



# RGB Perspectives

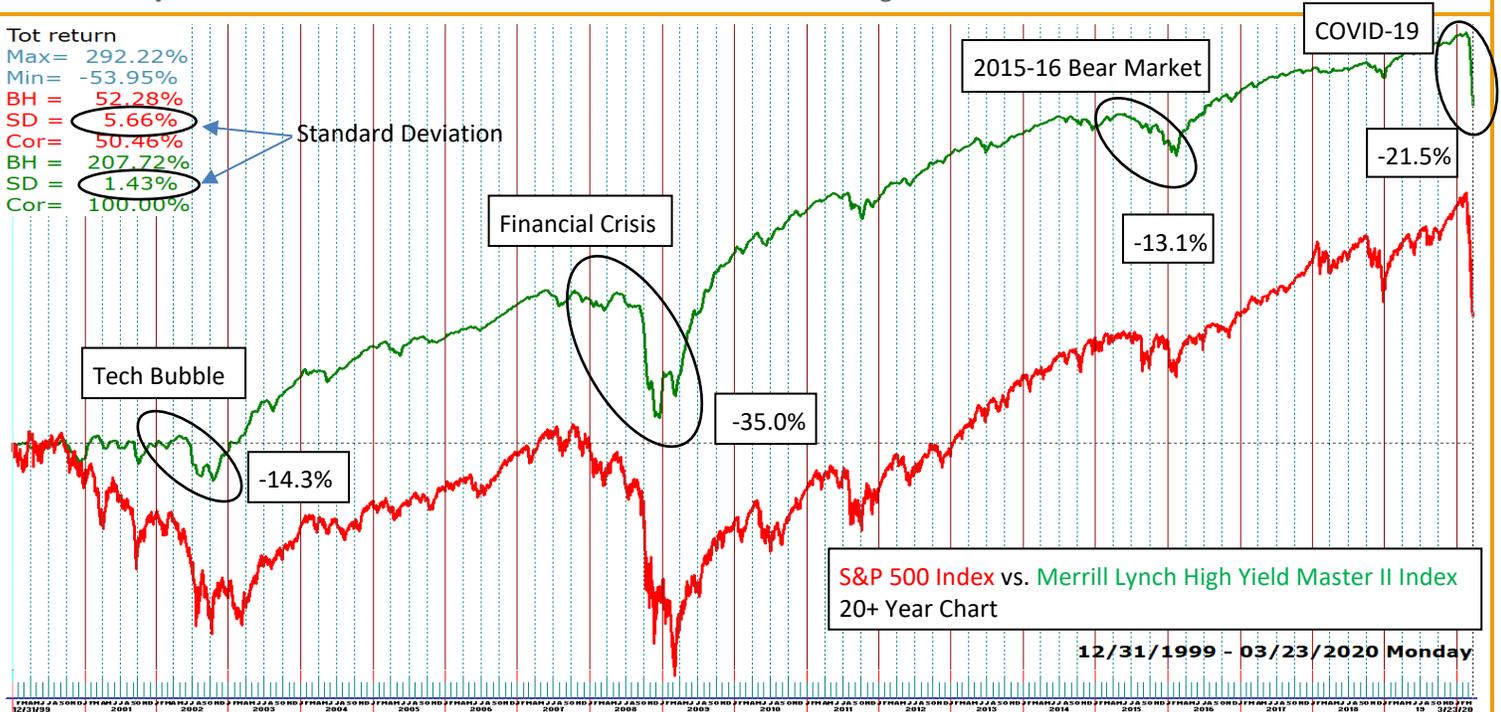
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First of all, I hope all of you are safe and healthy during the COVID-19 pandemic that has changed everyday life in a manner unimaginable just a month ago. Unfortunately, the pandemic continues to put pressure on the stock and bond markets as the US economy comes to a grinding halt, uncertainty prevails and liquidity issues drive prices lower. The good news is that this crisis will pass and when it is behind us there will be a great opportunity that awaits. I want to take today's *RGB Perspectives* to highlight what I expect to be a profitable opportunity.

The **Merrill Lynch High-Yield Master II Index** tracks the domestic junk bond market. Unlike treasury bonds, junk bonds tend to trend in the same direction as equities as junk bonds are influenced by expected default rates, in addition to changes in interest rates. Default rates rise when the economy is weak and junk bond investors therefore demand a higher yield to carry the additional risk associated with these types of bonds. As we know, when bond yields rise, bond prices fall. Therefore, when the economy is weak it tends to put pressure on both equity and junk bond prices. In the chart below you can see that junk bonds and the **S&P 500 Index** tend to trend in the same general direction.



The chart above also highlights the four largest declines in the junk bond index. Not surprisingly, each of those four declines happened at a time when the stock market was weak. The current decline, down -21.5% so far, is the second largest decline in the junk bond index over the last 20 years. Each time junk bonds have experienced a significant decline, they have provided great opportunities for good risk-adjusted returns; that is strong returns on low volatility. After the Tech Bubble, junk bonds rose over 88% before peaking in 2007. After the Financial Crisis, junk bonds rose 176% prior to peaking in 2015. What makes these investments so appealing is that they trend on low volatility compared to the overall market. The standard deviation (a measure of volatility) of junk bonds is a fraction of the equity markets as represented by the S&P 500, 1.43% vs 5.66%.

I have no way to know how long the current decline will last or how deep it will go. In fact, the lower junk bond prices fall, the greater the opportunity. I will be looking for a bottom in this low volatility group to take advantage of the good risk-adjusted returns that I expect to result from such a steep decline.

All of the RGB investment strategies remain in defensive positions. Thank you for your continued trust during these challenging times.

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