FHN FINANCIAL

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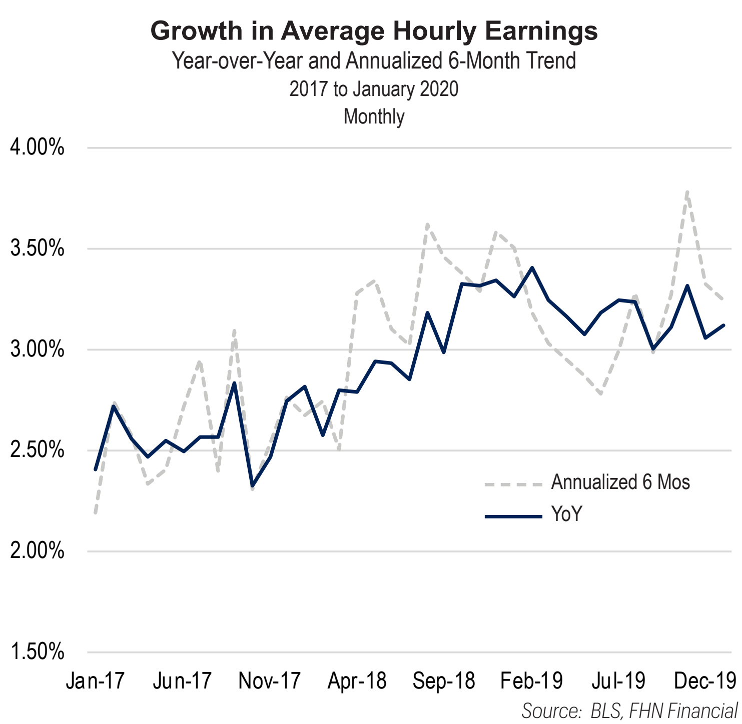
THE WEEKLY REPORT

Away from quite real concerns about economic growth in 2020, portfolio managers need to keep one eye on a possible rebound – particularly in the US. The January payroll report and large revisions to the 2019 establishment numbers point to continued slack in the US labor market, despite solid monthly job gains to start the year. A rebound would absorb slack before it creates inflation.

Downward revisions to total jobs last year reduced the total of hours worked, too. In the most recent 12 months, the average gain in aggregate hours (year over year) was 1.1%. For the preceding 12 months the typical increase was 2.1%. If the labor market were getting tighter, employers would be working existing employees longer. Indeed, that is the case in certain sectors of the private economy, just not true for the macro picture.

Slower growth in total hours worked, then, is one explanation for the absence of inflationary pressure for wages. The chart shows just a slow and steady rate of annual hourly wages between 3.0% and 3.3% for the last 18 months. The occasional upticks on a 6-month annualized basis have all flattened eventually.

Chris Low mentions another side to the labor slack, and decreasing growth in hours worked. "The upside of weaker job growth in 2019 is a hefty upward revision to productivity. The Fed failed to recognize the economy's better productivity when it normalized rates in 2017-18, but maybe this fresh look will help make the case for restraint from excessive tightening after the policy review."



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VIRUS NARRATIVE MUTATES CONSTANTLY IN MARKETS

Investors integrated four themes into risk and rates this week:

- The viral toll in China is much worse than expected. So far, the spread of cases to other countries is slow. There is growing fear China is under reporting the breadth of the health problems.
- The US economy entered 2020 with enough momentum to stay at the top of the global economy.
- EU growth is slipping hard, and there are too many bad data releases for growth to recover convincingly this quarter.
- Equity strength appears legitimate but is moderately overcooked. Bonds failed in their attempt to reach persistently lower prices.

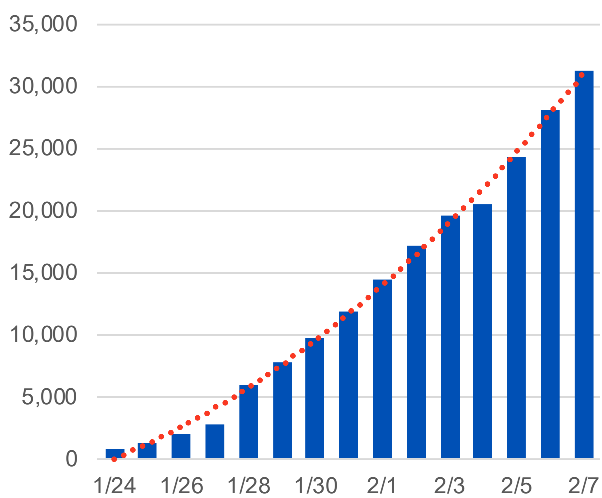
<u>As stories develop next week, here's a brief playbook outline for rate changes:</u>

1. Does the virus claim more Chinese victims outside the city of Wuhan and the Hubei province? Efforts to stop travel within the country started just more than two weeks ago. The geographic breadth of contagion can change expectations for an eventual improvement in China's consumption production.
2. Fed Chair Powell appears before the Senate Banking Committee on February 12. It should provide the first update on the Fed's view of coronavirus impact on the US and global economy. This week, Fed officials were still talking about Boeing production, a story from three weeks ago.
3. Can the S&P 500 – representing global stocks – stay above 3300? Can Brent crude get back to $58.50/barrel? Those are the two principal risk barometers that can move yields outside the range.
4. Curve shape. Further flattening will eventually pull intermediate yields lower. Steepening is the path to further sell-offs.

New virus cases continue unabated

As the number of cases mount, the percentage increases in new infections <u>should</u> slow. They have not, however. This week, daily additions rose from 11%-15% with each new report from Chinese health officials. Either cases were under reported earlier or attempts to slow contagion have failed.

Reported Coronavirus Cases in China
January 24 to February 7
Daily



Source: National Health Commission of China

Unfortunately, press reports from Western news outlets suggest current counts are too low, so next week's numbers are likely to run toward 50,000. The numbers below are as of the morning of February 7. Of total global cases reported to date of more than 31,000:

- 99.8% are in China
- Within China, 71% of the reported cases concentrate in Hubei province, which has a population of 58 million. That concentration is up from 66% to start the week, indicating Hubei's problems are getting worse.
- Cases that Chinese health officials label severe have been consistently in the 13%-15.5% range. That stability is on the uncanny side of expected statistical ranges.
- Deaths are climbing almost precisely with the number of reported cases. The initial conclusion, then, would be China has made no progress in delivering an effective treatment in the last three weeks for those who fall ill.

See *Economic Weekly* for a more extensive analysis of China's experience and what it could mean for economic growth there.

Risk-off trading precedes the weekend

For the first four days, bond yields closely tracked the improvement in global equities. Yields stayed stubbornly high on Thursday after 10-yr yields ran quickly to 1.68% before retreating again. After good payroll numbers for January, though, the results were not sufficient to avoid January's pattern of quick risk pull-backs to avoid the potential for inescapably bad headlines over the weekend. ***Just because early February didn't bring any bad news, the market still chooses to flinch. The behavior could continue another two weeks.***

The amount of the yield decline on Friday was significantly greater than the risk-on run late Wednesday.

S&P 500 Futures vs 10-Yr UST Yields
January 31 to February 7 (1:00 pm EST)
30-Minute Intervals

Source: CME, Bloomberg, FHN Financial

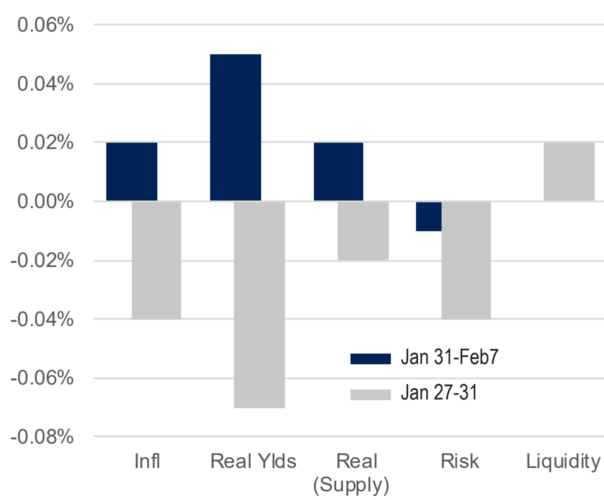
Breaking down the 14bp rate increase on 10s through Thursday to the decline on Friday (as of 1:00 p.m. EST) shows the following:

	10-Yr Yield		Major Themes
January 31	**1.50%**		
Infl Expectations		0.03%	Global growth/oil worries
Real Ylds		0.07%	Better financial conditions
Real Ylds (Supply)		0.02%	Auction sizes unlikely to fall
Risk Premium		0.03%	Rebound in Asian stocks
Liquidity		-0.01%	Increased 2-way volume
February 6	**1.64%**	0.14%	
Infl Expectations		-0.01%	Weak EU data
Real Ylds		-0.02%	China growth concerns
Real Ylds (Supply)		0.00%	N.A.
Risk Premium		-0.04%	Pre-weekend profit taking
Liquidity		0.01%	One-way trading
February 7	**1.58%**	-0.05%	

Source: FHN Financial

The common denominator between the two weeks was a decline in the risk term premium out the curve. Otherwise, the factors moved in opposite directions.

Component Changes in 10-Yr UST Yield
Week of January 27 and February 3



Source: FHN Financial

Oil is not the only commodity struggling

Crude prices remain the primary barometer of global growth risk due to the size and speed of the market. Energy trends, however, are noisy with more than a fair share of Middle Eastern conflict and regulatory baggage that can scramble the picture. Still, it's a premier look into risk sentiment because so many investors are involved.

Looking at industrial metals, though, gives a cleaner look at global fundamental trends that are then colored by confidence or worry about the outlook for global growth. After the trade-related rebound to end 2019, prices have fallen to the worst in the last 18 months. Year to date it has fallen 7.1% even though it never enjoyed oil's 2019 gains. Iron prices in Singapore, the index most closely related to China's economic fortunes, are down 14% this year.

Industrial Metal Commodity Price Index
Mid-2018 to Present

Source: Bloomberg

Last year, agricultural commodity prices were steamroller flat. This year, the index is down almost 5%. The inability to kickstart US ag exports to China is one way China's health disaster can impact selected regions in the US economy. This chart isn't as dire as industrial metals, but fixed income investors should watch for at least a 50% retracement of this year's drop.

Agricultural Commodity Price Index
Mid-2018 to Present

Source: Bloomberg

5s/30s curve bull flattens with risk-off

Four different yield curve segments are vital to understanding macro conditions, but the 5s/30s is the best single indicator. It started the week bear flattening on good economic news in the US but no obvious inflation pressures to trouble the long end. That the curve bull steepened to close out last week (1) was an important indicator than the "buy anything" mentality at month end (and before the weekend) was distorting valuations badly.

Source: FHN Financial

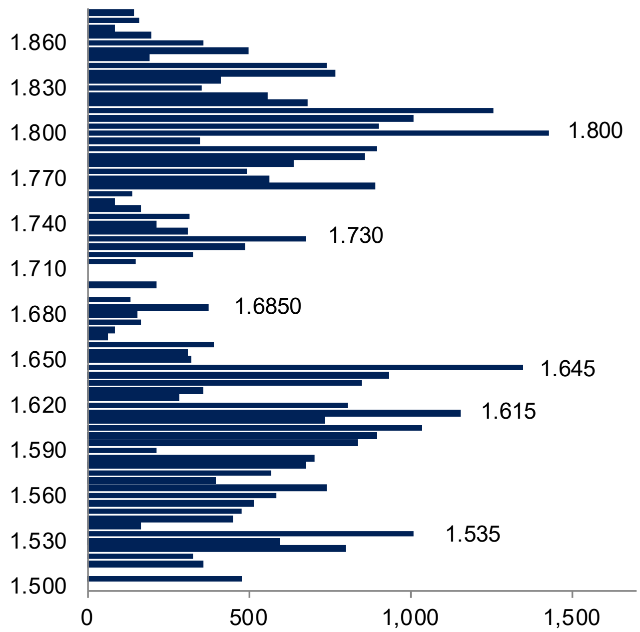
- A sustained bull steepener reflects growing concern about immediate prospects for the US or global economy. Based on the present Fed outlook, a big rally in the 5-yr is a de facto recession indicator, at least in the mind of fixed income investors or traders.
- A bear flattener is unsustainable. It says rates should go up because the economy is great but above-average risks in other markets create a large bid for 10-yr and 30-yr UST.
- A bear steepener for 3-5 days moves beyond a correction into a belief China's problems with the coronavirus are safely in the rear view mirror.

10-Yr flows stop above 1.645%, concentrate from 1.56%-1.62%

The best grip on short-term technicals confines the analysis period from January 3 forward. FHN Financial's volume at yield chart now captures that period to isolate:

- The importance of 1.730% as support
- Intermediate resistance at 1.565%
- The potential for a break to 1.765% if yields get past 1.73%

10-Yr UST Yields
With Volume Totals from Corresponding Futures Trading
Since January 3, 2020



Source: CBOT, FHN Financial
Note: Yield/Volume measured in 30-minute intervals

IMPACT OF NEW 20s DEPENDS ON DEFICIT, RATES

This week, the Treasury

1. Said actual borrowing needs could be lower than expected in 2020. The current estimate for the first half of this year is more than $200 billion lower than what was needed in the first half of last year.
2. Announced the imminent arrival of $100+ billion/year 20-yr auctions without saying whether it would reduce other auction sizes.

Without smaller auctions this year, the Treasury will either build its cash balances or shrink the amount of Treasury bills among private investors even more than expected. If bills do fall well below $2 trillion again, the Treasury can meet demand for short-term investments with SOFR floaters later this year or early in 2021. The Borrowing Advisory Committee recommended current coupon auction sizes stay the same.

Background: With large maturities arriving in 2021, Treasury needs new debt offerings rather than continually upsizing current auctions. It does not need the money this year, but can take advantage of low rates with the reappearance of the 20-yr now scheduled for May. The starting size of the 20-yr program is yet to be determined. TWR - 11.1.19.pdf

Rate Impact Takeaway: Treasury decisions matter most for the six months from April to October. Fewer bills should tighten values for UST less than 3 years, and rich 2s would surprise most traders focused solely on economic health and central bank policy. The introduction of the 20-yr could add 5-7bp to 30-yr yields as investors worry about the acceptance of the first new fixed-rate auction since 2009. By late fall, though, the absolute size of the deficit will govern the supply component for rates, the curve, and the relative attractiveness of Treasuries vs corporates.

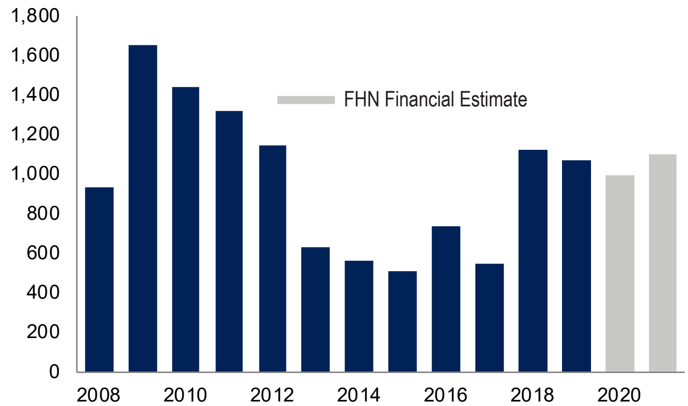
Highlights of quarterly refunding announcement

- The current pace of federal receipts, seasonal fluctuations, and Federal Reserve purchases of Treasury bills to maintain excess reserves above the $1.5 trillion threshold – most recently reported at $1.46 trillion – could reduce the amount of Treasury bills held by private investors from $2.4 trillion to $1.8 trillion by mid-summer. The figure hasn't been that low since late 2017.
- Federal Reserve bill purchases so far, Treasury noted, have not reduced liquidity or trading volumes. As bills already purchased by the Fed mature, they will be rolled over as additions to upcoming bill auctions, reducing the size of those offerings.
- The 20-yr will auction on Thursdays, the same day as TIPS. Maturities will be on the 15h of May, August, November, etc., the same as 10s and 30s. Settlements, however, will be at the end of each month. 20s will have the same long, when-issued period as TIPS, longer than other coupons by at least a week. Based on recommendations from investors and dealers, the initial size is likely to be at least $10 billion with subsequent reopenings at least $8 billion to ensure liquidity. ***Initial sizing is unlikely to be a critical factor in a successful launch.***
- Before the middle of the year, Treasury will issue a "request for information" on market interest and pricing for SOFR-indexed floating rate notes. This is the next step in developing this product. The potential role of those FRNs is discussed here.

Treasury supply coming off recent peak of 2018

After net Treasury issuance fell about $50 billion last year, FHN looks for a decline of as much as $75 billion in 2020. The estimate assumes the reduction in the need for new cash is finished in the first half of the year and the second two quarters match the borrowing requirements in the second half of 2019. The result puts net funds raised well under the $1-$1.1 trillion threshold forecast by the Congressional Budget Office and most Wall Street analysts.

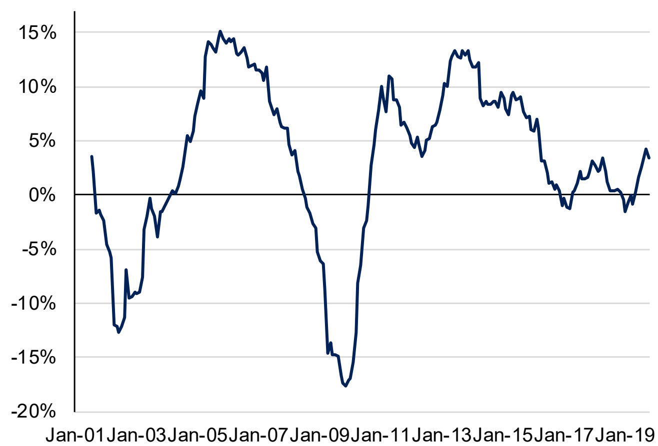
Treasury Net Change in Marketable Dept: Calendar Years 2008 to 2021



Source: US Treasury, FHN Financial

FHN Financial's forecast is based on both Treasury's borrowing estimates (released February 3) and the reacceleration of Federal receipts in the second half of the year. Most of that was related to increased tax collections/economic growth and not tariffs.

Annual Growth of Federal Receipts: Trailing 12 Months
2001 to Present



Source: US Treasury, FHN Financial

While the size of the federal deficit ultimately determines the relative value of Treasuries, rate levels, etc., the timing of deficit increases remains important because the later deficits arrive, the more flexibility the Treasury has to match its liability management with investor demand. Last year provided the perfect example of what doesn't work. Treasury's well-documented plan was to quickly increase bill issuance as soon as debt ceiling was lifted. Unfortuately, the end of the debt ceiling arrived precisely at the worst of the US/China trade war when rates were falling. Lower rates required cheaper bill valuations that eventually diverted cash from the repo market.

US liability management has four options

With reduced borrowing strain this year and an early rollout of the 20-yr, Treasury can choose among different debt management plans:

1. Reduce bills this year and increase them in 2021-2022 to deal with higher maturities rather than strain existing auction sizes.
2. Maintain bill sizes to meet investor demand, if necessary, and increase its cash balance. Rather than bills, cash levels could fluctuate to accommodate seasonal volatility. That plan may make it more difficult for the Fed to hit its excess reserve targets, however.
3. Replace bills with SOFR floaters. FHN's current calendar has that possibility beginning in the fourth quarter of this year. Capacity for SOFR floaters could exceed several hundred billion. On any demand above that level, it can slowly reduce its program of 2-yr FRNs tied to t-bill rates.
4. Use excess bill and FRN capacity to slowly reduce issuance of 10s and 30s to pull back on the maturity extension caused by the introduction of the 20-yr. Liability duration can be matched to the rate environment, cost optimization goals, and changes in the deficit.

The list is not comprehensive yet illustrates that – in derivative terms – lower debt burdens and the 20-yr introduction this provide Treasury a "put" option regarding the deficit the next two years. If it's higher than anticipated, the government can fund it without straining the term debt markets. If the deficit stays lower than expected, it can make gradual reductions to term debt to reduce costs. Remember, while Treasury's effective maturity is 70 months, the market-based optimum maturity is closer to 60 months or less.

Appreciating the potential interest rate benefits of flexibility in debt management contrasts with the frequently rigid, rules-based approach used by many analysts in forecasting Treasury issuance trends. In the words of the Fed, they are disciplined but not on a pre-set course.

Brief history of 20-yr UST from the 1970-80s

As rates gyrated 40 years ago, Treasury frequently changed its debt line up to adapt. Here's a synopsis from the Treasury's website:

1977 Introduction of 30nc25 year bonds to replace the 25nc20 year bonds first sold in 1974.

1978 New 15-yr bonds sold quarterly

1981 20-yr bonds replace 15-yr bonds in the line up

1985 30-yr bonds switch to noncallable, primarily to accommodate demand for UST strips

1986 20-yr bonds are eliminated due to popularity of 30s

Fed QE UST holdings are functionally equivalent to variable rate debt for Treasury

The Advisory Committee was asked last spring to consider the net impact of the Fed's large Treasury portfolio on its liability management. When the request was made, of course, the Fed was intent on shrinking that portfolio and considering a change in its composition from notes to bills. With the Fed now increasing excess reserves, the analysis is even more timely as the Treasury has to lengthen its planning period for co-existence with the Fed.

Here are key observations from the lengthy report delivered to Treasury this week:

- The Fed remits its net portfolio earnings to Treasury each January, equal roughly to the difference between the yield on the portfolio accumulated over the last 10 years and the average of interest paid on excess reserves.
- The key variable in the payments, then, are the rate on excess reserves.
- Those Fed payments effectively offset the Treasury's gross borrowing costs. ***Annual payments, then, vary up and down with short-term interest rates. "SOMA holdings can be thought of as translating Treasury debt into float-rate notes (FRNs) that are tied to the overnight interest rates set by the Fed…."*** the report concludes.
- The (almost) obvious but not intuitive conclusion, then, is when the Fed holds long-term bonds, the Treasury's net cost on the Fed's portfolio is roughly equal to IOER. If the Fed were to switch from owning bonds to bills, then Treasury's effective cost would still be floating at a rate in line with IOER. Treasury's net borrowing costs are not impacted directly by the composition of the Fed's portfolio or changes it might make after its 2020 policy review.
- ***The important planning consideration for Treasury is not borrowing costs, it's how long the Fed plans to sustain the total amount of Treasury holdings, then.*** Shorter maturities in the SOMA account would allow them to roll off faster, forcing Treasury to change its auctions and debt mix to replace those holdings via larger sales to private investors.

The good news for Treasury is the Fed appears to be in own more for longer mode as it continues to emphasize a surplus in excess reserves as a key part of its strategy to set monetary policy via the effective rate on fed funds.

Issuance updates and summaries

Unlike the last two years where changes in borrowing needs reflected changes in tax rates, supply forecasts will require more frequent changes. In 2020, the Treasury said this week, that will be particularly true as it watches tax receipts after the April deadline. To date, they appear to be running well ahead of projections.

FHN Financial's projections in this grid are as much as $150 billion less than estimates last published in November.

	Borrowing Increase	Net Funding Coupons	%	Other Net Funding TIPS	%	FRNs	Total	Total vs Increase
2012	1,145	847	74%	108	9%		955	83%
2013	762	744	98%	110	14%		854	112%
2014	650	523	80%	124	19%	164	811	125%
2015	640	378	59%	106	17%	164	648	101%
2016	733	324	44%	62	8%		386	53%
2017	545	332	61%	58	11%	6	396	73%
2018	1,120	660	59%	52	5%	40	752	67%
2019	*1,065*	*674*	*63%*	*72*	*7%*	*50*	*796*	*75%*
2020	*990*	*643*	*65%*	*58*	*6%*	*70*	*771*	*78%*
2021	*1,100*	*558*	*51%*	*56*	*5%*	*176*	*790*	*72%*

Source: FHN Financial and US Treasury Department
Note: Italics denote FHN Financial estimate.

The totals in the issuance by maturity table reflect i) an initial size of the 20-yr of $12 billion to start followed by upsizes at $10 billion/month with numbers escalating to $13/$11 billion next year; and ii) no decline in other auction sizes. SOFR floaters are estimated to start in the fourth quarter of this year with no immediate decline in t-bill floaters.

	2yr		3yr		5yr		7yr		10yr		20yr/30yr		TIPS		FRN	Total
2009	499	24%	431	20%	440	21%	303	14%	242	11%	129	6%	66	3%		2,110
2010	474	21%	432	19%	459	20%	363	16%	265	12%	168	7%	86	4%		2,247
2011	420	20%	384	18%	420	20%	348	16%	264	12%	168	8%	127	6%		2,131
2012	420	20%	384	18%	420	20%	348	16%	264	12%	168	8%	144	7%		2,148
2013	408	19%	377	18%	420	20%	348	16%	264	12%	168	8%	152	7%		2,137
2014	360	16%	336	15%	420	19%	348	16%	264	12%	168	8%	155	7%	164	2,215
2015	312	15%	288	14%	420	20%	348	16%	264	12%	168	8%	155	7%	164	2,119
2016	312	15%	288	14%	409	20%	337	16%	253	12%	157	8%	133	6%	164	2,053
2017	312	15%	288	14%	408	20%	336	16%	252	12%	156	8%	131	6%	164	2,047
2018	408	17%	384	16%	442	19%	362	15%	278	12%	182	8%	131	5%	202	2,389
2019	*480*	*18%*	*456*	*17%*	*492*	*18%*	*384*	*14%*	*300*	*11%*	*204*	*8%*	*152*	*6%*	*224*	*2,692*
2020	*480*	*17%*	*460*	*16%*	*492*	*17%*	*384*	*14%*	*300*	*11%*	*290*	*10%*	*155*	*5%*	*272*	*2,833*
2021	*480*	*15%*	*504*	*16%*	*492*	*16%*	*384*	*12%*	*300*	*10%*	*343*	*11%*	*155*	*5%*	*448*	*3,106*

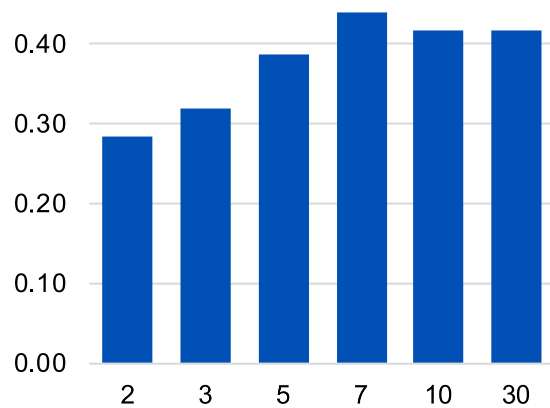
Source: FHN Financial

CAN UST HOLD EARLY 2020 ADVANTAGE?

It was clear in the second half of January that Treasuries were going to be the winning fixed-income sector for the month. Based on the failure of UST to outperform in 2019 unless there was a crisis, however, February will test whether global concerns can maintain the status of US government debt as a preferred asset class. Treasuries never produced two solid months in a row last year, leaving them as second choice behind corporates even when there were big rate moves.

The second question left from January is the staying power of long Treasuries. That is an easier question to address because it appears many traders did not cover 30-yr shorts even as the coronavirus infection displayed increasing power on the world stage and the financial markets. Lingering shorts can offer a latent bid if events don't allow a yield bounce. It is possible the intermediate curve has the most to surrender if investor confidence in growth returns in the first quarter. The 7-yr produced the best duration-adjusted returns, with 10-yr and 30-yr UST immediately following.

UST Return/Duration by Maturity



Source: FHN Financial

Globally, US bonds did better than international fixed income, while US equities led international results, too. EU data was mixed in January but ended on a sour note. US data came in with only mild disappointments. Plus the dollar's rise supported prices here. Measured in any major currency, US Treasury performance beat G6 government bonds by at least 120bp last month.

Summary results by sector

Mortgages: It would have been hard for events to conspire any better than they did to crush mortgage performance in January. Total returns were 70bp while returns fell 53bp short of Treasury durations. By contrast, 3-yr UST earned 93 basis points for the month. An aggressive bull flattener drove prepayment estimates up quickly, knocking 6 months off effective duration, while option volatility subtracted 3bp from excess returns as well. In that environment, there was no wiggle room to improve 30-yr results via allocation changes within the sector. Higher coupons did better in terms of excess returns, but the best absolute results were from lower coupons. Conventionals only beat GNMA 30s by 11bp on duration neutral results; the nominal margin was 30bp in favor of conventionals, however.

With less vulnerability to full flattening, 15s outpaced 30s on every performance aspect, with conventional returns at 82bp and excess returns lagging Treasuries by only 27bp. With few if any prepayment concerns, CMBS did very well, earning 1.91% returns, good for a 38bp improvement over comparable UST.

			Change	
	Jan 31	Dec 31	Month	Dec 14
UST 2s/10s	19	34	-14.6	-130
UST 5s/30s	69	70	-0.9	-41
UST 10-Yr Yield	1.51	1.92	-0.41	-0.66
UST 10-Yr TIPS	-0.14	0.14	-0.28	-0.59
5-Yr Swap Spread	0.3	3.8	-3.5	-11.8
Mortgage Index LOAS	50.7	37.6	13.0	53.1
Agency Avg LOAS	2.3	-1.8	4.1	12.2
1x5 Swaption Vol (bp)	68.1	63.5	4.6	-17.2
Inv Grade Credit LOAS	112.9	105.2	7.7	-5.0
FHN Financial Crdt Indx	211.9	188.0	23.9	-46.2
High Yield LOAS	418.7	359.6	59.1	-107.2
US Dollar	97.4	96.4	1.0	7.1
Dow Jones Industrials	28256	28538	-0.9%	81%
S&P 500	3226	3231	-0.4%	76%
NASDAQ	9151	8973	2.0%	108%
FTSE	7286	7542	-3.4%	36%
DAX	12982	13249	-2.0%	33%
Nikkei	23205	23657	-1.9%	46%
Shanghai	2747	3050	-10.0%	-6%
Hang Seng	26313	28190	-6.6%	34%
Commodity (Bloombrg)	74.8	81.0	-7.5%	-29%

Source: FHN Financial, FTSE Russell, Bloomberg

Investment grade credit: Intermediate corporates held in extraordinarily well in trying circumstances. Nominal returns of 1.46% were lower than comparable agency debt by only 10bp while missing UST results by 18bp. Intermediate corporates, then, put the shortfall in mortgages in better perspective. It wasn't only about Treasuries becoming rich. Actually, Treasuries just returned to average valuations of the last 18 months. The Treasury transition from cheap to fair looked so dramatic because it happened so quickly. Long corporates could not keep up with longer Treasuries, naturally, falling behind by 192bp. Again, that contrasts with overseas governments trailing UST by 225bp (measured in dollars).

Down in credit was not that costly last month. The overall quality gap from single-A to triple-BBB was only 20bp, and the long end difference was only about 75bp. Financials and utilities fared much better than industrials where energy, telecom and basic machinery did poorly. Banks did particularly well despite struggles in the stock market.

Agencies: US agency debt returns largely kept up with the blistering pace of the Treasury rally in January. Intermediate spreads widened about .5bp vs UST and 4bp vs LIBOR swaps. The widening against LIBOR was partly due to the large number of callable bonds auctioned that saw issuers' swapped costs increase as they kept up with the flood of redemptions. Total returns for the month were 1.54% with long agencies at 4.54%. Those returns fell short of UST by 2bp for both intermediates and long paper. Callable spreads widened during the month, but returns were still quite positive. Agencies did much better than sovereigns and broke even against supranationals.

Municipals: Tax-exempt municipals were near the top of the pack in January, posting respectable returns of 1.79%. That fell short of Treasuries by only 17bp due to underperformance at the long end by 37bp. Taxable municipals, on the other hand, soared to a 5.28% return, beating Treasuries by 82bp.

TIPS: Despite the decline in inflation expectations, the rally in real rates was enough to push TIPS to a return of 2.27% to start the year. Relative to coupons, particularly intermediates, that was enough to beat coupon Treasuries by 37bp.

Risk Sectors

- While coronavirus concerns punished global equities, excellent tech company earnings buoyed US stocks. NASDAQ's total return of 2.0% – on top of excellent performance in 2019 – helped keep other US sectors afloat. As mentioned above, the haven value of the US dollar helped keep international sales of US stocks to a minimum. Asian stocks had just begun to recover at the end of 2019 thanks to the improving trade outlook. That set them up, unfortunately, for profit taking in addition to the uneven toll that will be levied on economies there in the first half of the year.
- Commodities gave back a lot more than they gained in the fourth quarter, falling 7.5%. The index closed at the low of the last four years. Oil fell about 13% between Brent crude and West Texas Intermediate, while some distillates fell as much as 20%. Industrial metals surrendered 7.4% with copper leading the way at -10%. Gold was up 4.6%. Ag commodities were mixed, with soybeans down the most on the possibility China will not be able to fulfill its buying commitment signed on January 15. Overall, ag was down 6.3%.
- High yield excess returns fell about 100bp last month. That's well below the worst months in the US/China trade battle. Still, flat nominal results did not even beat cash. Energy's big losses were sufficient to wipe out the entire sector's returns. On a hedged based, energy HY fell 3%. No sector stayed in the black after hedging duration, but losses in consumer names were manageable.
- Emerging markets earned 1.54% in nominal return, falling short of UST by 87bp. Corporate bonds did better than government securities. Venezuela and Turkey both enjoyed rebound results. Latin America fared worse than Asia.

Investment Grade Sector Returns: January

Returns on a duration adjusted basis hedge maturity exposure against UST and LIBOR-based interest rate swaps.

		Duration Adjusted	
	Returns	UST	LIBOR
Total	2.01	-.34	-.43
Intermediate	1.21	-.20	-.28
Treasuries	2.44		-.24
Mortgages	.70	-.53	-.61
Corporates	2.35	-.80	-.97
Agencies	1.54	-.02	-.11

Source: FHN Financial