OPUS INVESTMENT MANAGEMENT

Investments in harmony with you℠

Quarterly Commentary

September 30, 2020

Executive Summary

ANN TRIPP
President

MARKET COMMENTARY

At the end of last quarter, as many of us were just beginning to see signs of light at the end of the dark tunnel brought on by the COVID-19 outbreak, we pointed to a few developments that could justify the more positive sentiment in the market. Progress on a vaccine, the gradual re-opening of states, recovery in economic data, and most importantly, federal stimulus, were some of these reasons we pointed to for the renewal of risk appetite in the market. So, what has changed since then? In some ways not much, as we are seeing a continuation of positive economic data, market support from the Federal Reserve, and a continued appetite for risk; all of this is evidenced by continued strong equity market returns, and the Bloomberg Barclays U.S. Aggregate Bond Index returning 0.62% for the quarter. More importantly for us however, as we attempt to navigate the challenging road ahead, we must be mindful of certain key risks on the horizon.

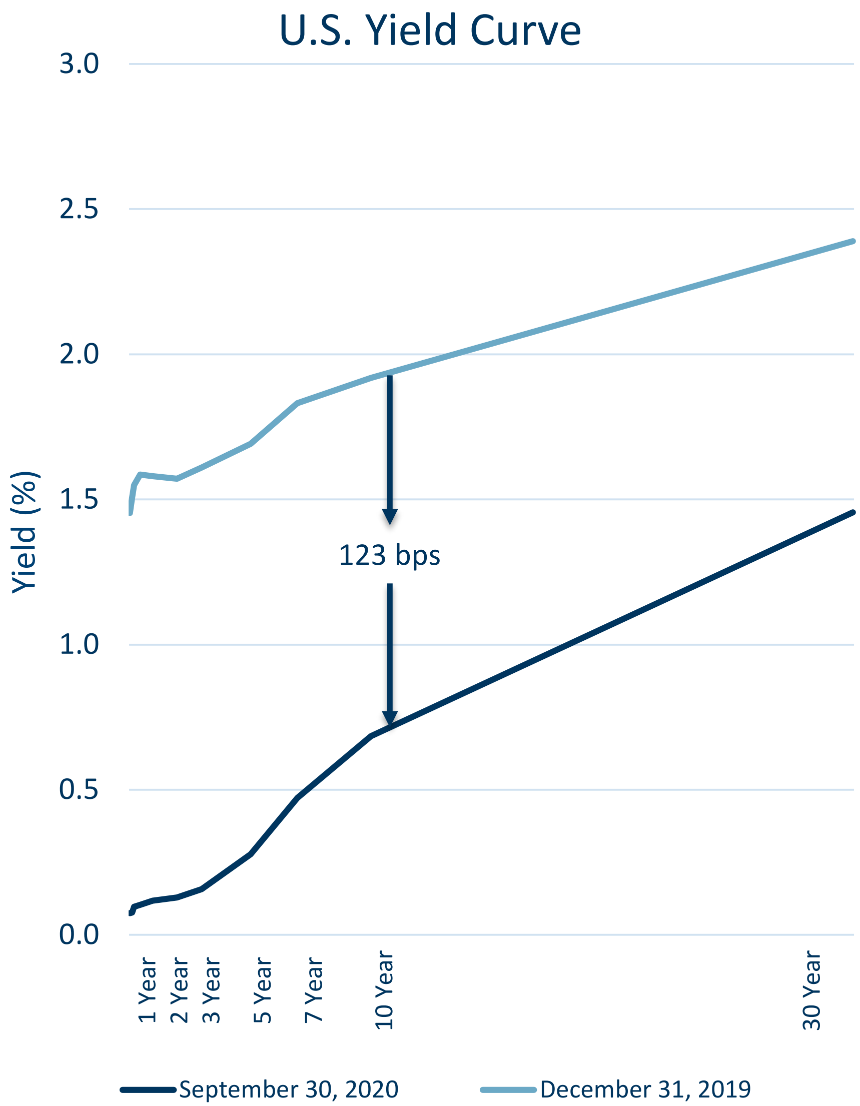
After Congress and the White House worked together to pass sweeping fiscal stimulus earlier this year in the form of the CARES Act, many were hoping for a repeated effort to provide individuals, businesses, and municipalities with further aid to stave off the negative effects of a continued economic slowdown. So far, these hopes have been delayed. We saw Senate Republicans respond to the Democrats' $3 trillion proposal with the much smaller, $1.1 trillion HEALS Act, focusing primarily on more direct stimulus to individuals and an extension of the Paycheck Protection Program. When Democrats balked at the proposal, citing among other things the lack of aid to states and local governments, Republicans tried to pass an even smaller, more targeted package. President Trump also extended increased unemployment benefits through an executive order, given the lack of legislative action. While both sides have signaled a willingness to compromise, spurred on by comments by the Federal Reserve that further fiscal stimulus is critical to economic recovery, at time of writing, the magnitude and form of further fiscal stimulus remains to be seen. Further complicating matters is the upcoming election, and the contentious nature of political debate surrounding the open Supreme Court seat.

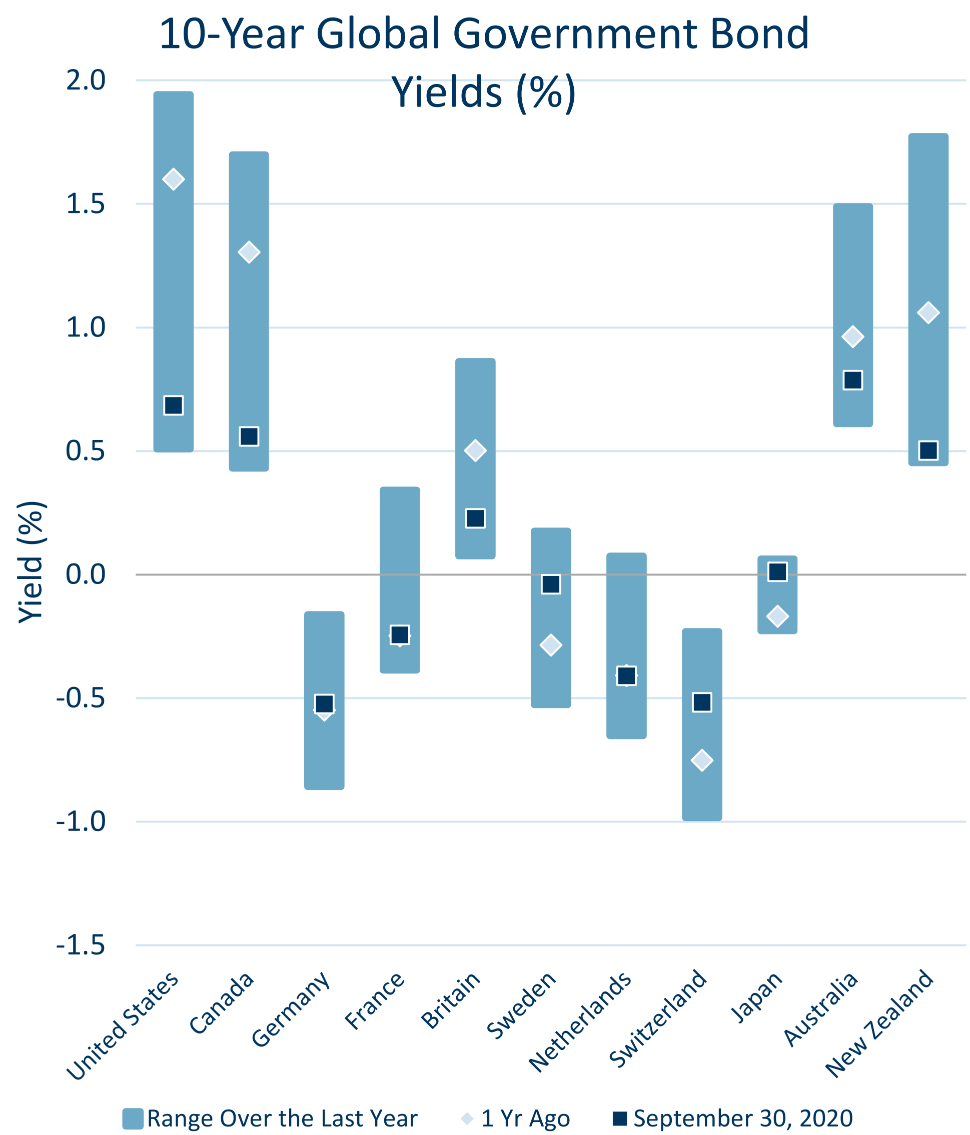
While the politicians stall, the Fed has continued to step in and aid the markets. Within the fixed income space, we have seen yields sink to all-time lows, via a combination of continued low rates and a further decline in the additional yield investors demand for riskier securities. The former point is driven by Fed guidance showing rates are likely to remain low through 2023, a sentiment echoed by central banks worldwide. Meanwhile, in a quarter during which we saw the S&P 500 surpass its pre-COVID peak only months after the pandemic, demand for risk assets is supported by Fed buying of corporate and municipal debt. While these measures served to inject much-needed liquidity into the market during a time of tremendous uncertainty, we must be mindful of what may occur once support is removed.
As we progress through the coming months, we at Opus will be mindful of developments surrounding the U.S. election, specifically related to tax policy and further federal aid, while also keeping an eye on new coronavirus developments domestically and internationally. We will continue to evaluate risk in the context of longer-term uncertainties, with all-in yields at historic lows. Most importantly, we will consider the needs of you, our client, as we navigate the road ahead.

Ann

Economic Outlook

Globally, interest rates remain low

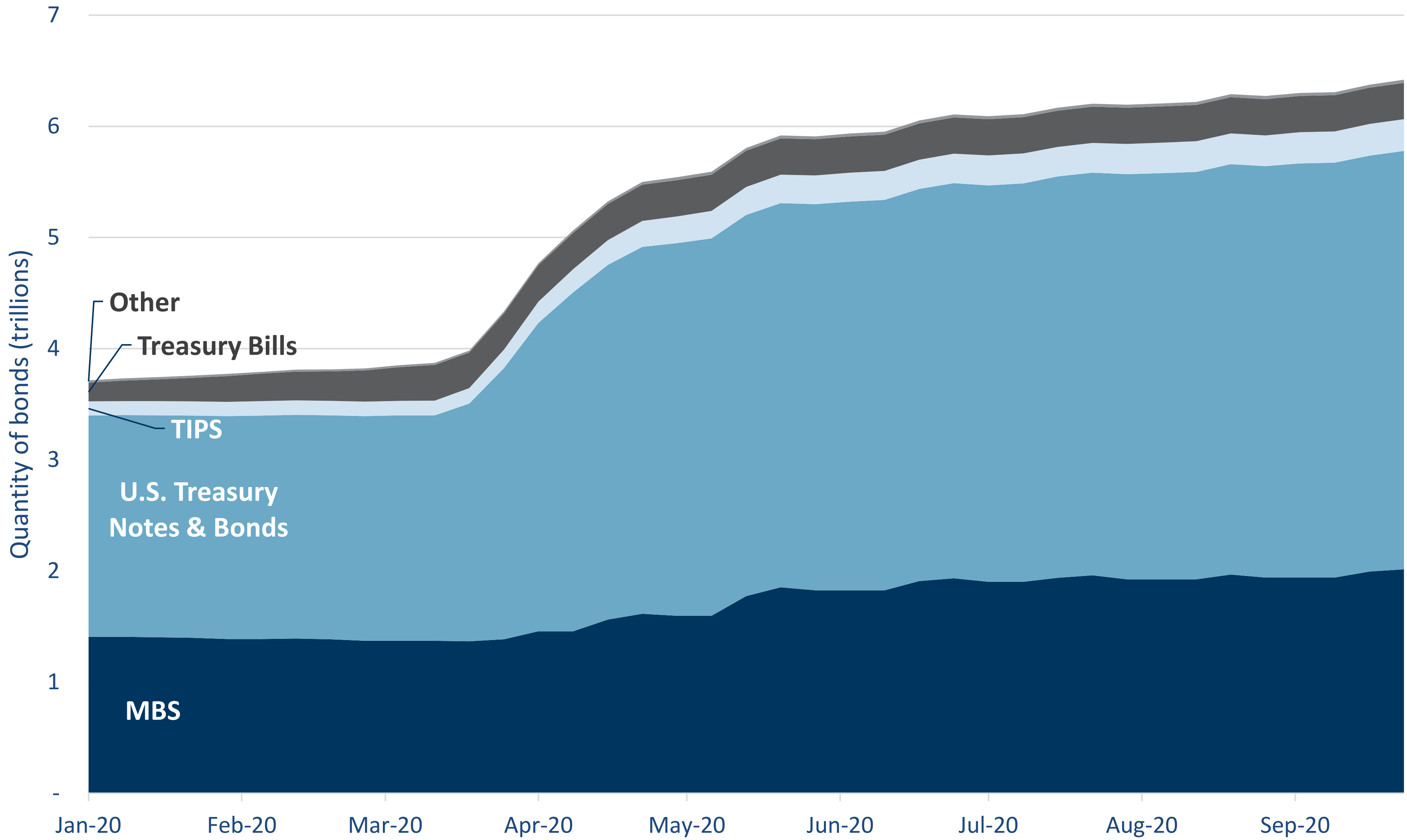




Source: Opus, Bloomberg

Economic Outlook

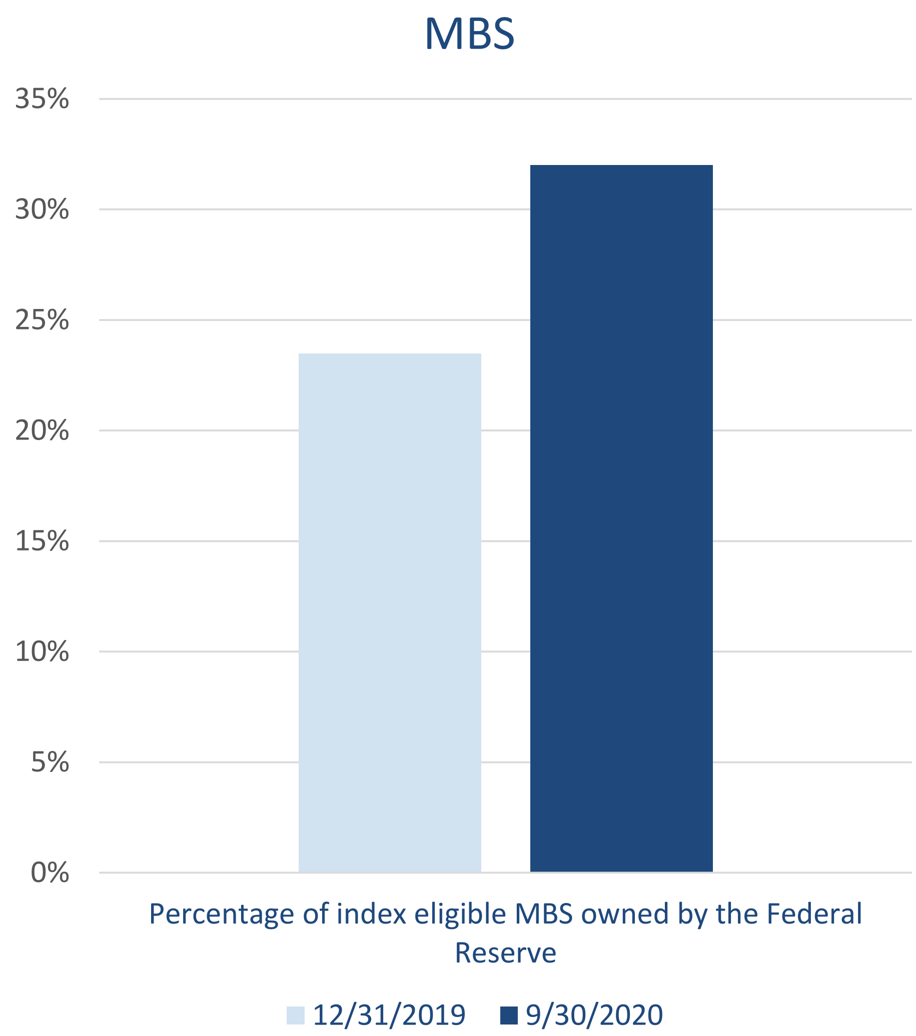
Unprecedented market intervention by the Federal Reserve through bond purchase programs

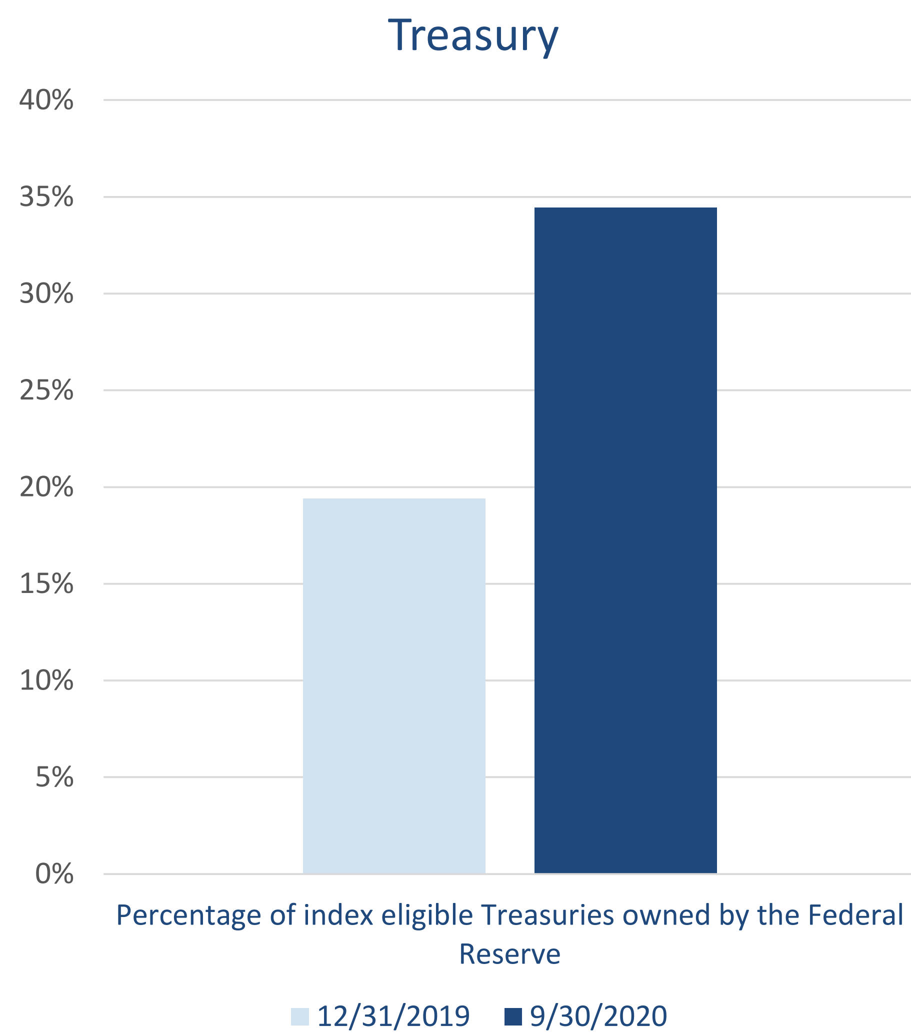


Source: Federal Reserve, Bloomberg, U.S. Treasury, Other includes CMBS, U.S. Agency bonds, and floating rate notes

Economic Outlook

The Federal Reserve owns nearly a third of both the residential mortgages and Treasuries in the aggregate bond index

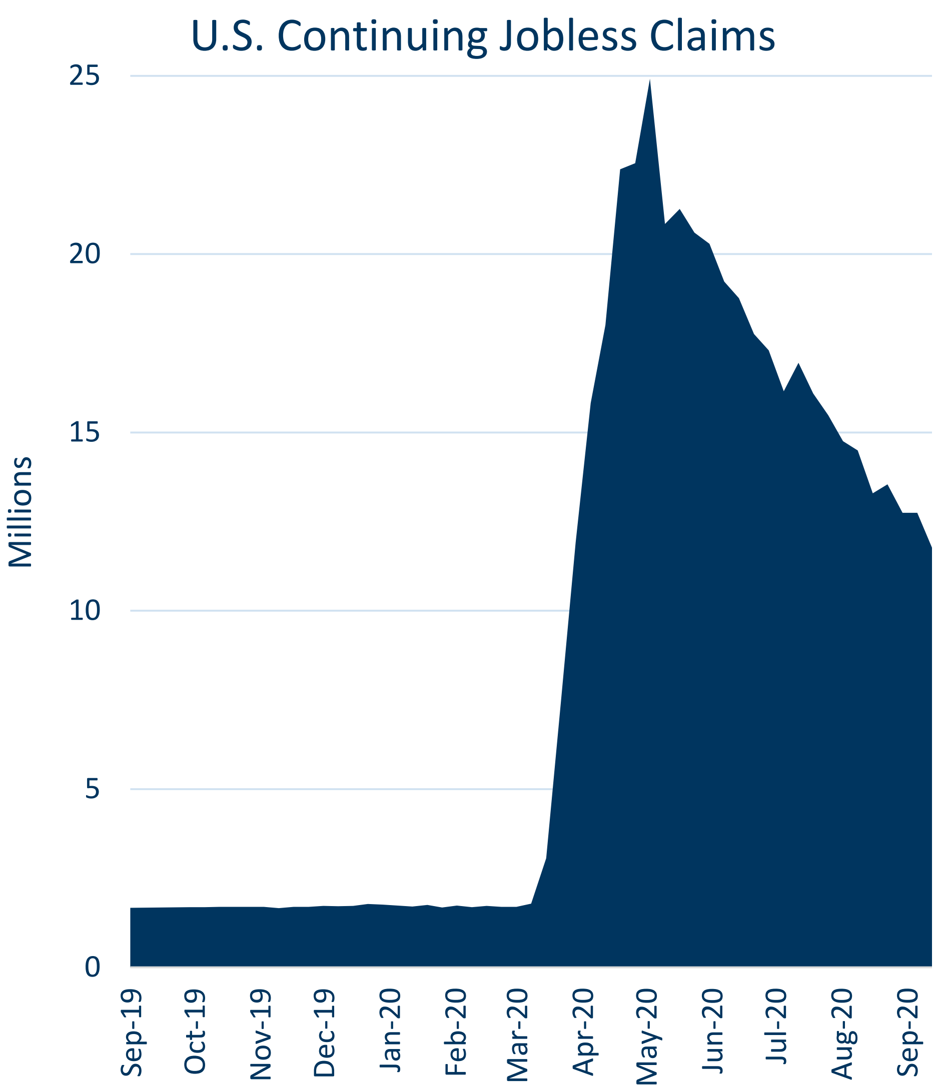


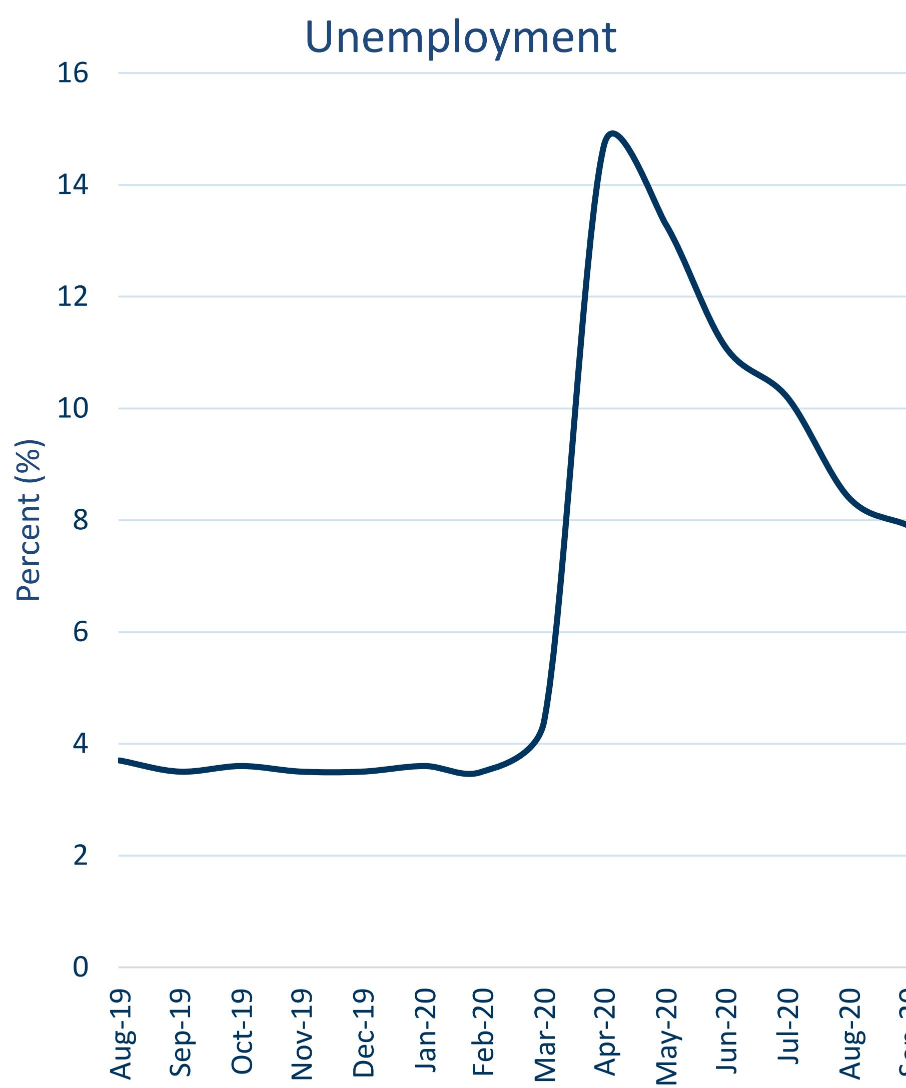


Source: Opus, Bloomberg, Federal Reserve, U.S. Treasury

Economic Outlook

Employment starting to show signs of improvement, but remains challenged



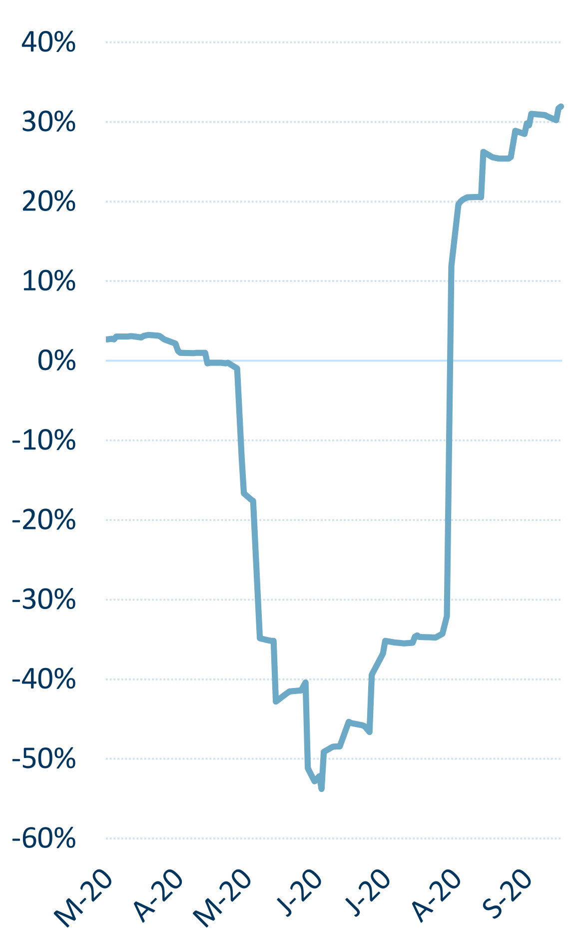


Source: Opus, Bloomberg, U.S. Department of Labor, U.S. Bureau of Labor Statistics

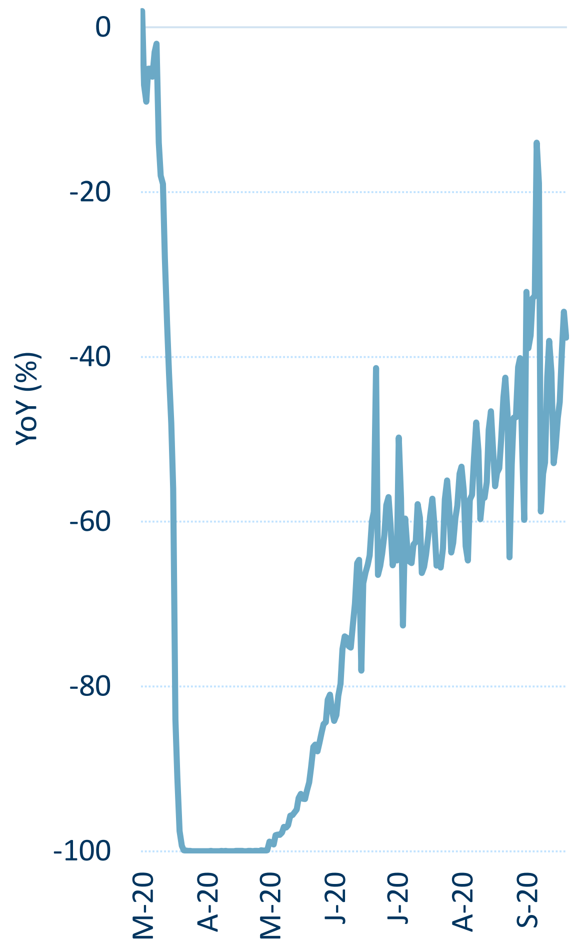
Economic Outlook

High frequency economic data improving

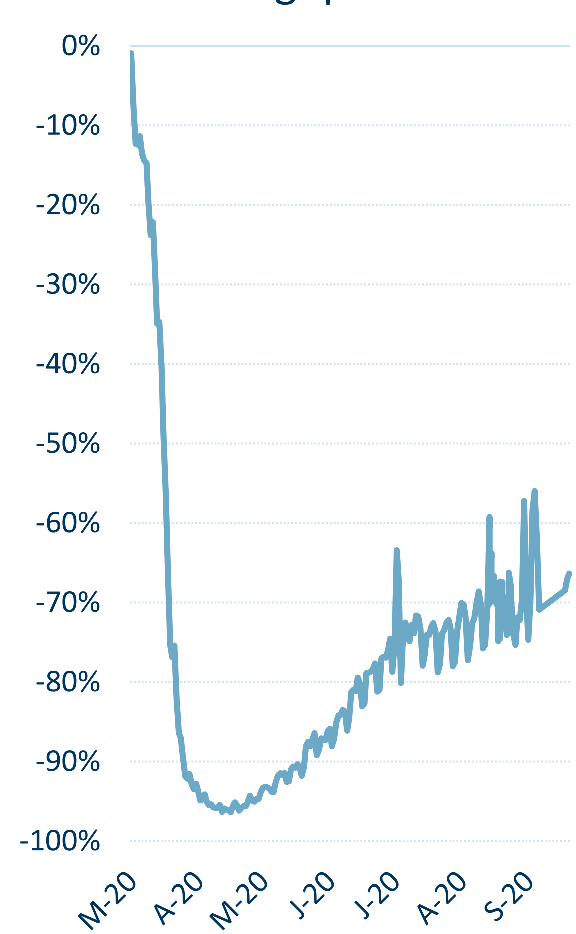
Atlanta Fed GDP Now Forecast



Open Table Reservations U.S.



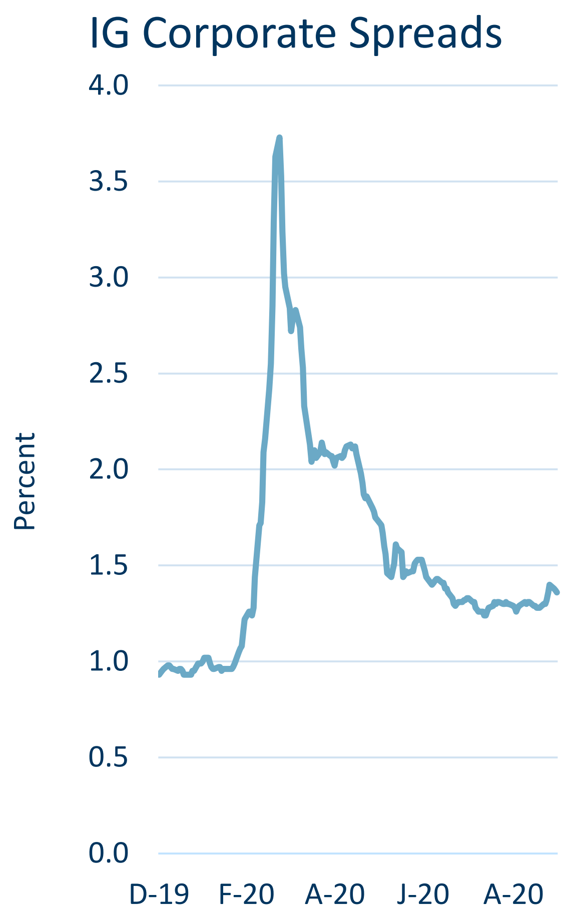
U.S. TSA Traveler Throughput YoY



Source: Opus, Bloomberg, Federal Reserve Bank of Atlanta, Open Table, Transportation Security Administration (TSA)

Economic Outlook

Valuations reflect an optimistic view of recovery, but we must consider risks related to increased political tensions, inability to pass meaningful fiscal stimulus, trade relations, and a COVID-19 second wave.



Source: Opus, Bloomberg

Economic Outlook

U.S. economy reopens from COVID-19 pandemic shut-downs, while political tensions elevate

Monetary and fiscal stimulus likely to continue

- Fed's target rate expected to remain near zero through 2023, QE programs continue to inject massive liquidity into markets.
- CARES act benefits for individuals, small business and municipalities starting to deplete while second package negotiations have stalled in Congress.
- Global central banks reinstate QE programs.

Resulting in a rebound in risk assets

- S&P 500 hit all-time high in early September before a quick sell-off to close the quarter.
- Investment grade corporate bond issuance has surpassed $1.5 trillion in 2020, more than all of 2019.
- All-in-yields near historic lows with the Fed extending its Corporate Credit Facility through year-end.

However, outlook might be underpricing risk

- Second quarter growth declined 31.4%, consensus estimates for third quarter GDP growth are 25%.
- Concern over increasing confirmed COVID-19 cases is causing some areas to pause reopening plans.
- November election on the horizon, coupled with increased trade tensions with China and Europe.

Source: Opus, Bloomberg

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