CORPORATE CREDIT OBSERVATIONS

AUGUST 24, 2020

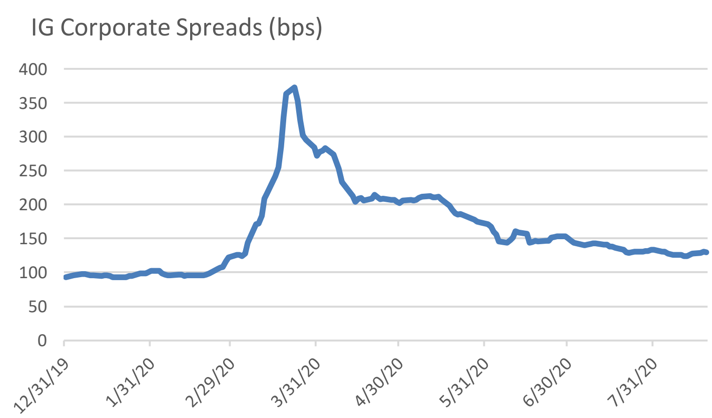
US Presidential elections have historically been a source of market volatility. With less than 70 days until the 2020 election, we have fielded many questions from partners, particularly on the potential impact to corporate bond markets. We do not currently foresee a significant impact and, absent unexpected developments, we believe that despite today's absolute level of rates, the corporate bond market still offers compelling relative value.

We Expect November's Presidential Election to Have a Limited Impact on US Corporate Credit

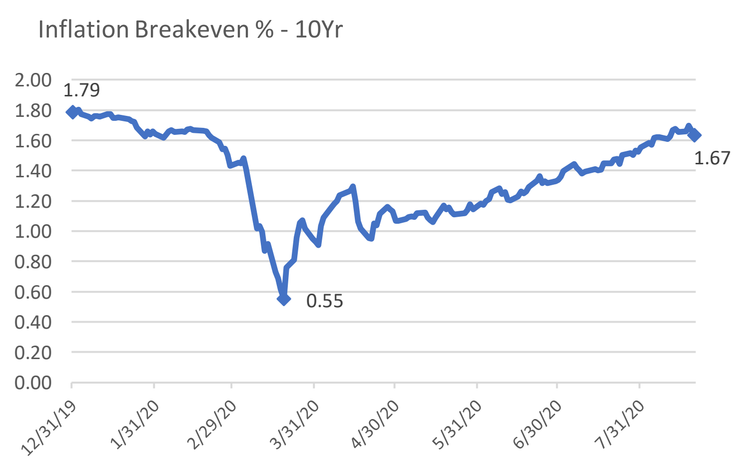
- The Coronavirus pandemic and the Federal Reserve market backstop have been the driving force in the bond market for some time and we do not expect that to change.
- The Democratic Party is more friendly to big business than it used to be; Biden's proposed corporate tax increase from 21% to 28% is relatively modest and still leaves rates well below their prior 35% level. If elected, changes to the tax code would not be likely before Fall of 2021 given the budget cycle and pandemic response.
- Trump has hinted at further tax cuts but has not rolled out any new tax plans as part of his 2020 platform. Any such effort would probably be focused on making the payroll tax deferral and personal income tax cuts permanent, rather than further reducing corporate tax rates.
- Biden is currently favored to win, with polling data aggregators FiveThirtyEight giving him nearly a 3-in-4 chance of being elected. A tightening of the race, or the possibility of a contested election, could be sources of market volatility.

While Return Expectations are Muted, the Case for Fixed Income Remains Strong

- With the Federal Reserve's policy response largely intended to support supply by stabilizing businesses, supply should continue to exceed demand, particularly service sectors that depend on public consumption. This should help keep inflation subdued for the foreseeable future. We also believe deflation is more likely than inflation despite record fiscal and monetary stimulus. This, and a FOMC "not even thinking about thinking about raising rates", should keep a lid on Treasury yields.
- IG Corporate spreads have tightened from their late-March levels but remain more than 30 basis points wider than at the start of the year. Despite record-breaking summer issuance, spreads continue to grind tighter as investor demand remains high. With the Federal Reserve backstopping IG Corporate debt inside five years, we believe a material widening of IG Corporate spreads in short and intermediate maturities is not likely.
- Return upside appears lower than it was coming into the year, although we anticipate respectable fixed income performance from carry and moderate spread tightening. With cash yields back near zero and equities testing all-time highs, we expect to see sustained corporate demand given strong technical factors and limited compelling alternatives.
- In the worst case, if rates were to move materially higher it would likely be due to an increase in inflation expectations driven by a robust rebound in demand, most likely in response to positive Coronavirus news. In such a scenario, bond losses would likely be small relative to gains realized elsewhere in investor portfolios.



Source: Bloomberg, API
Bloomberg Barclays US Aggregate Corporate Index and LUACOAS Index



Source: Bloomberg, API
10 Yr inflation breakeven (10yr minus 10yr TIPS)
USGGBE10 Index

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ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM