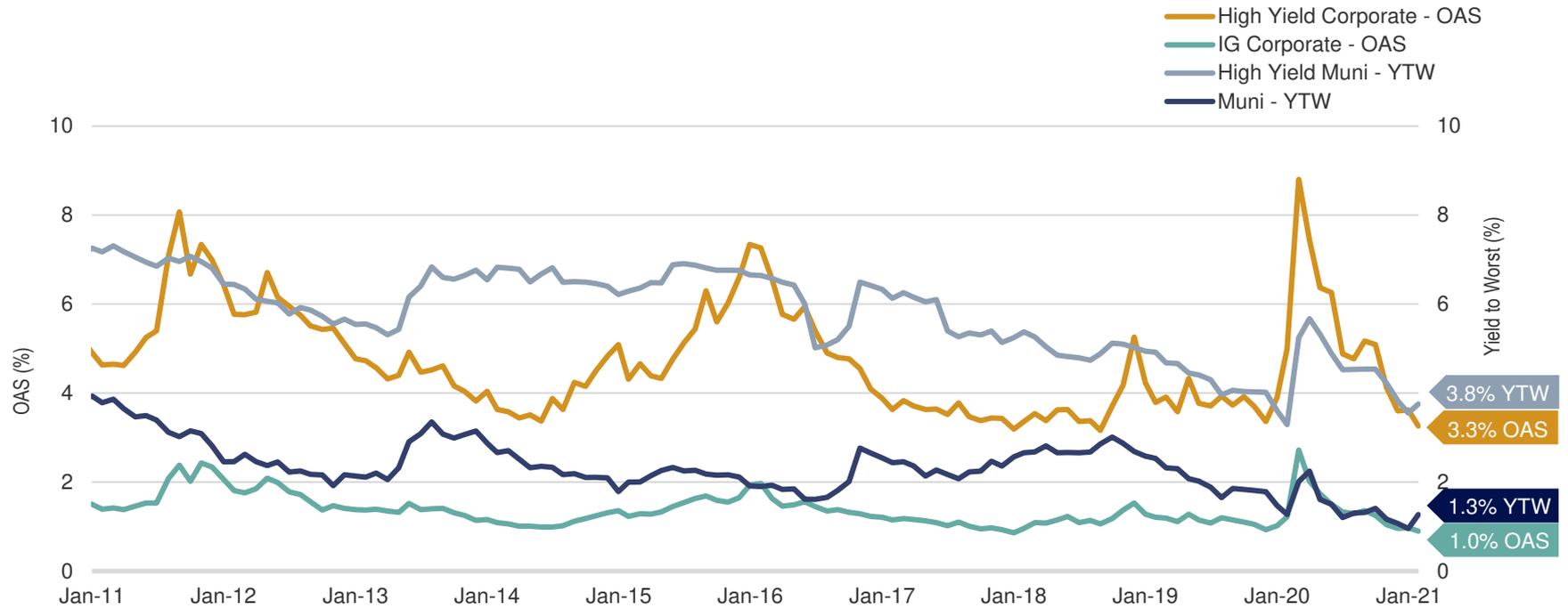
Source: Bloomberg



Credit Spreads Have Retraced 2020 Moves

Corporate Option-Adjusted Spreads and Municipal Yield-to-Worst

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Past performance does not guarantee future results.

Source: Bloomberg, Thornburg

OAS (Option Adjusted Spread) – The flat spread over the treasury yield curve required to discount a security payment to match its market price.



Observations in Global Fixed Income

March 2021 Views

Market Developments & Thornburg Flagship Strategies

Relative Value
Opportunities

Market
Dynamics

Flagship Global
Fixed Income
Strategies

Performance



Relative Value Matters

March 2021 Views

Upside Potential	Downside Risk
DEVELOPED MARKET SOVEREIGNS AND AGENCIES	
<ul style="list-style-type: none"> ▪ U.S. Agency Mortgage-Backed Securities 	<ul style="list-style-type: none"> ▪ U.S. Agencies ▪ U.S. Agency CMBS ▪ Developed Market Sovereigns
DEVELOPED MARKET CORPORATES	
<ul style="list-style-type: none"> ▪ Short Duration Investment Grade Corporates ▪ Short Duration High Yield Corporates ▪ Select BBB Corporates 	<ul style="list-style-type: none"> ▪ Intermediate Single A and Above Industrials ▪ High Yield with High Commodity Correlation ▪ Long Duration Corporates
SECURITIZED PRODUCTS	
<ul style="list-style-type: none"> ▪ Consumer Related ABS – Multiple Tranche ▪ Non-Agency RMBS - Non-QM and Jumbo ▪ Esoteric ABS 	<ul style="list-style-type: none"> ▪ Lower-Rated CLOs ▪ CMBS
EMERGING MARKETS	
<ul style="list-style-type: none"> ▪ Select EM FX ▪ Select EM Local 	<ul style="list-style-type: none"> ▪ EM External Corporates ▪ EM External Sovereigns

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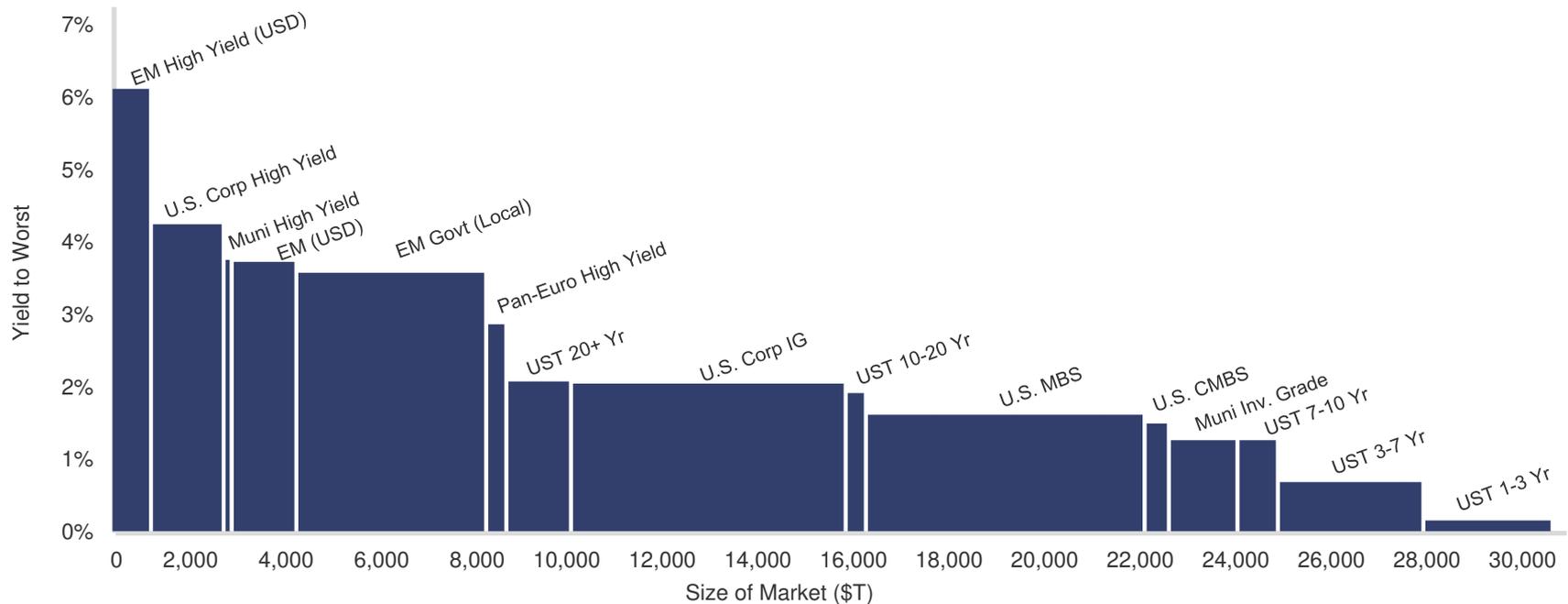


Success Requires Thinking Outside the Style Box

Fixed Income Sector Yield-to-Maturity and Market Values

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Caveat Emptor – Investor goals must be grounded in reality and balance the risk of investing in a narrow or volatile asset class with the yield pick-up being offered. The current market environment demands a flexible approach and a broad investment mandate to increase the odds of success.



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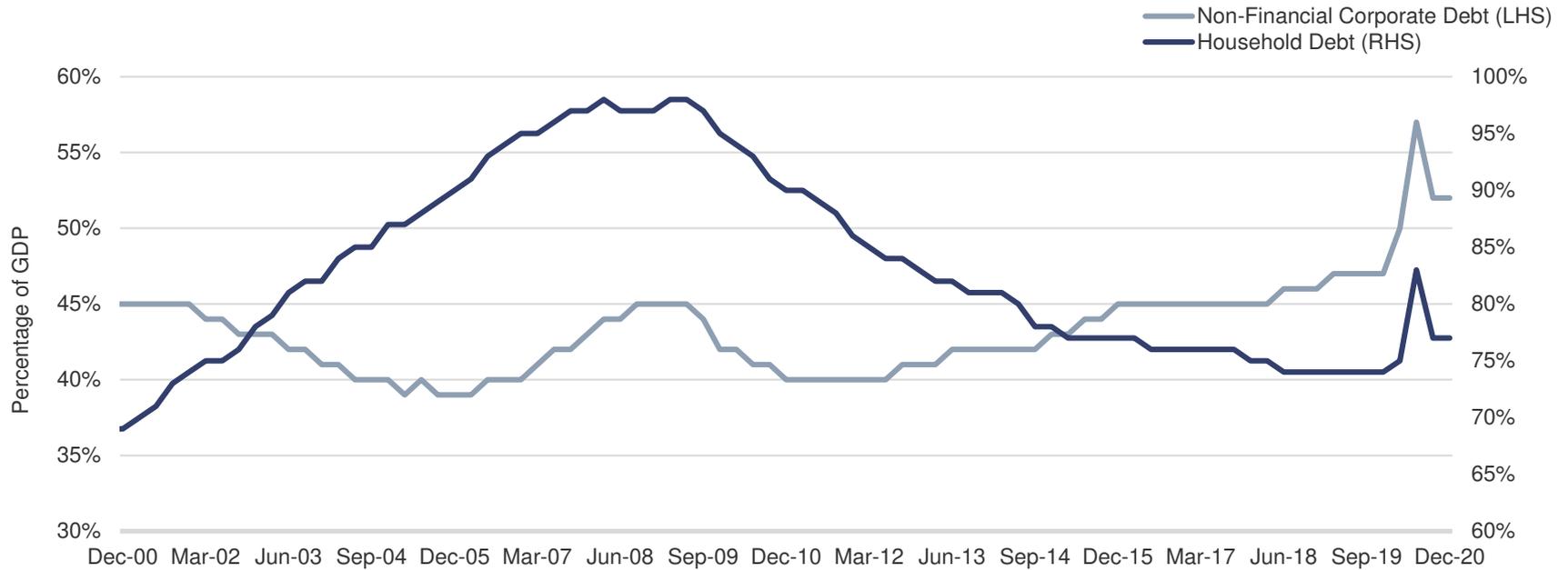
Source: Bloomberg
We use the Bloomberg Barclays indices for markets.

Consumers Better Positioned Than Corporations

U.S. Corporate Debt and Household Debt as % of GDP

31 DECEMBER 2020

Household Debt down from GFC Highs, Corporate Debt Near Record Levels – We favor consumer debt over corporate debt given the increase to near record levels of corporate debt. Consumers have deleveraged since the 2009 and are better positioned in today’s environment. We favor accessing consumer debt through bond structures such as Residential MBS, Auto-Loan ABS, Online Lending.



Source: Bloomberg



Risks Have Increased; Yields Have Decreased

Bloomberg Barclays U.S. Corporate Index Modified Duration and Yield

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Duration Has Increased as a Result of Falling Yields – The Bloomberg Barclays U.S. Corporate Index yield-to-worst peaked at 2.25% in November of 2018 and bottomed at 0.82% in July of 2020. During that time, the duration of the index increased from 7.25 to 8.48 years.



Past performance does not guarantee future results.

Source: Bloomberg

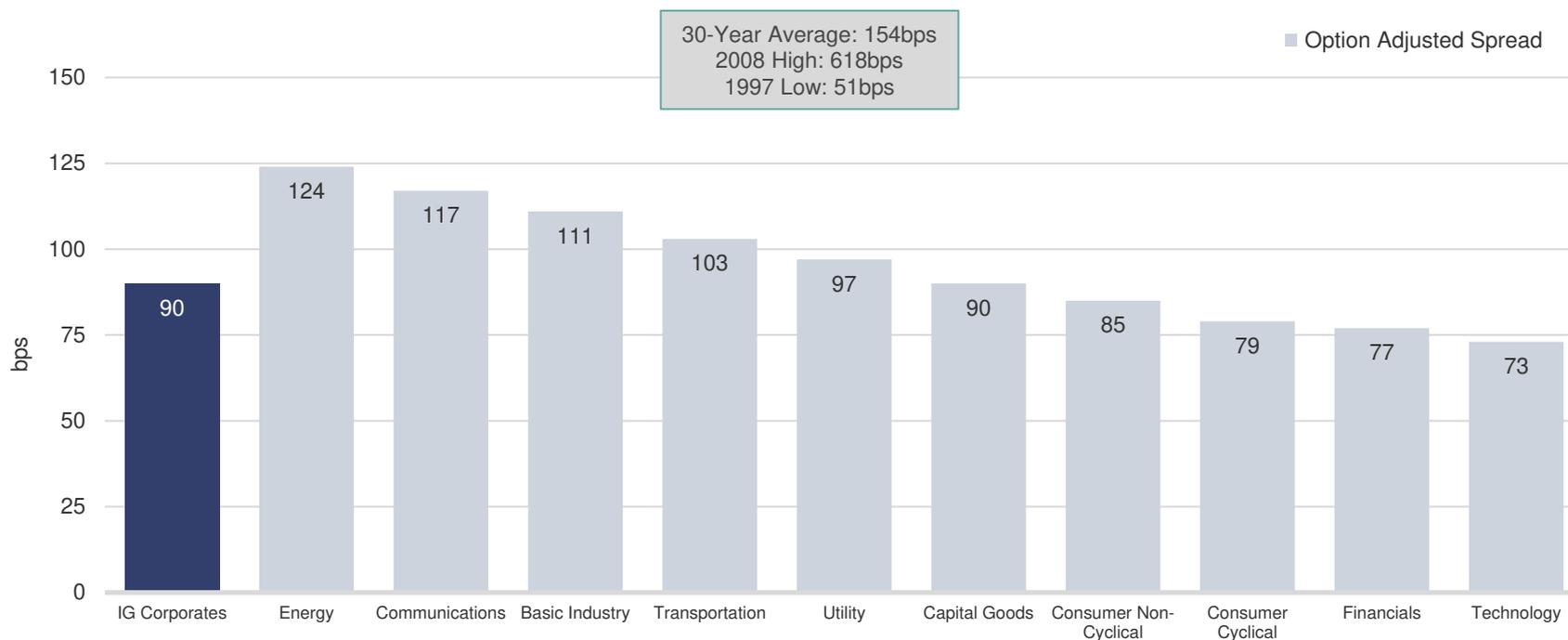


IG Spreads below Long-Run Average

Investment-Grade Credit Option Adjusted Spread

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Increase in Base Rates Presents Opportunities – The run-up in rates has made absolute yields more palatable while pockets of volatility have provided entry points. Credit research and security selection are paramount in this type of environment.



Past performance does not guarantee future results.

Source: Bloomberg, ICE, Thornburg

OAS (Option Adjusted Spread) – The flat spread over the treasury yield curve required to discount a security payment to match its market price.

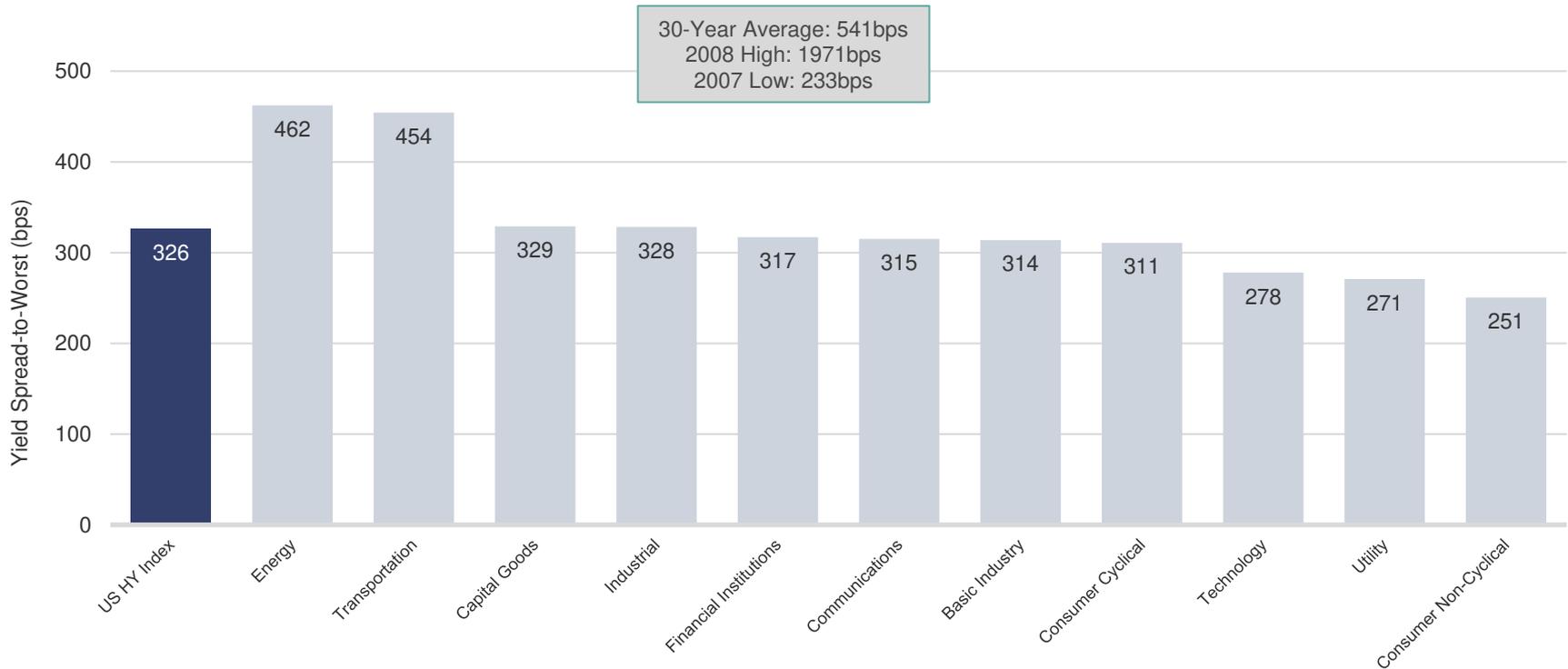


High Yields Spreads Tightened to Start the Year

Spread-to-Worst of High Yield Sectors

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High Yield Returns Have Been Skewed by a Junk Rally – Investors have flocked to the low quality of the market and areas such as Energy and Transportation. In the first quarter, BB-rated bonds are roughly flat on the year while CCC-rated bonds are up more than 10%.



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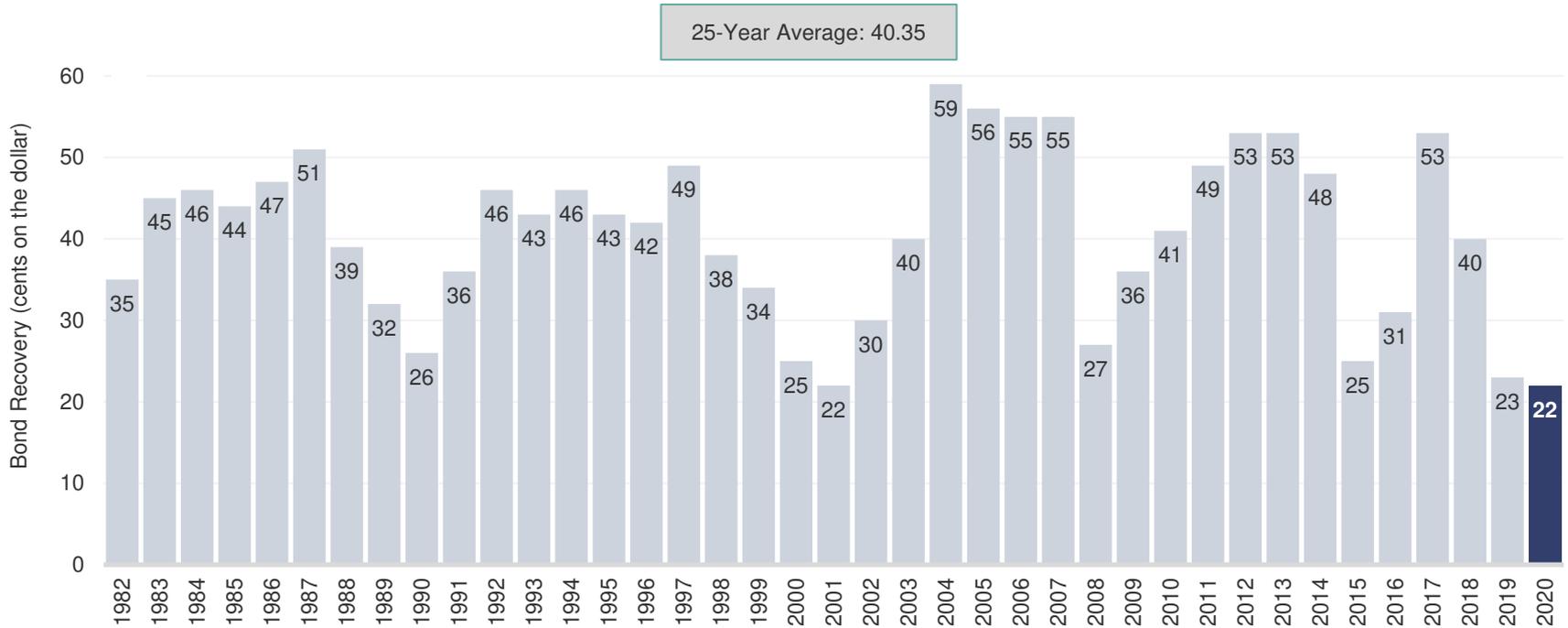
Source: Moody's, Bloomberg, JPMorgan, Thornburg



2020 Was an Abysmal Year for Recovery Rates

High Yield Bond Recovery Rates

31 DECEMBER 2020



Source: JPMorgan, Moody's Investors Service, Markit, S&P/LCD

NOTE: Recovery rates are issuer-weighted and based on prices 30 days after the default date.

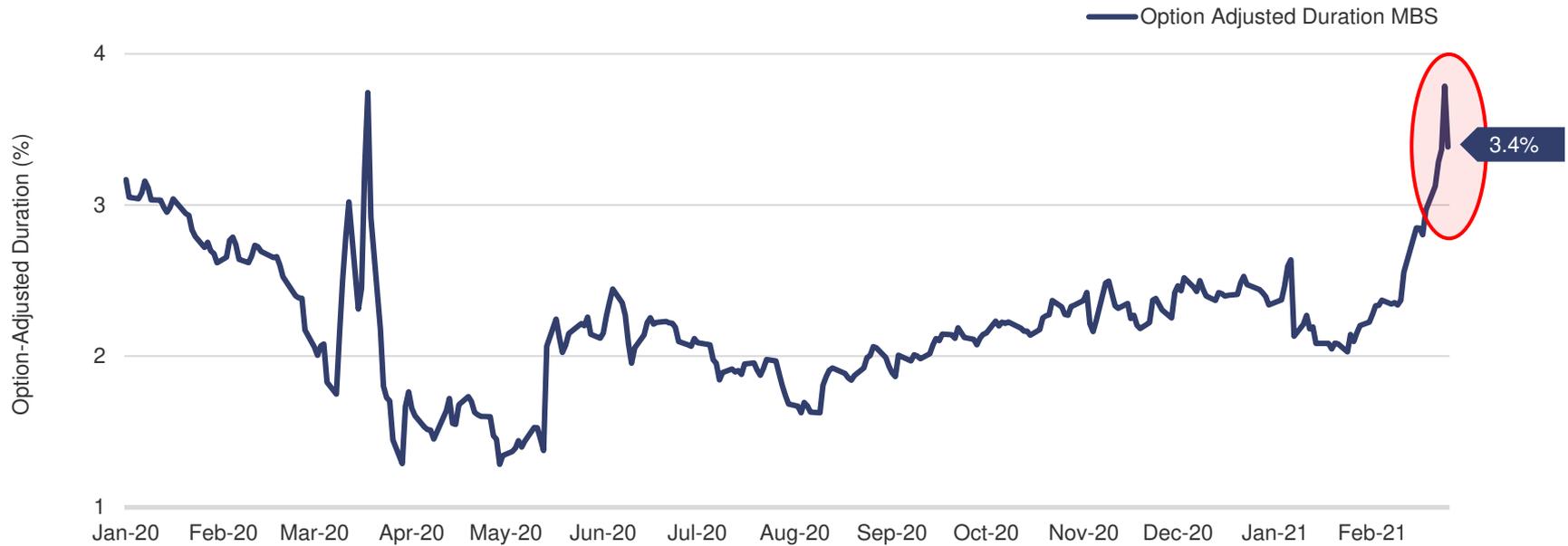


MBS Duration Spikes with Treasury Rates

MBS Universe Option-Adjusted Duration

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Duration Extension on 30-Year MBS Happened Practically Overnight – The spike in Treasury rates that occurred in February took a toll on MBS durations. The 30-year MBS index duration nearly doubled in a month and at a time when interest rates were climbing higher. Our bias towards shorter dated, lower coupon and lower loan balance MBS holdings proved beneficial and protected against the duration spike.



Source: Bloomberg

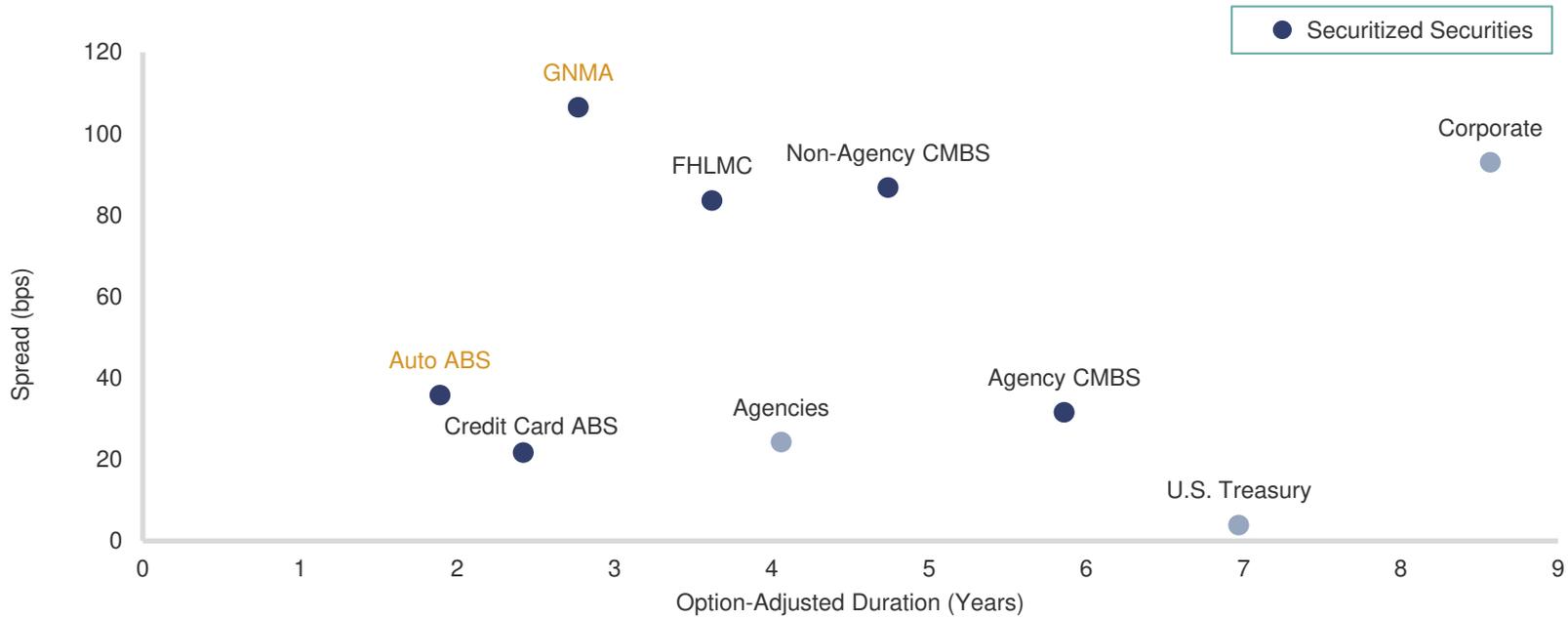


Securitized Space Presents Attractive Relative Value

YTW and Duration of Select Securitized Indices

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Areas of Securitized Slow to Recover – As hedge funds folded, the securitized space lost part of its buyer base. This has created opportunities to pick up yield in GNMA bonds, or shorten duration versus corporate bonds in Auto ABS bonds.



Past performance does not guarantee future results.

Source: Bloomberg



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