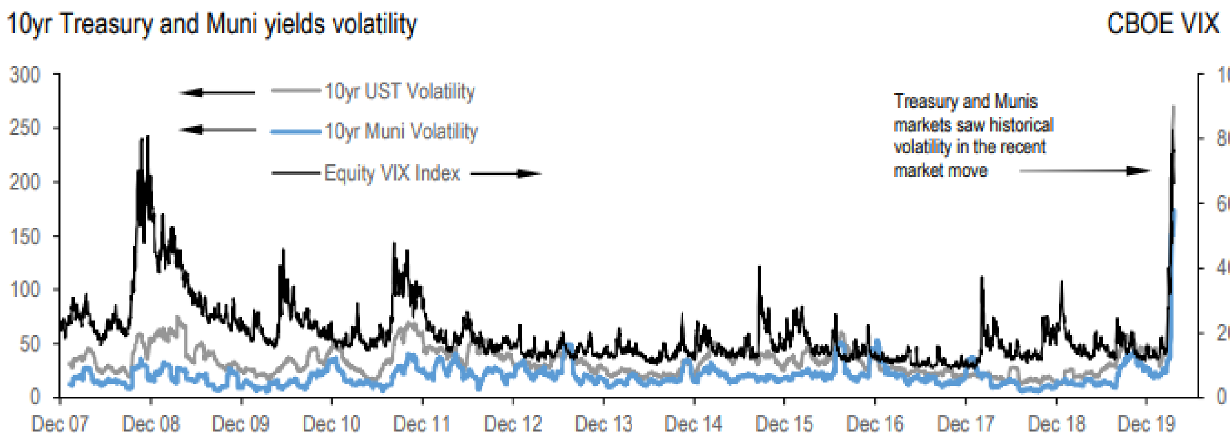
KARMIN CAPITAL

What Is Happening In The Fixed Income And Credit Markets

While the 31% sell-off in the S&P 500 during the past month[1] is the focus of most investors, the precipitous drop in the credit markets is equally – if not more -- unnerving. Many investors bought bonds – investment grade and high yield – along with mortgage real investment trusts and preferred securities issued from financial corporations such as banks as an alternative way to seek income. Up until the past 30 or so days, the strategy was successful. Since then it has been disastrous. (The end of this letter shows the price changes for various credit securities.)

Investors are selling anything and everything in terms of stocks and bonds to raise cash. The liquidity and depth of the fixed-income markets – especially those involving credit – is quite poor. Volatility – or the price change – of the bond markets is unprecedented. The fixed income or bond markets are more volatile today than they were even during the 2008 Global Financial Crisis.



Source: JP Morgan Note: UST and Muni yields volatility are calculated based on 25 days

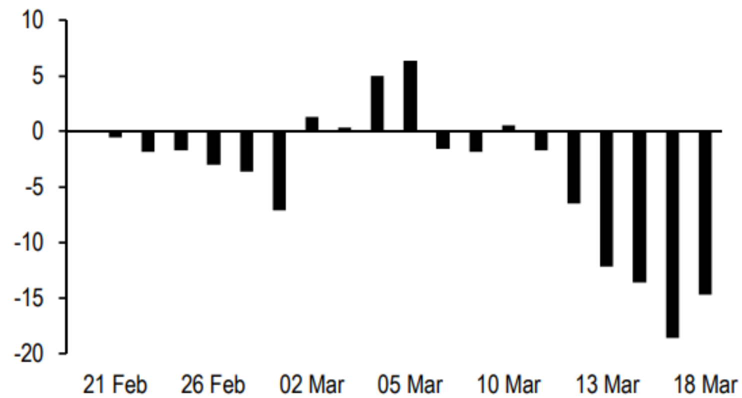
The sell-off in credit markets (bond or interest rate markets which are not U.S. Treasuries) is in part a result of a change in the bond market structure. Market participants who were previously liquidity providers are now liquidity takers. The bid / ask spread (or the price at which you can either buy or sell a security) is now estimated to be 8x wider than normal for the Treasury market. Additionally, investors are fearful that the government will shut down the financial markets for a period of time. If you own a Treasury bill or any fixed income product which you had regarded as a proxy for cash and the market is closed for a period of time, those products --- including Treasury bills – may not be viewed as cash.

Almost all of our clients put their cash into money market funds or Treasury bills. There are different types of money market funds. We typically invest your money in a Fidelity Government Money Market Fund (symbols on your statement could be for example either FDRXX or FZAXX). These funds invest in U.S. government securities and are structured to maintain a stable net asset value (NAV) of $1.00. They do not place restrictions on your ability to redeem the fund and / or access your money.

A second major type of money market fund is a prime fund. Unlike the government money market funds, these funds can invest not only in government securities but also corporate debt. Prime funds usually maintain the $1 NAV, but that is not guaranteed. A few of these Funds "broke the buck" recently meaning that their NAV is slightly below $1.

During the past week, redemptions at **prime** money market funds were intense. From March 11 to March 18th, prime institutional money market market funds (MMFs) lost $65 billion or 20% of their portfolios because of redemptions.

Daily Change In Prime Institutional Money Market Balances ($



Source: iMoneyNet, data as of 3/18/2020

The rules surrounding money market funds pushed some of the prime funds to within 2% of the 30% weekly liquidity threshold required. If breached, the SEC requires the fund's board to decide if it needs to impose a liquidity fee of up to 2% on all redemptions or even suspend redemptions for up to 10 days. Such actions would cause panic and more redemptions.

Thus, the only liquidity for some investors is to hold cash or U.S. Dollars. That can be seen in the recent move up in the U.S. dollar versus other currencies.

The Federal Reserve knows of the dysfunction within the credit markets and has announced numerous programs to provide liquidity to the money market, Treasury and mortgage-backed securities markets. It will take time, but the Fed should succeed in providing stability. Most importantly, the Treasury and the Federal Reserve will need to provide a back stop for the corporate credit or bond markets. News reports within the past 24 hours indicate that such a program will be enacted shortly.[2]

Both the equity and fixed-income markets will remain volatile until the spread of the corona virus slows and until the federal government is able to enact a wide-spread fiscal package.

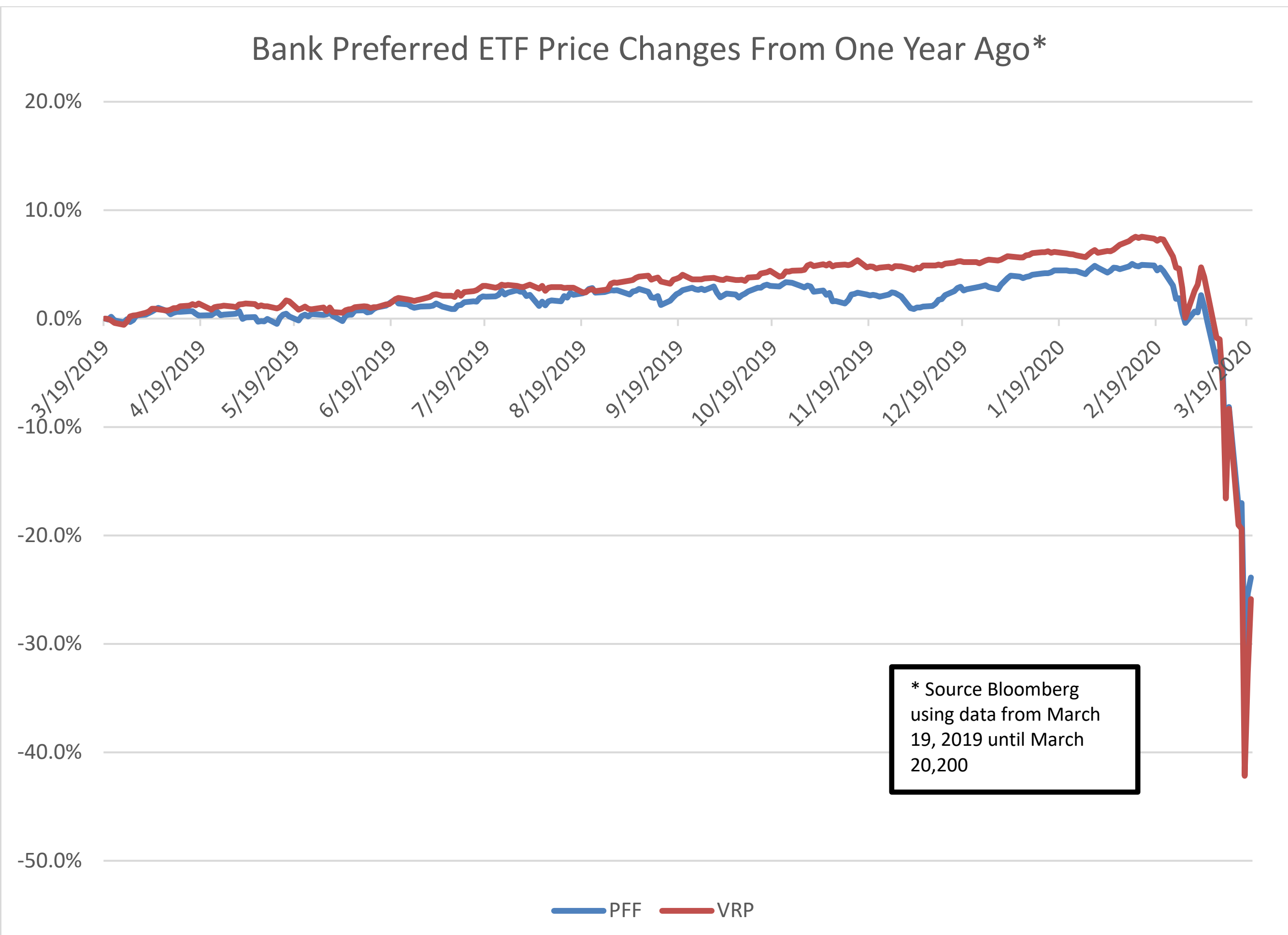
Sincerely,

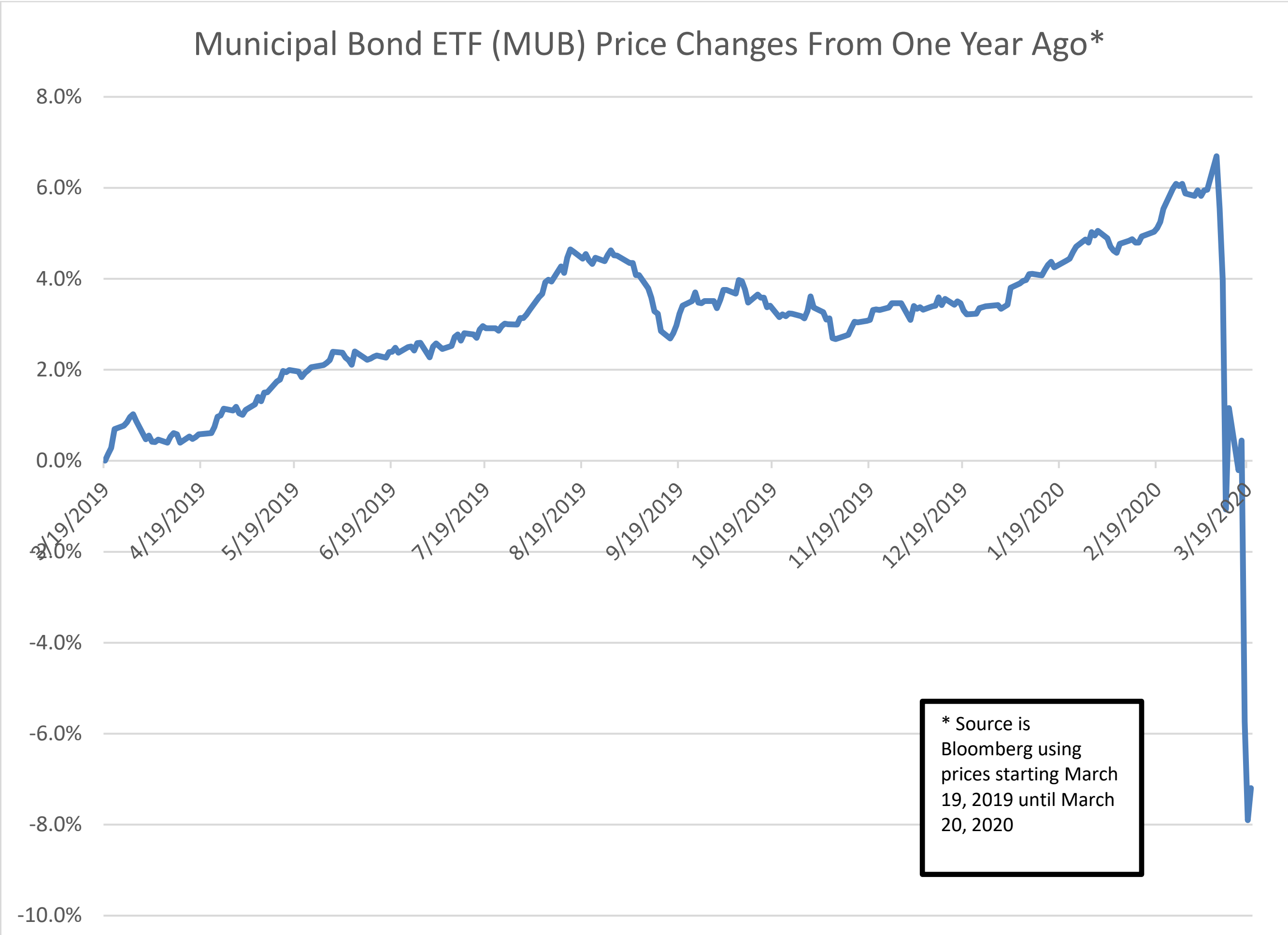
Peter Karmin
Managing Member

Stuart Loren
Director

Citations and Disclosures

[1] Bloomberg Finance
[2] Bloomberg Finance story March 22, 2020 “Congress May Allow Fed To Purchase Longer-Term Corporate Debt”




Municipal Bond ETF (MUB) Price Changes From One Year Ago*
8.0%
6.0%
4.0%
2.0%
0.0%
-2.0%
-4.0%
-6.0%
-8.0%
-10.0%
3/19/2019
4/19/2019
5/19/2019
6/19/2019
7/19/2019
8/19/2019
9/19/2019
10/19/2019
11/19/2019
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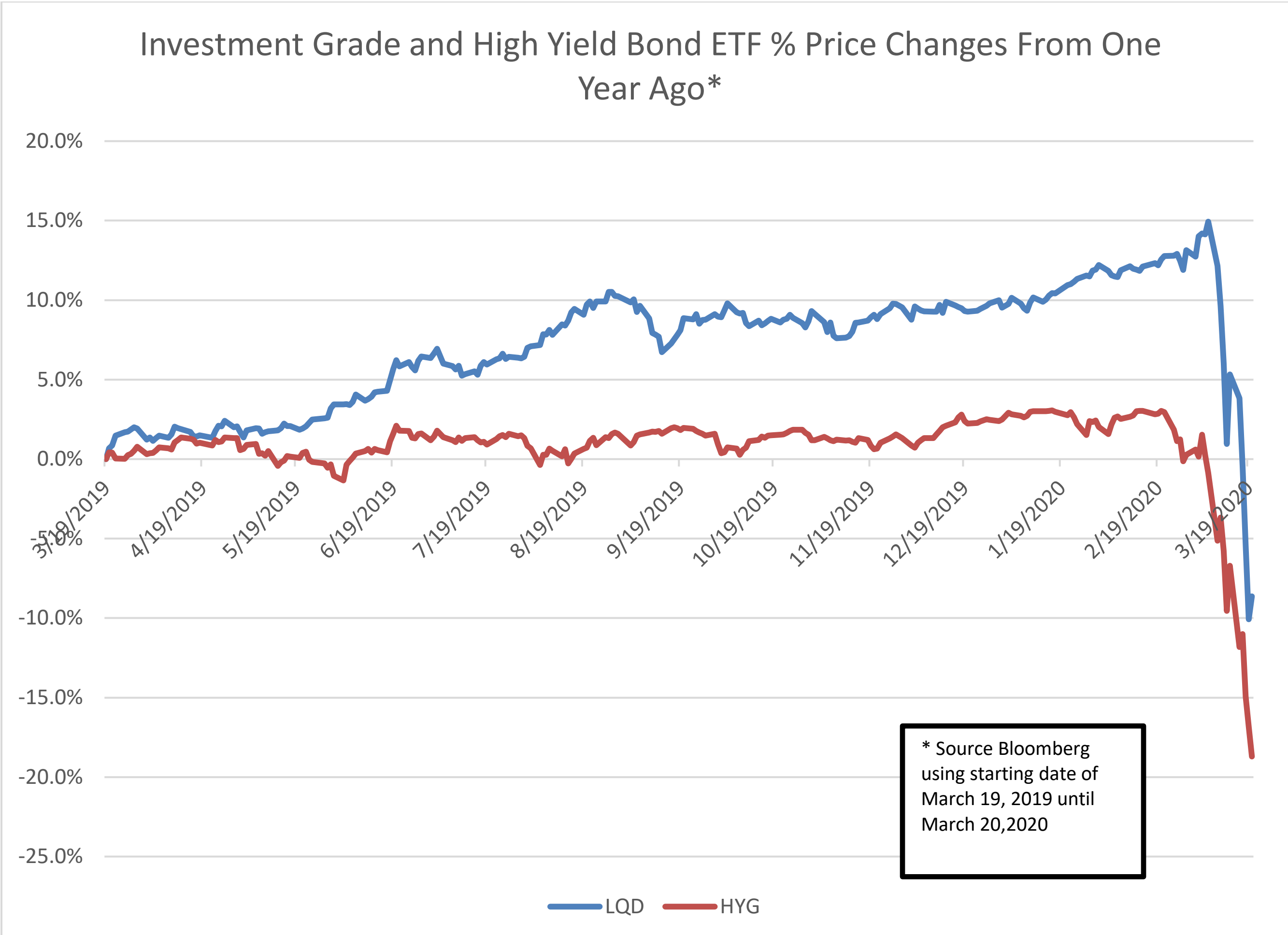
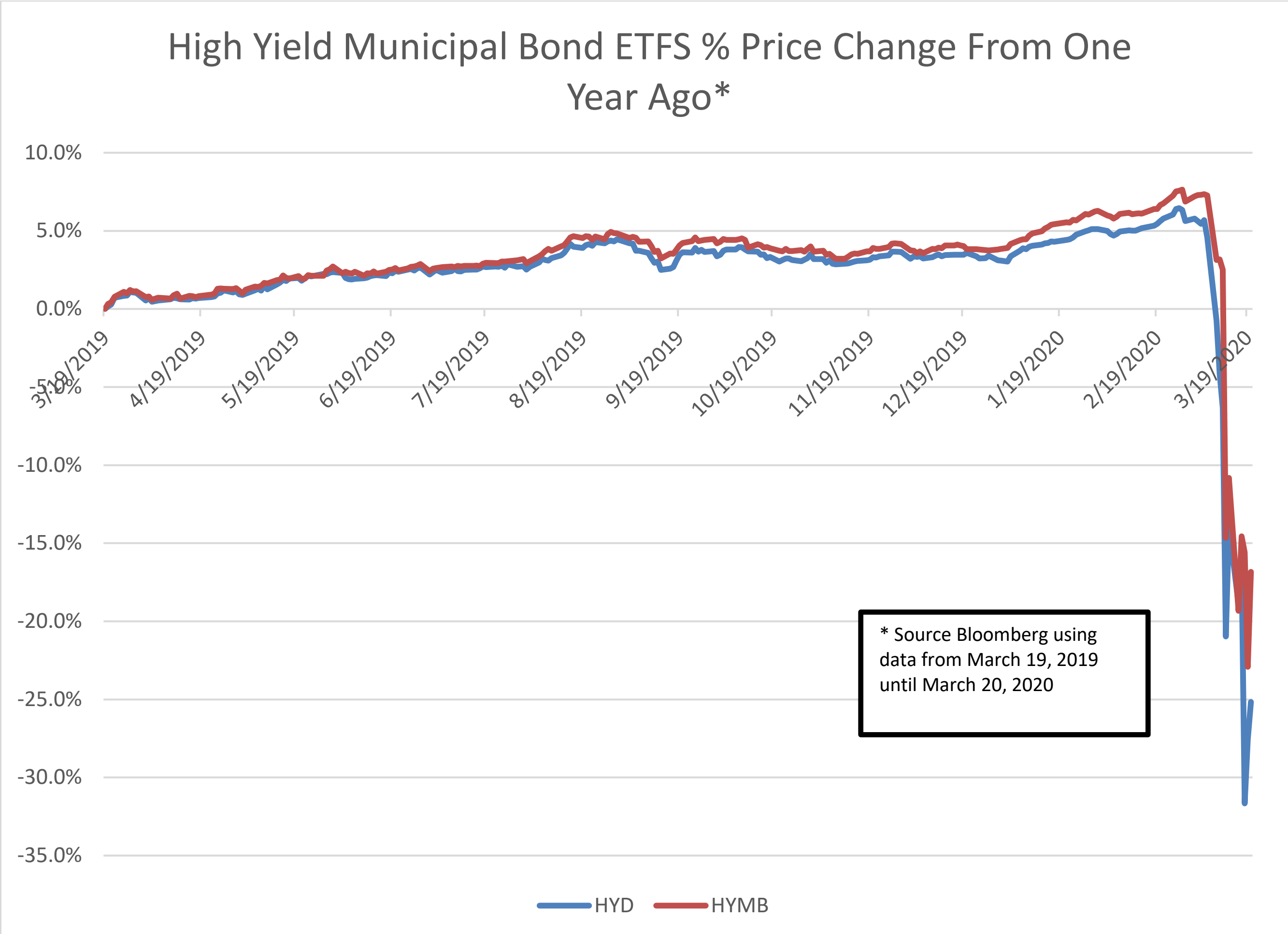
1/19/2020
2/19/2020
3/19/2020
* Source is Bloomberg using prices starting March 19, 2019 until March 20, 2020


Investment Grade and High Yield Bond ETF % Price Changes From One Year Ago*
20.0%
15.0%
10.0%
5.0%
0.0%
-5.0%
-10.0%
-15.0%
-20.0%
-25.0%
3/19/2019
4/19/2019
5/19/2019
6/19/2019
7/19/2019
8/19/2019
9/19/2019
10/19/2019
11/19/2019
12/19/2019
1/19/2020
2/19/2020
3/19/2020
* Source Bloomberg using starting date of March 19, 2019 until March 20,2020
LQD
HYG


High Yield Municipal Bond ETFS % Price Change From One Year Ago*
10.0%
5.0%
0.0%
-5.0%
-10.0%
-15.0%
-20.0%
-25.0%
-30.0%
-35.0%
3/19/2019
4/19/2019
5/19/2019
6/19/2019
7/19/2019
8/19/2019
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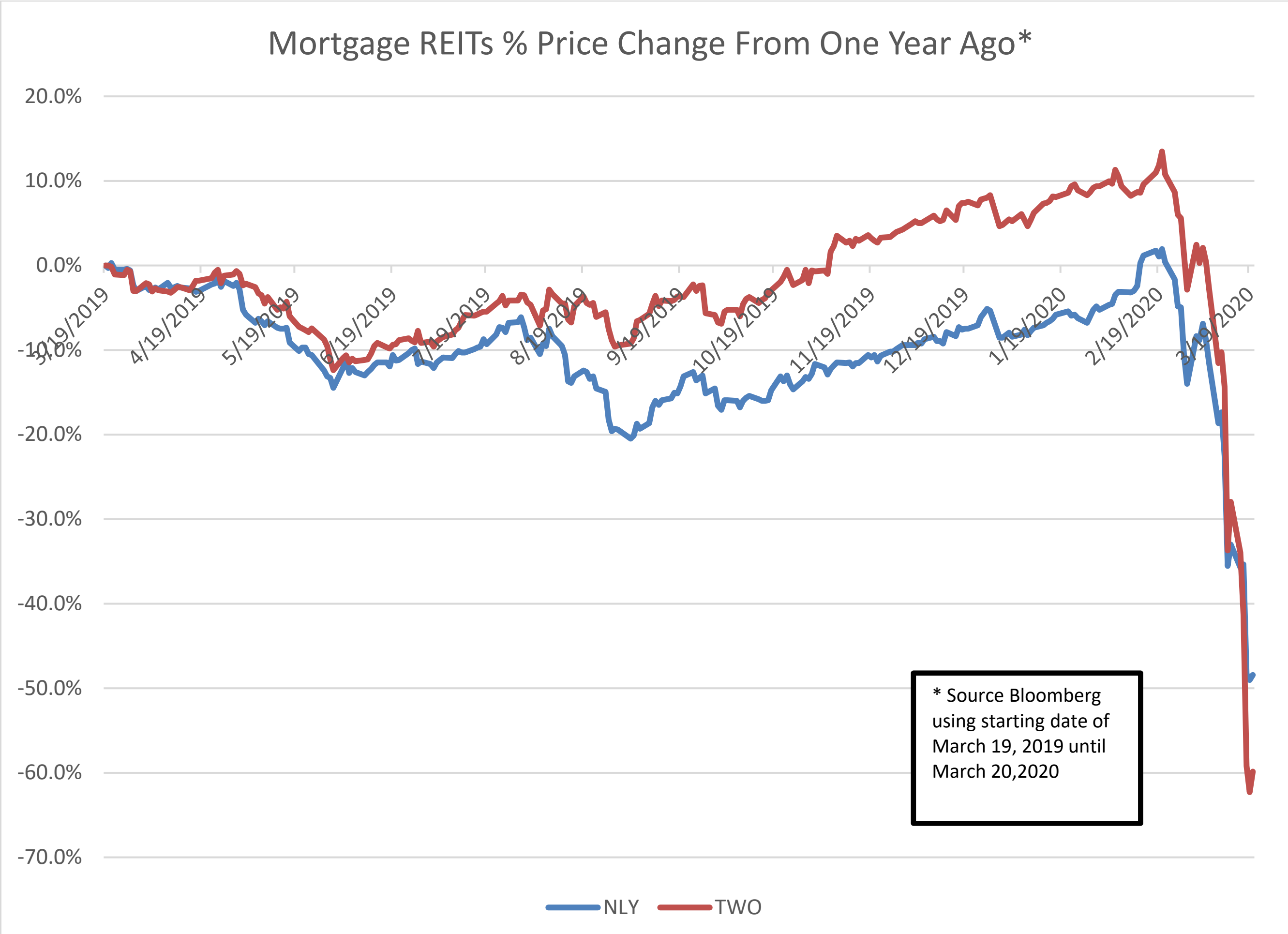
* Source Bloomberg using data from March 19, 2019 until March 20, 2020
HYD
HYMB



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