FixedIncomeQuarterly

MARKET PERSPECTIVES – FIXED INCOME SERVICES GROUP

2019… The Start of Something New?

The year began with some blaring changes. Politically, the House of Representatives reversed control, thus diminishing the influence of the republican-party and the pro-economic executive branch posture. Lessening benefits of last year's tax cuts, a widening government budget (incentivized to keep interest rates low) and receding corporate profits may all be headwinds to domestic economic expansion. The predicted Fed rate hikes have all but vanished with even a higher probability of a rate cut.

There seems very few, if any, arguable factors suggesting potential and/or justifications for significantly higher interest rates. A sudden reversal of inflation (which is currently a world-wide "non-issue") or perhaps surprisingly robust upside growth projections domestically or abroad? Conversely, there seems to be ample pretexts to suggest lower rates via a material event: Hard Brexit, a trade impasse, a compromise on the European Union, foreign bank meltdown, etc.

The last quarter of the year brought some uneasiness as corporate spreads, an indicator of risk, began to widen sharply. However, when looking in context, spreads were widening from 5 year lows. Since the beginning of the year, those spreads have now fallen 30 basis points, settling right on top of the 5 year averages. *(see article on page 4)*

Despite the changing landscape, higher yields in some sectors are holding up. For example, corporate bonds and certificates of deposit provide higher yields in the short and intermediate parts of the curve versus a year ago (*see chart next column*).

Treasury rates are stagnant while demand is shifting the spread curves all facilitating the changing strategic planning process. This quarterly addresses several of these changes in hopes to guide fixed income investors toward an appropriate path of security selection with consideration for each individual investor's risk profile.

Illustrative Portfolio Statistics

	Maturity Range	Yield on 2/26/18	Yield on 2/26/19	YoY Yield Increase
Corporate Ladders	1 to 5	3.01%	3.30%	**0.29%**
	1 to 10	3.40%	3.61%	**0.21%**
	1 to 15	3.69%	3.87%	**0.18%**
	5 to 10	3.73%	3.86%	**0.13%**
	5 to 15	3.97%	4.10%	**0.13%**
CD Ladders	1 to 2	2.18%	2.58%	**0.40%**
	1 to 3	2.32%	2.65%	**0.33%**
	1 to 4	2.43%	2.71%	**0.29%**
	1 to 5	2.54%	2.80%	**0.26%**

Sources: Raymond James, Bloomberg LP
Yields shown are illustrative only, calculated using the arithmetic means based on the maturity range combined with the credit quality percentages, and are not inclusive of sales credit or fees.
Corporate Ladders Credit Quality: A (25%), BBB (75%).

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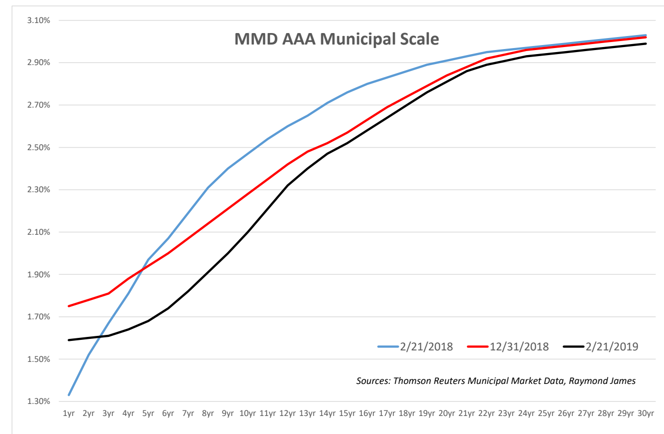
Looking for Yield Across the Curves

There are many variables that play a role in strategic portfolio planning. Among all the various methods of management, building a portfolio of individual bonds stands out in that it can be unique (tailor-made) to each person in every feature (maturity, cash flow, credit, etc.) and precision. Precision meaning that as long as the portfolio is held to maturity and barring default, the cash flow, income and date of redemption are certain. This is regardless of interest rate changes and interim price fluctuations. This makes individual bonds quite a powerful tool for investors!

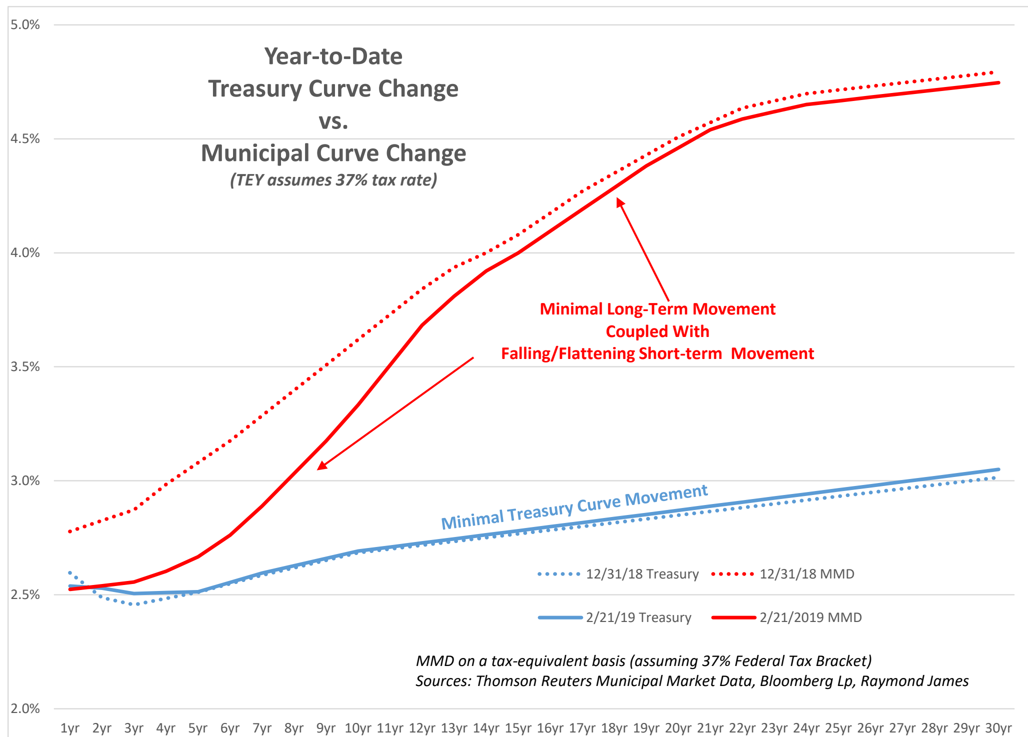


Changing market conditions occur because of an abundance of interrelated global, economic and data variables. Things started to change the second we flipped the calendar into 2019. There were many predictions surrounding the number of times the Fed would hike interest rates after pushing them higher 4 times in 2018. Now the current implied probabilities suggest that a rate cut is more likely than a rate hike in 2019.

So far, uncertainty has driven this year's flight to quality. The demand for short term municipal bonds has completely changed the shape of the municipal bond curve.

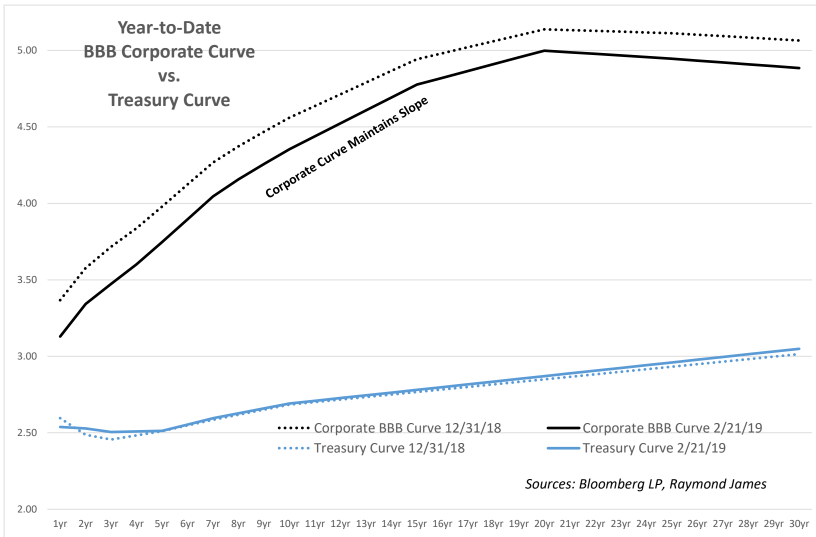
A year ago, there was a steady fast rising slope (blue line in chart above) to the municipal yield curve. At the start of 2019, the municipal curve already began flattening (red line). By February 2019, strong demand and diminishing supply had pushed shorter term yields down; however, longer term yields remained relatively steady.

Treasury yields have shown minimal movement year-to-date and although municipal yields have compacted



on the short end, the intermediate and long end municipal yields have remained relatively the same.

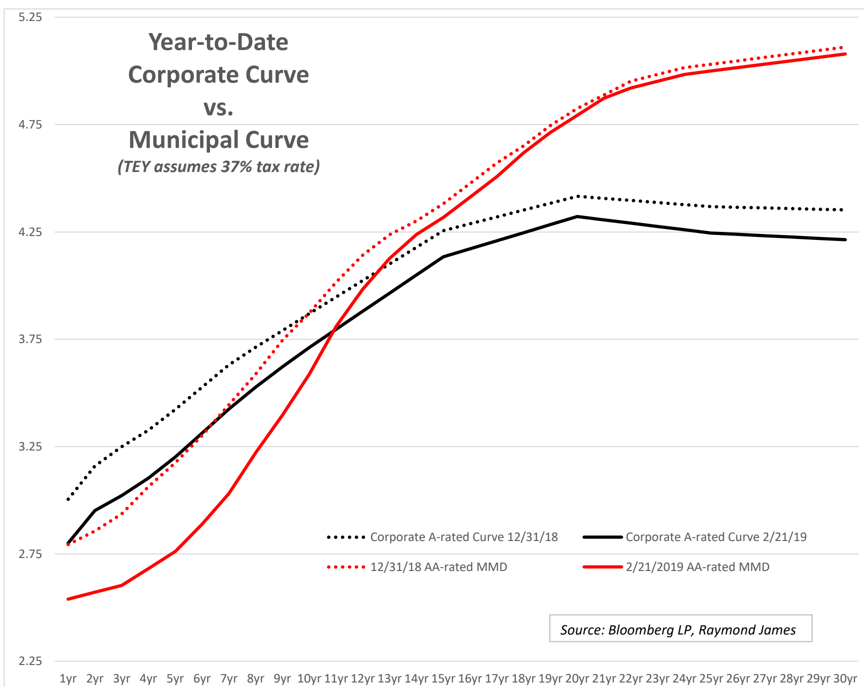
The year-to-date story is different in the corporate sector. Just as Treasuries have shown very little change in slope or yield this year, the corporate curve has also shown little change to its steady slope in the short and intermediate maturity ranges.



There are many variables that can alter how we look at bonds. The shape of the curves (slope) can direct investors to potential yield pick-up. The spread to Treasuries and the shape of the Treasury curve also dictate where the value may lie.

If we combine the two spread products (municipal and corporate bonds), it becomes noticeable that the market is giving us good value with corporate bonds inside of 10 years (even for investors in the high tax brackets) and with municipal bonds greater than 10 years. The 6-11 year corporate maturity range captures 80%-90% of the value of the curve. This is accomplished between 12-18 years in maturity on the municipal curve. *(see page 9)*

Individual investors may possess different needs such as liquidity, income or cash flow. Identifying those needs is step one along with recognition of risk profile (understanding the amount of risk you are willing to take). Your financial advisor, along with the entire fixed income team can then identify where to position on the curve and where the market is providing the greatest opportunities. This combination of investor need and market opportunity helps formulate an optimal and individualistic strategy.



The driving forces behind the yield an investor achieves include benchmark interest rates (Treasury yields) and the measure of risk the market assigns to a particular credit such as a specific corporate or municipal bond at a particular point on the curve. These forces are dynamic, meaning tomorrow's optimal mix of assets and/or favored curve positon may be different than today's.

The following section will highlight the specifics of how corporate bond spreads have fared over the last year.

Corporate Credit Spreads

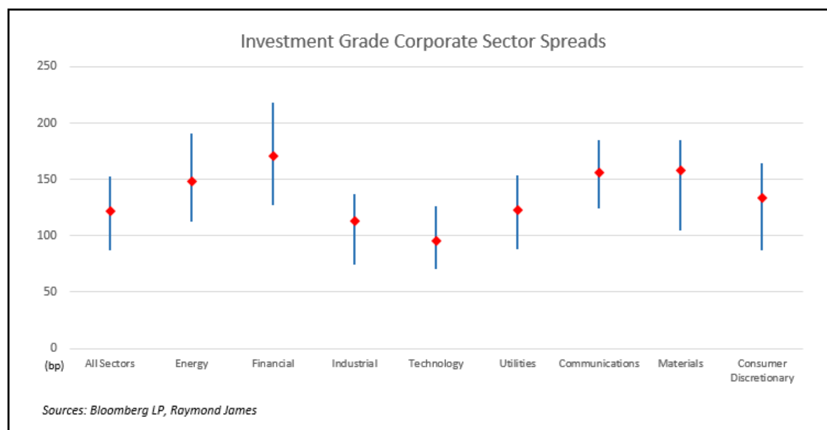
Spread is an indication of real and/or perceived risk. The recent increased volatility in corporate spreads has raised the level of discussion and perhaps escalated investor concerns. How is this affecting values in corporate bonds?

Investment grade (IG) corporate bonds have been a relatively reliable investment enduring an average default rate over a 5-year period of less than 1% (just 0.91% from 1970-2017, per Moody's). When corporate spreads spent the better part of the last 2018 quarter steadily rising, many speculated that the market was heading toward a perilous set of events that could negatively impact investors' corporate holdings and thus portfolio valuations. Rising company debt levels, and a high volume of "BBB" rated debt have helped to foster the fear for an undesirable potential market sector "black eye"; one that could increase corporate costs and possibly even fuel the next recession. But what is the market actually telling us?

One of the best indicators of market perceived corporate risk is spread. Spread is the difference between bond yield and its benchmark (corresponding Treasury). The wider (higher) the spread, the more yield the market is demanding. Simply put, the wider the spread, the riskier the bond.

The graph below plots the range of spreads for corporate sectors over the past year (blue line) along with the current spread of each sector (red diamond). The top of a blue line is its riskiest point and the bottom of the line is its least risky point for the last year. The current spread levels (red diamonds) are all near the past year's mid-range point, indicating they are neither at the riskiest nor least risky levels.

The above Bloomberg screenshot depicts investment grade corporate spreads over the last 5 years, providing an even wider scope for measuring the relative risk of investment grade corporate bonds. The 5 year high and low range is between 79-224 basis points. The low end of the range occurred on February 1, 2018. Although spreads generally increased during 2018, they shot up somewhat dramatically in the last quarter which triggered much market pessimism and/or panic. Despite all the hype and all the volatility, today's IG corporate spread of 121bp is right on the 5 year average 122bp.



The recent spread reversal indicates that investor's concerns are on the decline. As they decline, investors are less likely to gravitate toward Treasury bonds. This could in time, theoretically narrow the credit spread between corporate and Treasury bonds; however, if the general flight-to-quality trend continues, the corporate/Treasury spread may widen. For now, corporate bonds are providing relatively attractive yields. ▪

Tax Time… Could Mean Muni Time?

Taxes rarely, if ever, conjure up good feelings; however, municipal bonds may be one of the few remaining bright spots providing a resource to neutralize tax burdens through their tax advantage.

As illustrated in *Looking for Yield Across the Curves (ppg 2-3)*, although the short end of the municipal curve is down in yield, the intermediate and long end of the municipal curve have maintained. Thomson Reuters Municipal Market Data (MMD) AAA scale as of February 25th indicates that 10 year municipal bonds yield 2.10% tax-free income. For a client in the 37% tax bracket, the taxable equivalent yield is 3.33% (meaning a 2.10% on a tax-free bond = 3.33% on a taxable bond). By comparison, a 10 year Treasury bond provides a 2.67% yield. Investors enjoy a 67bp yield pickup (spread) with municipal bonds. Many investors that live in high state income tax locales may get an exemption from local and state income taxes, providing a benefit versus some taxable alternative such as CDs, corporates, etc.

State & Local Tax (SALT) Deduction: New tax codes have prompted various discussions including the change in the write off deductions for State & Local Tax (SALT). SALT deductions were unlimited in 2017. In 2018, there is a $10,000 cap.

Assume an investor accumulates $20,000 in property taxes and another $20,000 in state and local taxes. The value of a client's 2017 write off would be:

2017: $40,000
2018: $10,000

Under the new SALT guidelines, the same client's 2018 write off caps at $10,000. Taxpayers will be left looking for new ways to shelter their income and municipal bonds represent a tried and true method for lowering annual tax liabilities via earning tax free income (lowering taxable income levels).

Here's how a tax-exempt municipal bond can shelter income:

- AAA-rated bond
- Maturity 9/15/2031, Call 9/15/2026
- Yield-to-Maturity 3.04%
- Yield-to-Call 2.08%
- Price $120.251

Based on the MMD municipal scale, a AAA muni due in 2031 yields ~2.32% and one due in 2026 ~1.82%. In order to earn the same after tax income with a taxable bond, an investor would need to receive 4.82% in 2031 and/or 3.30% in 2026. Particularly for maturities greater than 10 years, municipal bonds can provide higher tax-equivalent yields versus taxable alternatives but in the form of tax-exempt income.

	Municipal AA Scale		Corporate
	Yield	Tax-Equivalent	A-Rated Yld
2020	1.58%	2.51%	2.78%
2021	1.60%	2.54%	2.92%
2022	1.62%	2.57%	2.98%
2023	1.67%	2.65%	3.06%
2024	1.75%	2.78%	3.16%
2025	1.87%	2.97%	3.27%
2026	1.95%	3.10%	3.39%
2027	2.07%	3.29%	3.49%
2028	2.18%	3.46%	3.59%
2029	2.30%	3.65%	3.68%
2030	2.44%	3.87%	3.76%
2031	2.54%	4.03%	3.85%
2032	2.61%	4.14%	3.93%
2033	2.69%	4.27%	4.02%
2034	2.73%	4.33%	4.10%
2035	2.79%	4.43%	4.14%
2036	2.85%	4.52%	4.18%
2037	2.92%	4.63%	4.22%
2038	2.98%	4.73%	4.25%
2039	3.04%	4.83%	4.29%
2040	3.08%	4.89%	4.28%
2041	3.11%	4.94%	4.26%
2042	3.13%	4.97%	4.25%
2043	3.15%	5.00%	4.23%
2044	3.16%	5.02%	4.22%
2045	3.17%	5.03%	4.21%
2046	3.18%	5.05%	4.20%
2047	3.19%	5.06%	4.20%
2048	3.20%	5.08%	4.19%
2049	3.21%	5.10%	4.18%

Sources (as of 3/4/19): Thomson Reuters Municipal Market Data, Bloomberg Lp, Raymond James
Tax-equivalent yield assumes 37% Federal Tax Bracket

Screening State Tax-exemption

Looking beyond the federal tax advantages offered through municipal bonds reveals their tax treatment on a state level. Investors seeking to minimize taxes paid may have another tax-exempt consideration when strategically building their portfolio. Municipal bonds typically offer high credit quality, federal tax exemption and in many states, a state tax exemption.

In most cases (there are exceptions) municipal bonds issued in a specific state are exempt from both federal and state taxes for investors domiciled in that state. Municipal bonds issued outside of an investor's home state are most often federally tax exempt but subject to state taxes (again there are exceptions). As a result, some investors limit their purchases on out-of-state bonds, looking solely to bonds issued in their state of residence. All things equal this appears to be advantageous; however, there are several reasons why looking out-of-state can still make sense.

We specifically discuss diversification in the following section which happens to be one of the reasons to look for municipal bonds issued outside of one's home state. Geographic diversification, issuer concentration, varied maturities, different sectors, etc. are all features that can be varied to help manage risk. Creating a portfolio of municipal bonds all issued from the same town, all maturing on the same date, all entirely airport issues, etc., creates event or market risk that can easily be mitigated. In the same manner, holding bonds from various states may create a more balanced exposure. Putting all of your eggs in one basket is generally not the best strategy, regardless of any bias to a home-state and/or its financial position.

In addition to managing risk, there may be a sound mathematical rationale for exploring options beyond one's home state. In other words, even after paying a state tax on certain bonds, they may provide more net income to the bottom line versus in-state options. An out-of-state municipal bond's yield may be high enough to offset the state income tax providing a higher net income.

For example, a Georgia resident purchases a Texas issued municipal (out-of-state) bond yielding 2.12%. The bond is federally tax-exempt but subject to Georgia state taxes. After paying state taxes, the Texas bond's 2.12% yield is approximately the same as a Georgia issued bond yielding 2.00%. In this example, Georgia investors can out-yield state issued municipal bonds with out-of-state issued bonds having more than 12bp in yield.

The "yield hurdle" can often be jumped largely because searching for out-of-state issues opens a much larger pool of possibilities. Of course, the higher an investor's home state tax is, the higher the out-of-state yield needed to break even.

There are many reasons beyond this discussion which may influence specific bond selection. The following chart provides a detailed state breakdown helping to isolate possible yield advantages. ▪

	Top State Income Tax Rate	Top Marginal Rate Including Top Federal Rate of 40.8%	In-State Yield:	1.50%	2.00%	2.50%	3.00%	3.50%
			Out-of-State Equivalent Yields					
Alabama	**5.00%**	45.80%		1.58%	2.11%	2.63%	3.16%	3.68%
Alaska	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%
Arizona	**4.54%**	45.34%		1.57%	2.10%	2.62%	3.14%	3.67%
Arkansas	**6.90%**	47.70%		1.61%	2.15%	2.69%	3.22%	3.76%
California	**13.30%**	54.10%		1.73%	2.31%	2.88%	3.46%	4.04%
Colorado	**4.63%**	45.43%		1.57%	2.10%	2.62%	3.15%	3.67%
Connecticut	**6.99%**	47.79%		1.61%	2.15%	2.69%	3.23%	3.76%
Delaware	**6.60%**	47.40%		1.61%	2.14%	2.68%	3.21%	3.75%
Florida	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%
Georgia	**5.75%**	46.55%		1.59%	2.12%	2.65%	3.18%	3.71%
Hawaii	**11.00%**	51.80%		1.69%	2.25%	2.81%	3.37%	3.93%
Idaho	**6.93%**	47.73%		1.61%	2.15%	2.69%	3.22%	3.76%
Illinois	**4.95%**	45.75%		1.58%	2.10%	2.63%	3.16%	3.68%
Indiana	**3.23%**	44.03%		1.55%	2.07%	2.58%	3.10%	3.62%
Iowa	**8.53%**	49.33%		1.64%	2.19%	2.73%	3.28%	3.83%
Kansas	**5.70%**	46.50%		1.59%	2.12%	2.65%	3.18%	3.71%
Kentucky	**5.00%**	45.80%		1.58%	2.11%	2.63%	3.16%	3.68%
Louisiana	**6.00%**	46.80%		1.60%	2.13%	2.66%	3.19%	3.72%
Maine	**7.15%**	47.95%		1.62%	2.15%	2.69%	3.23%	3.77%
Maryland	**5.75%**	46.55%		1.59%	2.12%	2.65%	3.18%	3.71%
Massachusetts	**5.10%**	45.90%		1.58%	2.11%	2.63%	3.16%	3.69%
Michigan	**4.25%**	45.05%		1.57%	2.09%	2.61%	3.13%	3.66%
Minnesota	**9.85%**	50.65%		1.66%	2.22%	2.77%	3.33%	3.88%
Mississippi	**5.00%**	45.80%		1.58%	2.11%	2.63%	3.16%	3.68%
Missouri	**5.40%**	46.20%		1.59%	2.11%	2.64%	3.17%	3.70%
Montana	**6.90%**	47.70%		1.61%	2.15%	2.69%	3.22%	3.76%
Nebraska	**6.84%**	47.64%		1.61%	2.15%	2.68%	3.22%	3.76%
Nevada	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%
New Hampshire*	**5.00%**	45.80%		1.58%	2.11%	2.63%	3.16%	3.68%
New Jersey	**10.75%**	51.55%		1.68%	2.24%	2.80%	3.36%	3.92%
New Mexico	**4.90%**	45.70%		1.58%	2.10%	2.63%	3.15%	3.68%
New York	**8.82%**	49.62%		1.65%	2.19%	2.74%	3.29%	3.84%
North Carolina	**5.25%**	46.05%		1.58%	2.11%	2.64%	3.17%	3.69%
North Dakota	**2.90%**	43.70%		1.54%	2.06%	2.57%	3.09%	3.60%
Ohio	**5.00%**	45.80%		1.58%	2.11%	2.63%	3.16%	3.68%
Oklahoma	**5.00%**	45.80%		1.58%	2.11%	2.63%	3.16%	3.68%
Oregon	**9.90%**	50.70%		1.66%	2.22%	2.77%	3.33%	3.88%
Pennsylvania	**3.07%**	43.87%		1.55%	2.06%	2.58%	3.10%	3.61%
Rhode Island	**5.99%**	46.79%		1.60%	2.13%	2.66%	3.19%	3.72%
South Carolina	**7.00%**	47.80%		1.61%	2.15%	2.69%	3.23%	3.76%
South Dakota	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%
Tennessee*	**2.00%**	42.80%		1.53%	2.04%	2.55%	3.06%	3.57%
Texas	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%
Utah	**4.95%**	45.75%		1.58%	2.10%	2.63%	3.16%	3.68%
Vermont	**8.75%**	49.55%		1.64%	2.19%	2.74%	3.29%	3.84%
Virginia	**5.75%**	46.55%		1.59%	2.12%	2.65%	3.18%	3.71%
Washington	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%
Washington, DC	**8.95%**	49.75%		1.65%	2.20%	2.75%	3.29%	3.84%
West Virginia	**6.50%**	47.30%		1.60%	2.14%	2.67%	3.21%	3.74%
Wisconsin	**7.65%**	48.45%		1.62%	2.17%	2.71%	3.25%	3.79%
Wyoming	**0.00%**	40.80%		1.50%	2.00%	2.50%	3.00%	3.50%

**Interest and dividends only* *Sources: individual state tax/dept. of revenue websites as of the date of publication, Raymond James*

Diversification

The message to diversify investor portfolios is so routine that its importance may be desensitized to an investor, or worse, disregarded. It's like ignoring the warning label attached to a prescription drug. The underlying message is important but easy to overlook. That is, until it's too late.

Diversification can take many forms: by obligor, by sector, geographically, by coupon, by maturity, etc. The idea of not putting too many eggs in one basket carries merit. Let's look for example, at diversifying by obligor.

The chart on the right provides a simple comparative illustration of 2 portfolios side-by-side and the effects of obligor diversification. The first uses 20 issuers to create a 10 year laddered portfolio while the second uses 10 issuers. Should 1 issuer default ($25,000 in the diversified portfolio and $50,000 in the other), the downside to the 10 issuer portfolio can be greater than the difference in the size of the holding due to not only the loss of principal *(assumes a 0% recovery rate and constant reinvestment)*, but the forward loss of interest earned on that principal. In this example, $25,000 in principal plus the lost compounding interest reflects an aggregate difference of -$32,119. Diversification cannot guarantee anything but increases the probability of mitigating negative consequences.

The same principle applies to other forms of diversification, such as diversifying geographically. Should some catastrophic event occur in a specific state, county or local region, you do not want all of the portfolio's debt tied to that location. By the same rationale, bonds should not be tied to one industry such as all energy. Even within a particular state, Raymond James wide scope of underwritings and negotiations often allow an investor to diversify while concentrating inside that state. The size and flexibility of the municipal department allows various tailor-made strategies, both within a single state or on a national scale. ▪

----------BBB Corporate Hypothetical----------				
	Diversified 5% per Obligor		**10% per Obligor**	
1yr	25,000	3.127%	50,000	3.127%
	25,000	3.127%		
2yr	25,000	3.341%	50,000	3.341%
	25,000	3.341%		
3yr	25,000	3.466%	50,000	3.466%
	25,000	3.466%		
4yr	25,000	3.592%	50,000	3.592%
	25,000	3.592%		
5yr	25,000	3.733%	50,000	3.733%
	25,000	3.733%		
6yr	25,000	3.879%	50,000	3.879%
	25,000	3.879%		
7yr	25,000	4.025%	50,000	4.025%
	25,000	4.025%		
8yr	25,000	4.135%	50,000	4.135%
	25,000	4.135%		
9yr	25,000	4.233%	50,000	4.233%
	25,000	4.233%		
10yr	25,000	4.328%	50,000	4.328%
	25,000	4.328%		
	500,000	3.786%	500,000	3.786%
	10 years compounded int (semi-annual)	727,540		727,540
	10 yrs (S/A), in year 5, 6yr bond defaults	697,384		665,265
	Difference in loss of principal + compounded interest			(32,119)

Example for illustrative purposes only. Does not represent actual bonds and is demonstrating simple compounding interest over a 10 year period. Sources: Bloomberg LP Compound Interest Analyzer, Raymond James.

Alternative Minimum Tax (AMT)

The Alternative Minimum Tax (AMT) dates back to 1969. It was established to prevent the wealthiest individuals from using deductions and credits to avoid paying any federal income taxes. As time progressed, AMT was affecting mostly non-exceedingly wealthy taxpayers. In December of 2017, the Tax Cuts and Jobs Act was signed, keeping AMT but raising the exemption and phase out levels. The result is estimated to alter the 5.25 million taxpayers affected by AMT down to approximately 200,000 taxpayers. *(Source: CNN Money)*

Since nearly 96% of the taxpayers that were affected will no longer be AMT affected, it might be beneficial to take notice that in general, AMT municipal bonds are trading with significantly wider spreads than comparative non-AMT bonds. Thus, investors can pick up yield on similar and sometimes the exact same obligors that issue both AMT and non-AMT bonds. Of course investors should consult with their tax accountants and/or attorneys to verify that they will no longer be subject to AMT. ▪

Where Is The Value?

Municipals (AAA)				Corporate A			
Year	Yield	Add'l Yld	Capture	Year	Yield	Add'l Yld	Capture
1	1.57		52%	1	2.82		66%
2	1.59	0.03	53%	2	2.94	0.13	69%
3	1.63	0.03	54%	3	3.00	0.06	71%
4	1.66	0.03	55%	4	3.08	0.08	72%
5	1.70	0.04	56%	5	3.18	0.10	75%
6	1.76	0.06	58%	6	3.30	0.12	78%
7	1.84	0.08	61%	7	3.41	0.12	80%
8	1.94	0.10	64%	8	3.52	0.11	83%
9	2.03	0.10	67%	9	3.62	0.10	85%
10	2.14	0.10	71%	10	3.72	0.09	87%
11	2.24	0.11	74%	11	3.80	0.09	89%
12	2.34	0.10	78%	12	3.89	0.09	92%
13	2.41	0.07	80%	13	3.98	0.09	94%
14	2.49	0.08	83%	14	4.07	0.09	96%
15	2.55	0.06	85%	15	4.16	0.09	98%
16	2.62	0.07	87%	16	4.20	0.04	99%
17	2.68	0.06	89%	17	4.24	0.04	100%
18	2.73	0.05	91%	18	4.28	0.04	101%
19	2.79	0.06	93%	19	4.32	0.04	101%
20	2.84	0.05	94%	20	4.36	0.04	102%
21	2.89	0.05	96%	21	4.34	-0.01	102%
22	2.91	0.03	97%	22	4.33	-0.01	102%
23	2.92	0.01	97%	23	4.31	-0.01	101%
24	2.95	0.02	98%	24	4.30	-0.01	101%
25	2.96	0.01	98%	25	4.28	-0.01	101%
26	2.97	0.01	98%	26	4.28	-0.01	101%
27	2.98	0.01	99%	27	4.27	-0.01	100%
28	2.99	0.01	99%	28	4.27	-0.01	100%
29	3.00	0.01	100%	29	4.26	-0.01	100%
30	3.02	0.01	100%	30	4.25	-0.01	100%

As of: 3/5/2019 *Source: Bloomberg LP, Raymond James*

Know What You Can Own

Many wealthy investors choose individual bonds to preserve their wealth. These laddered strategies can provide defined cash flows, steady income and the flexibility afforded by owning bonds with stated maturities. The table below summarizes a few illustrative portfolios to give investors an idea of current yields.

▪

	Maturity Range	Avg. Maturity	Duration	Yield to Worst	TEY*	AAA	AA	A	BBB
	Portfolio Statistics					Credit Quality			
Municipal Ladders	1 to 5	3	2.79	1.71%	2.89%	20%	60%	15%	5%
	1 to 10	5.5	4.86	1.91%	3.23%	20%	60%	15%	5%
	1 to 15	8	6.73	2.15%	3.63%	20%	60%	15%	5%
	5 to 10	7.5	6.37	2.06%	3.48%	20%	60%	15%	5%
	5 to 15	10	8.11	2.32%	3.92%	20%	60%	15%	5%
	5 to 20	12.5	9.68	2.52%	4.25%	20%	60%	15%	5%
	10 to 20	15	11.10	2.75%	4.65%	20%	60%	15%	5%
Corporate Ladders	1 to 5	3	2.75	3.32%				25%	75%
	1 to 10	5.5	4.77	3.65%				25%	75%
	1 to 15	8	6.58	3.92%				25%	75%
	5 to 10	7.5	6.23	3.91%				25%	75%
	5 to 15	10	7.86	4.15%				25%	75%
CD Ladders	1 to 2	1.5	1.41	2.55%					
	1 to 3	2	1.88	2.62%					
	1 to 4	2.5	2.32	2.68%					
	1 to 5	3	2.76	2.74%					

Sources: Raymond James, Bloomberg LP, MMD; as of 3/5/19
**TEY is based on the top federal tax bracket (37%) plus the Medicare surtax (3.8%)*
Yields shown are illustrative only, calculated using the arithmetic means based on the maturity range combined with the credit quality percentages, and are not inclusive of sales credit.

- ✓Identify acceptable risk factors.
- ✓Define desired income.
- ✓Create required cash flow.
- ✓Identify requisite redemption period.
- ✓Create needed liquidity.
- ✓Isolate personal biases.
- ✓Use appropriate asset mix.
- ✓Diversify.
- ✓Rebalance when applicable.

Diversification and strategic asset allocation do not ensure a profit or protect against a loss. Investments are subject to market risk, including the possible loss of principal. The process of rebalancing may carry tax consequences.

Additional Fixed Income and Strategy Resources

Doug Drabik - Sr. Fixed Income Strategist
Drew O'Neil - Fixed Income Strategist
Rob Tayloe - Fixed Income Strategist

The Fixed Income Strategy Group provides market commentary, portfolio analysis and strategy to Raymond James advisors for the benefit of their clients. We are part of the larger 13 person Fixed Income Services Group (FISG) within Raymond James' Fixed Income Capital Markets Group of more than 475 fixed income professionals including trading and public finance experts in 41 nationwide locations. This publication does not constitute Fixed Income research, but rather it represents commentary from a trading perspective.

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- **Weekly Bond Market Commentary**
- **Monthly Fixed Income Perspectives (PDF)**
- **Fixed Income Market Commentary by Kevin Giddis**
- **Fixed Income Weekly Primer (PDF)**
- **Municipal Bond Investor Weekly (PDF)**
- **Fixed Income Quarterly (PDF)**
- **Weekly Index Monitor (PDF)**
- **Weekly Interest Rate Monitor (PDF)**

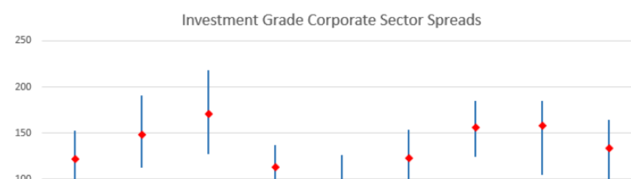
Investment Types/Expertise Include:

- Treasuries/Agencies
- Brokered CDs
- Corporate bonds
- MBS/CMOs
- Tax-exempt municipals
- Taxable municipal bonds
- Preferred securities

The State of Corporate Spreads
By Drew O'Neil
February 25, 2019

A popular discussion topic towards the end of 2018 and into 2019 has revolved around the corporate bond market and trying to determine how much risk is in this asset class is at the moment. Historically, holding investment grade corporate bonds has been a relatively safe investment, with an average default rate over a 5-year period of less than 1% (just 0.91% from 1970-2017, per Moody's). Some commentators are speculating that due to a combination of factors (increased debts levels, the sheer amount of BBB rated bonds, the potential for a recession, potentially increasing refinancing costs, etc.) that corporate bonds could be the next black eye experienced by the market. But what is the market actually telling us?

One of the best indicators of how much risk the market perceives there to be in a corporate bond is its spread. A spread is the difference between a bond's yield and the yield on its benchmark (i.e. corresponding Treasury). The wider (higher) the spread, the more yield the market is demanding for this bond versus a corresponding security with little perceived credit risk. Simply put, the wider the spread, the riskier the bond. The graph below plots the range of spreads for corporate sectors over the past year (blue line) along with the current spread of each sector (red diamond). If all of the red diamonds were at the very top of the blue lines, this would be telling us that the market thinks that corporate bonds are the riskiest they have been over the past year. But as you can see, current spread levels are all near the past year's mid-range point.



The author of this material is a Trader in the Fixed Income Department of Raymond James & Associates (RJA), and is not an Analyst.

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