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Benefits of Fixed Income Active Management

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TPFG Portfolio Management Team

Jennifer Enstad, CFA
Chief Investment Officer

Eric Neufeld, CFA
Portfolio Manager

Erwin Ma, CIMA®
Financial Analyst

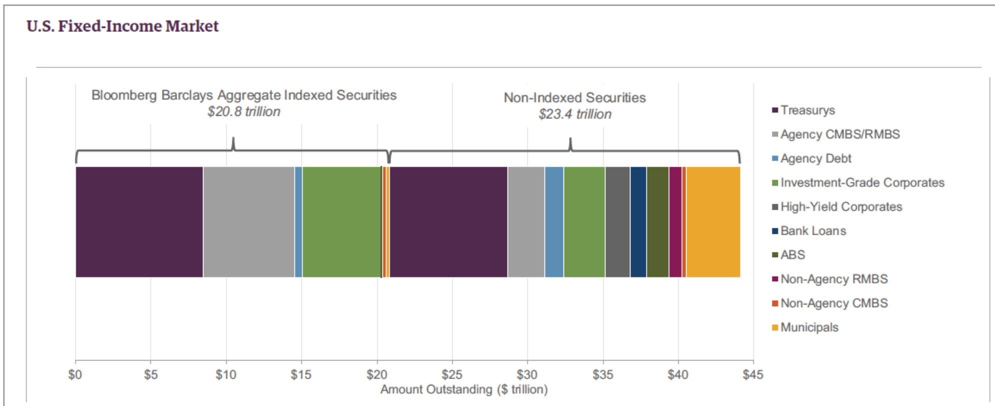
In March 2020, in response to the COVID-19 pandemic, the Federal Reserve reduced the Federal Funds rate to 0.00%. Treasury yields fell across maturities in conjunction with the move and, by the end of August, the 10 Year Treasury yield was just 0.72%. In recent meetings and press conferences, Chairman Powell has indicated he expects rates to remain low for an extended period. These circumstances present a challenge for fixed income investors.

Considering the challenges of a low rate environment, we believe active management has an advantage over passive fixed income strategies. The composition of the Bloomberg Barclays US Aggregate Bond Index, along with an uneven recovery, supports active over passive investing for fixed income.

There are several disadvantages to investing in the broad bond index:

- Lack of diversification - The index primarily consists of 3 sectors: Treasuries, government-backed mortgage bonds, and investment-grade corporate bonds.
- Low yielding Treasuries offer little current income. In fact, real yields, which are adjusted for inflation, are negative across all maturities.
- Over time, the investment-grade corporate bond portion has become dominated by BBB rated securities, which is the lowest investment-grade rating.
- Interest rate risk remains elevated with a duration of close to 6. If rates should reverse and move higher, there is little protection for investors.
- The index is required to add new issues without regard to quality or sector weighting.

The U.S. fixed income market is much larger and more diverse than the three sectors in the index. In fact, the market value of securities available outside of the index is larger than what is available in the index. This gives active managers a wider opportunity set for constructing a compelling fixed income portfolio.



1. Source: SIFMA, Wells Fargo, S&P LCD, Barclays Excludes sovereigns, supranationals, and covered bonds. As of 9/30/2019.

Another reason active managers have an advantage is due to the uneven and unpredictable nature of this recovery. We have seen an acceleration of trends in technology, consumer preferences, and how we work and live. Active managers, through bottom-up credit analysis, can focus on securities that will benefit from these trends.

Overall, a wider opportunity set and the ability to select securities with strong risk/return profiles should provide an advantage for active fixed income managers.

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