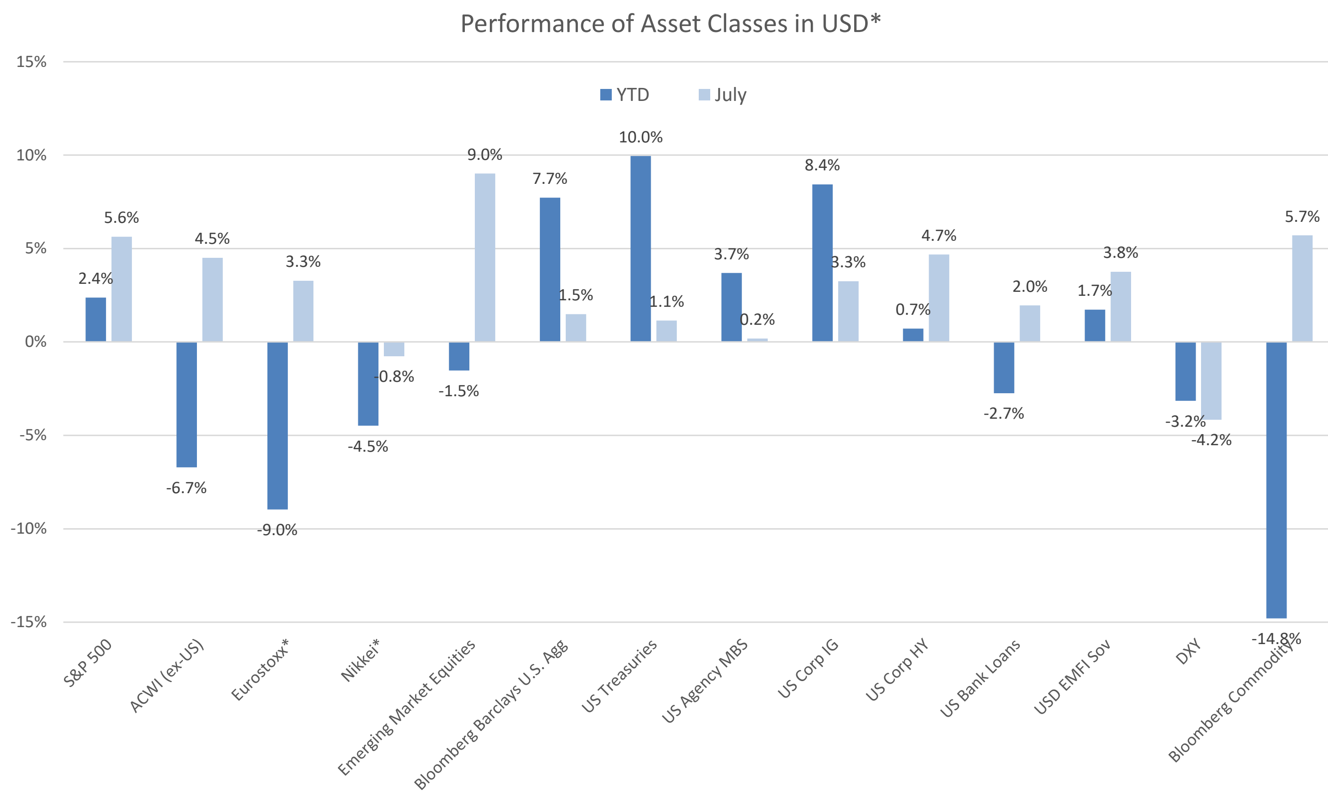
July 2020 Commentary – Prepared for AMG

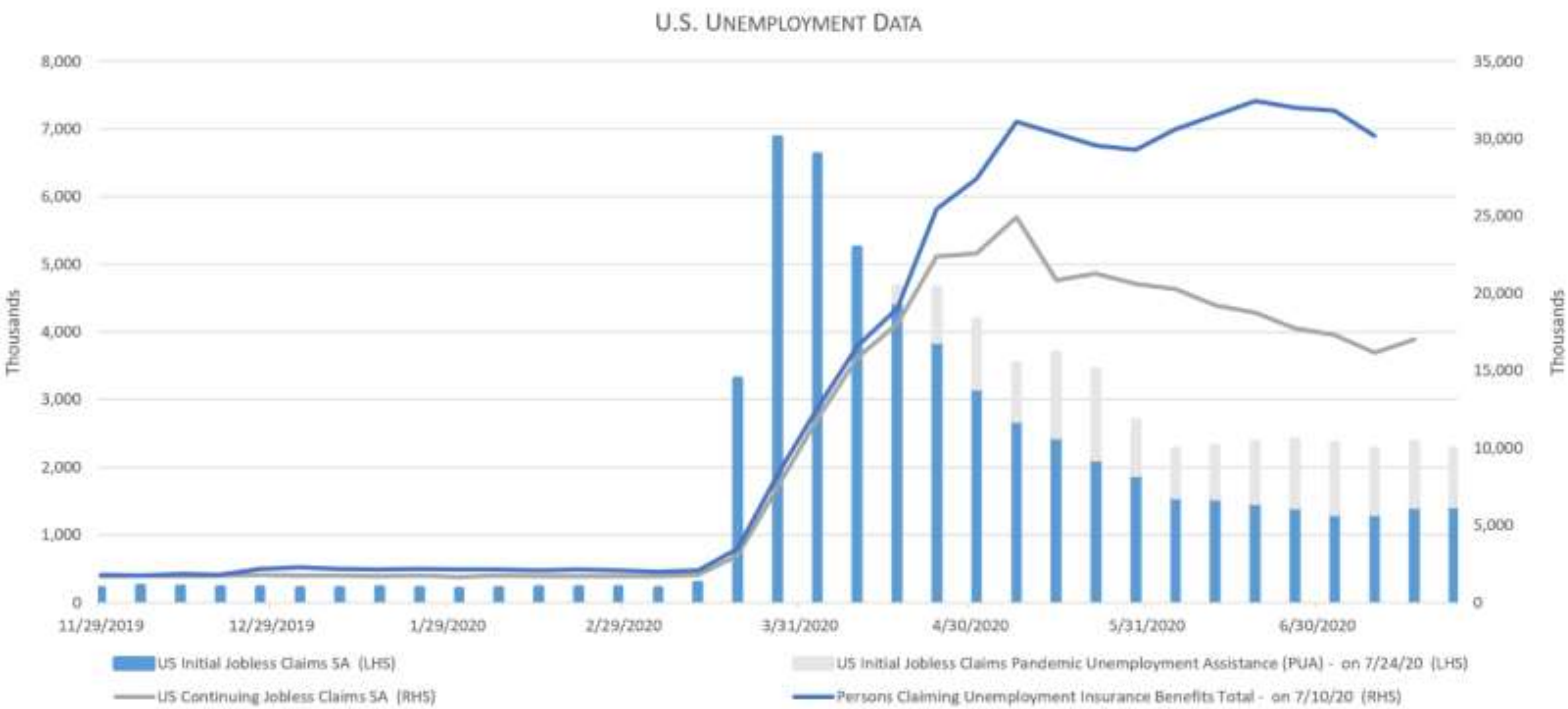
Overview

Risk and safe-haven assets broadly rose in July as investors weighed mixed economic data and quarterly corporate earnings results. The U.S. Treasury curve flattened as yields fell across tenors, led by a decline of 22 basis points (bps) on the yield of the 30-year bond. Notably, high yield (HY) corporate bonds returned 4.69%, as measured by the Bloomberg Barclays US Corporate High Yield Index, erasing their negative return for the year. U.S. equities rose as the S&P 500 Index returned 5.64%. Gold rallied to a record high based on spot price, closing the month at $1,975.86 per ounce. Continued growth in COVID-19 cases and deaths in the United States clouded the economic outlook. According to figures from the Centers for Disease Control and Prevention, the U.S. set a record for new case growth per day at nearly 75,000, and the geographic impact of the pandemic is now more widespread than the initial outbreak in March, which was concentrated heavily in the Northeastern states.[1] Investors were particularly focused in July on the ramifications of the potential expiration at the end of the month of the $600-per-week federal unemployment benefit, originally passed by Congress in March as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Whether the benefit should be extended and at what scale emerged as key sticking points in Congress as legislators tangled over fiscal stimulus measures. The benefit did lapse.

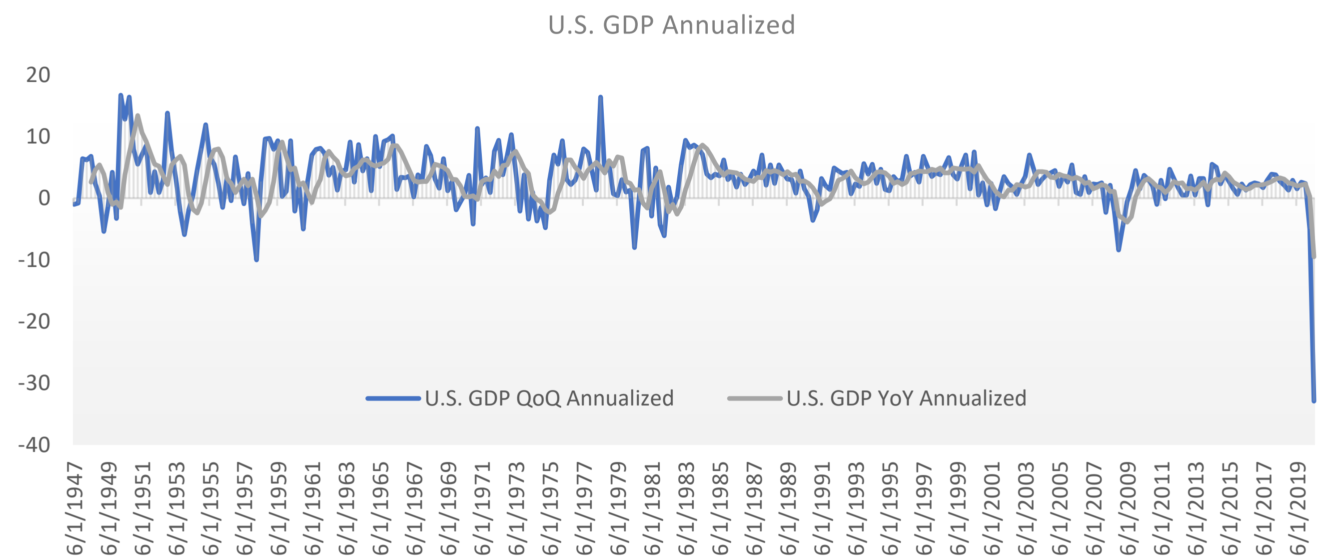
[1] https://www.cdc.gov/covid-data-tracker/index.html#trends



The extent to which unemployment benefits are extended is meaningful as millions of American workers remain displaced. In the week ended July 25, seasonally adjusted initial jobless claims were 1,434,000, an increase of 12,000 from the previous week's revised level. Initial claims for Pandemic Unemployment Assistance (PUA) were 830,000. Seasonally adjusted continuing claims during the week ended July 18 were over 17 million, an increase of 867,000 from the previous week's revised level. This was the first uptick in continuing claims since the week of May 22. (*Figure 2*) The unemployment rate implied by continuing claims was 11.6% for the week ended July 18.



U.S. second quarter gross domestic product (GDP) contracted by 32.9% quarter-over-quarter (QoQ) annualized, according to the advanced estimate released by the Bureau of Economic Analysis. If the estimate holds, it will have been the worst quarter going back to 1947. (*Figure 3*) The largest driver of the economic contraction was personal consumption, which declined 34.6% QoQ annualized. The decline in personal consumption and GDP was more than three times the previous worst contraction. Personal consumption of services declined 43.5% in the second quarter while gross private investment declined 49.0% QoQ annualized, the largest contraction since the record set in 1975.



Against the backdrop of a 10.3% U-3 unemployment rate for July and the worst annualized QoQ GDP print since 1947, the Federal Reserve decided to keep the Fed Funds Target Rate unchanged at the July Federal Open Market Committee (FOMC) meeting. Chairman Jerome Powell announced that the Fed expects to maintain this target "until (the FOMC) is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."[2] As several economic data points have improved, the committee cautioned that the ongoing health crisis "poses considerable risks to the economic outlook over the medium term."[2]

The U.S. dollar, as measured by the U.S. Dollar Index (DXY), weakened against the currencies of its G10 peers and had its worst month on a percentage basis since September 2010. The dollar sell-off took place amid growing skepticism of the U.S. economic recovery, uncertainty over fiscal support from Congress and rising U.S. COVID-19 infection rates. The dollar weakened significantly versus the currencies of other developed markets (DM), particularly euro and euro-linked countries. European leaders agreed in July to a 750 billion euro recovery package of grants and low-interest loans that will be backed by common bond issuance by the European Commission. This positive news, combined with some European countries reopening due to improved COVID-19 markers, which helped economic activity improve in Europe versus the United States, provided catalysts for DM currencies to rally against the dollar.

[2] Federal Reserve Chairman Jerome Powell, July 29, 2020, press conference

At DoubleLine, we remain vigilant in monitoring the upcoming economic data releases and the possible ramifications of continuing unemployment.

U.S. Government Securities

The Treasury market has generally been calm since the upheaval in March, but July was extraordinarily calm. Trading volume was typical, but price volatility was unusually low. The intraday range on the 10-year Treasury yield was a relatively modest 19 basis points. The range of closing yields around the downward sloping trend line was just eight basis points, and the ICE BofA MOVE index - a measure of implied volatility - fell to an all-time low of 41 in late July. Yields generally trended lower through the month, with more pronounced drops at longer maturities, as a resurgent COVID-19 and increasing tension with China weighed on Treasury investors' outlook. The Bloomberg Barclays U.S. Treasury index returned 1.14% for the month, bringing the year-to-date return to 9.96%

The FOMC met in late July with no new policy actions. The tone was dovish in the face of rising COVID-19 cases and an acknowledged slowdown in high-frequency economic data. Consensus expectations called for the Fed to pass on policy rate changes, increased asset purchases or yield curve targeting. Many thought the Fed would introduce some form of enhanced forward guidance to reinforce its accommodative stance, but chairperson Powell remained patient, even while professing to be prepared to take further action as needed.

Real yields fell more sharply than nominal yields in July, and implied inflation expectation ratcheted higher through the month. The 10-year TIPS yield fell 31 basis points during the month, from -71 basis points on June 30 to an all-time low of -103 basis points on July 31. The 10-year breakeven inflation rate rose to a post- COVID-19 high of 155 basis points, aided by, among other factors, the ongoing recovery in oil prices. The Bloomberg Barclays U.S. TIPS index returned 2.30% in in July and the year-to-date return rose to 8.44%.

We expect a deceleration in the recent yield declines in August, and also a deceleration in the rise in implied inflation rates. Two-year yields have little room to move lower, as they are now barely above the overnight repo rate and there is little prospect of the Fed moving policy rates negative. The expectation that the Fed will keep the Fed funds rate near zero for an extended period has brought the five-year yield to near a practical minimum as well. We expect the recent 50 to 80 basis point range on the 10-year Treasury yield to hold through August.

U.S. Treasury Yield Curve

	06/30	07/31	change
3 month	0.13%	0.08%	-5 bp
2 year	0.15%	0.11%	-4 bp
5 year	0.29%	0.20%	-9 bp
10 year	0.66%	0.53%	-13 bp
30 year	1.41%	1.19%	-22 bp

Agency Mortgage-Backed Securities

July prepayment speeds showed little change over the month with 30-year Fannie Mae prepays increasing to 31.2 Constant Prepayment Rate (CPR) from 30.8 CPR, 30-year Freddie Mac prepays decreasing to 31.8 CPR from 32.0 CPR, and lastly 30-year Ginnie Mae II prepays decreasing to 35.8 CPR from 37.2 CPR.

The Freddie Mac US Mortgage Market Survey 30 Year Homeowner Commitment National Index decreased 14 bps and reached a historic low of 2.98% during the month. Despite continued new mortgage rate lows, higher coupons are starting to show early signs of burnout. Relatively unchanged conventional speeds are positive in the context of rising turnover due to a rebound in-home sales post-COVID-19 shutdowns. Ginnie issuers continue to buy out D90+ loans, however, involuntarily prepays decreased compared to last month's sharp spike.

In July, monthly gross issuance of Agency MBS reached the highest level so far this year at $297 billion, and net issuance increased to $47 billion. Out of the $47 billion net issuance, $21bn was Fannie Mae, $38bn was Freddie Mac, and -$12bn is Ginnie Mae. The Federal Reserve purchased $105 billion gross Agency RMBS in July, bringing the total gross QE4 Agency MBS purchases to $892 billion.

Aggregate 30-day delinquent rates decreased for a consecutive month from 5.6% to 4.9% for 30-year Freddie loans and decreased from 5.8% to 5.6% for 30-year Fannie loans. The share of borrowers who missed one payment declined from 3.7% in May to 0.9% in August as most borrowers who were hit by the COVID-19 shock have moved through the stages of delinquency. However, D30 rates remain slightly higher than the pre-COVID average of roughly 0.7%.

In July, the Bloomberg Barclays US MBS Index duration contracted from 2.07 to 1.68. The Index's total return for the month was 0.18% with an excess return, measured relative to maturity-matched Treasuries, of -0.02%.

Non-Agency Residential Mortgage-Backed Securities

Non-Agency RMBS delivered positive returns during the month whilst continuing its gains from the prior month. Credit spreads tightened as the U.S. economy continued towards a path of recovery as employment opportunities returned and business sentiment improved. Despite this progress, credit spreads still remain wider than their pre-COVID levels. Mortgage forbearance[1] rates as of July 28th was approximately 8.2% for private label mortgages.

During the month, there was approximately $7 billion[2] in issuance mainly originating from: re-performing loans, Non-QM, and Jumbo Prime. Due to the closure of the new issue market, Non-Agency RMBS net issuance has been negative for 2020. The current pace of cumulative year-to-date issuance is on par with cumulative 2018 year-to-date. Total gross issuance for 2020 is estimated to reach approximately $85 billion.

The most recent reading of home prices for the month of May showed an increase of 3.70% year over year[3], decreasing approximately 20 basis points from the prior month. The housing market has been resilient despite the pandemic lockdown and market volatility. The pandemic has affected renters more negatively than homeowners, which are more likely to hold lower income jobs in the hospitality and retail sector. Existing home sales for the month of June increased 20.7% from the prior month[4]. Sales are down 11.3% year over year, though rebounding strongly from their lows in May. Housing inventory has also fallen to 4.0 months' supply compared to 4.8 months' supply in May.

The 30-year mortgage rate finished the month at 2.99%[5], down 14 basis points from the prior month, and reaching an all-time low since the start of the data series of 1971. Mortgage rates continue to fall despite the continued growth in home purchase applications[6] and falling inventory of homes.
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Commercial Mortgage-Backed Securities
Private-label commercial mortgage-backed securities (CMBS) continued to mark new issuance in July with two conduit deals totaling $1.63 billion and three single asset, single borrower (SASB) deals totaling $1.49 billion pricing throughout the month. While we have started to see post-COVID-19-originated loans in conduit deals, the market priced its first post-COVID-19-originated SASB deal in July. Demand for new-issue paper continued to outpace supply, leading to most deals being well oversubscribed across the capital stack. The outstanding private-label CMBS universe decreased slightly by 0.05% to $581.4 billion, approximately 9.3% higher year-over-year (YoY).

Legislation to boost the commercial real estate (CRE) market was introduced in July with the bipartisan bill Helping Open Properties Endeavor (HOPE) Act. The HOPE Act aims to help distressed CRE/CMBS borrowers by providing government guarantees for banks to take preferred-equity stakes in exchange for cash infusions, enabling borrowers to cover up to a year of debt service and other expenses. While analysts saw little likelihood that the act would be included in stimulus measures being debated at the beginning of August, congressional leaders, including Idaho Sen. Mike Crapo, appealed to Treasury Secretary Steven Mnuchin and Federal Reserve Chairman Jerome Powell to intervene.

CRE price growth continued to feel the effects of the pandemic in July, with the RCA U.S. All-Property Commercial Property Price Index (CPPI) remaining flat month-over month (MoM), resulting in a YoY gain

[1] Black Knight
[2] Bloomberg
[3] S&P Corelogic Case-Shiller 20-City Home Price Composite
[4] National Association of Realtors Existing Home Sale Index
[5] Freddie Mac Primary Mortgage Market Survey
[6] Mortgage Bankers Association

of just 3.6%, the smallest rate of annual growth since 2011. Retail price growth struggled the most, falling 0.3% MoM and 0.7% YoY, the first annual decline for a CRE sector in nearly a decade. While industrial price growth continued as the top performer, gaining 7.6% over the past year, the pace has been slowing since the middle of 2019, when prices were growing around 12% annually. CRE transaction volume plunged 68% YoY to $44 billion in the second quarter of 2020, the largest decline since the second quarter of 2009. Retail transaction volume fell 72% in the second quarter of 2020, the worst YoY change on record, and hotel transactions fell 91% to a record low of 71. While the industrial sector fared better than others, transaction volume still fell 50% in the quarter.

CMBS delinquencies stabilized somewhat in July, with the rate of loan delinquencies 30 days or longer declining slightly to 8.5%. However, the rate of loan delinquencies 90 days or longer and special servicing rate increased. The improvement can be attributed to borrowers being granted COVID-19-related relief, which is expected to continue over the coming months. The six-month COVID-19 relief typically granted will expire by October so it remains to be seen how delinquencies will perform in the fourth quarter.

CMBS secondary market cash spreads continued to grind tighter in July, resulting in a flattening across the capital stack as demand outpaced both new-issue and secondary supply. AAA last cash flows (LCFs) tightened by 13 basis points (bps) to S+97, having retraced approximately 90% of their widening, while BBB- LCFs tightened by 160 bps to S+575. There was limited secondary conduit mezzanine supply relative to significant secondary volumes in March through May. Given the rebound in prices, coupled with limited supply and slowing trading volumes, SASB paper for the less-impacted sectors are now trading close to or above par, while the more-impacted hotel and retail SASB deals have become range bound.

The CMBX market moved tighter in July at the top of the stack as the return of new-issue conduit brought back originators while the bottom of the stack remained tiered by vintage and credit. Overall, 2012-2018 AAA reference indices tightened by 7 bps while 2012-2018 BBB- reference indices widened by 2 bps.

Asset-Backed Securities

ABS continued to build momentum in July, delivering its fourth consecutive month of positive returns and seeing healthy transaction volumes in both the primary and secondary markets.

The most liquid segments of ABS, as measured by the Bloomberg Barclays US ABS Index, returned 0.42% while esoteric ABS, measured by the ICE BofA US Fixed Rate Miscellaneous ABS Index, returned 0.86%. For the latter index, generic spreads over US Treasuries rallied steadily throughout the month, closing 17 bps lower at 283. This was mostly driven by credit curves flattening as bids improved for the lower-rated tranches of ABS debt that have generally lagged the rallies seen in their investment-grade rated counterparts.

The only missing ingredient for ABS performance during July was duration, as longer-duration sectors such as investment grade corporate bonds and US Treasuries outperformed due to the rally in long end rates. In terms of new issue activity, there were 33 transactions that priced in July for a total of $22 billion in issuance. This marked the highest month of issuance for the 2020 calendar year, but gross ABS issuance volumes are still about 25% lower on a year-over-year basis.

Investment Grade Credit

U.S. investment grade (IG) credit continued to rally in July on better than expected corporate earnings. In addition, the Federal Reserve's support for credit markets through special lending facility programs, which at the end of July were extended by three months through the end of the year, is boosting investors' confidence, creating robust demand for corporate credit. IG credit spreads as measured by the Bloomberg Barclays US Credit Index tightened by 16 basis points (bps) to 126 bp for the month, outperforming duration-matched U.S. Treasuries by 167 bp.

The total return for the month was 3.08%, bringing the year-to-date (YTD) total return to 8.05%. In addition, yields on IG credit fell to an all-time low of 1.78%.

Cyclical and commodity-exposed sectors outperformed. The best-performing sectors on a total return basis were independent energy, utility (other), natural gas, railroads and transportation (other). The worst-performing sectors were leisure, finance (other), supranationals, foreign agency and gaming.

At the ratings level, loans rated BBB outperformed, posting a total return of 3.52% versus 3.07% for loans rated A and 2.65% for loans rated AA.

Across the curve, long duration credit notably outperformed, posting a total return of 6.09% versus 1.39% for intermediate duration credit and 0.39% for short duration credit. The outperformance in long duration credit was partially driven by the rally in the long end of the Treasuries market.

Dollar-denominated IG new issuance was subdued, with $94.2 billion of gross issuance and $14.8 billion of net issuance. YTD, gross new issuance stands at $1,470 billion, surpassing the full-year record of $1,468 billion set in 2017.

IG funds' inflows were $42.5 billion, extending cumulative inflows to $194 billion since March of this year.

Collateralized Loan Obligations

New-issue supply of U.S. collateralized loan obligations (CLOs) continued its upward trend in July, with $9.13 billion pricing across 22 transactions. Since the start of the year, $44 billion has priced via 101 CLOs. Although year-over-year (YoY) primary issuance is down approximately 40%, volume has increased each month since March.

After a four-month hiatus, refinancing (refi) activity resumed with two transactions pricing in July. YoY, refi, reset and reissue activity was down.

In the secondary market, the monthly supply of CLO bids wanted in competition (BWIC) decreased to $2.7 billion after June's near-record high of $5.9 billion. Despite the decline, the secondary market remains quite active compared to historical levels, especially in the investment grade (IG) space.

CLO fundamentals largely improved in July as ratings-based metrics strengthened and weighted average spread (WAS) and minimum overcollateralization (OC) cushion rose. The median Moody's triple-C and below percentage exposure fell to 7.25%, which is once again lower than the standard threshold of 7.5% for U.S. broadly syndicated loan (BSL) CLOs. This decrease in Caa/CCC-rated excess supported OC tests. The percentage of CLOs within their reinvestment period that breached a junior OC test fell from 15% in June to 11% in July. Despite these improvements, the U.S. loan trailing 12-month (TTM) default rate ended July higher at 3.9%.

CLO market-based metrics, such as the distressed ratio (loans bid below 80% of par), net asset value (NAV) and market value overcollateralization (MVOC), continued to improve alongside the S&P/LSTA Leveraged Loan Price Index, which rose 1.95%. The market value of CLO collateral now covers BB-rated tranches on average.

CLO spreads were bifurcated in July, with the upper part of the capital stack tighter and the lower part wider as concerns about economic fundamentals linger. Spreads remained wide relative to the beginning of the year. The J.P. Morgan CLO Total Return Level Index rose 0.63%, contributing to a negative YTD total return of 0.52%.

Bank Loans

The bank loan market posted another solid month of returns in July, rising 1.96% after a 9.70% return in the second quarter. Returns were relatively consistent across ratings classes, with loans rated B rising 2.11% and CCC rising 1.95%; loans rated BB lagged, up 1.73%. The weighted average bid price of the S&P/LSTA Leveraged Loan Index continued to rebound, ending the month at 91.63, a significant improvement from the low of 76.23 reached at the market nadir March 23. The average loan rated BB traded above 96 and the average loan rated B above 94 while loans rated CCC and below continued to lag substantially and traded at an average price of 78. On a year-to-date (YTD) basis, the bank loan market has returned a negative 2.74%.

The early read from the second quarter earnings season is that results exceeded very low expectations, with many companies pointing to sequential improvements as the quarter progressed and moved into July. That said, the default rate continued to inch higher in July as companies with unsustainable capital structures sought bankruptcy protection. The default rate rose to 4.14% in the trailing 12-month period on an issuer-count basis, up from 3.70% in June.

On the technical side, the bank loan new-issue market slowed from June levels and remained well below volumes seen in recent years as companies showed a preference to raise capital in the high yield (HY) bond market. The steady drip of outflows from loan mutual funds continued, but the creation of $8.1 billion of collateralized loan obligation (CLO) vehicles provided some incremental demand for bank loans.

With three-month LIBOR now inside of 25 basis points (bps), bank loan coupons have contracted substantially from the start of the year, when three-month LIBOR was around 190 bps. That said, the market still trades at a reasonable discount to par, offering some upside convexity in the event that risk assets continue to rebound. The market ended July with a yield to maturity (YTM) of 6.12% and a spread to maturity (STM) of 5.31%, providing reasonable compensation in a world of anemic interest rates.

High Yield

High yield (HY) returns were very strong in July, with the Bloomberg Barclays US Corporate HY Index returning 4.69%. Index yield fell 150 basis points (bps) for the month to 5.37% while spreads tightened 138 bps to 488 bps. Investors reacted positively to headlines about potential COVID-19 vaccines amid a market backdrop of surging inflows, record issuance and continued historically low U.S. Treasury yields.

By rating, loans rated BB outperformed modestly, increasing 4.88%. Loans rated CCC closely followed, rising 4.76%, and loans rated B lagged with a gain of 4.50%. All sectors were up for the month, with the three best-performing being aerospace/defense (+9.53%), independent energy (+8.02%) and automotive (+6.02%). The worst sectors were oil field services (+0.32%), airlines (+0.66%) and refining (+2.40%).

The par-weighted 12-month default rate ended July at a 10-year high of 6.22%, up 4 bps points from June and 359 bps from 2.63% at the end of 2019. The energy sector continues to account for a substantial portion of defaults, representing 44% of the par-weighted total over the last 12 months for a sector rate of 19.70%. For reference, the current default rate compares to 10.3% in 2009 and a 25-year average of 2.90%.

Downgrades by volume continued to outweigh upgrades in the U.S. HY market in July, though by a much smaller margin than in June. In July, $37.7 billion of downgrades were registered compared to $31.5 billion of upgrades for a trailing 12-month upgrade-to-downgrade ratio of 0.4x. On a year-to-date (YTD) basis, downgrades total $657.2 billion compared to $152.7 billion of upgrades. Recall, the upgrade-to-downgrade ratio ended 2019 at 0.8x, 2018 at 1.3x and 2017 at 1.4x. As for fallen angel volume, June was more muted than recent months, with a total of $7.1 billion, bringing the YTD mark to $204.2 billion, already exceeding the prior full-year record of $150.2 billion set in 2009.

Primary activity experienced seasonal moderation in July but remained very strong, with HY pricing $26.7 billion of deals after achieving an all-time monthly record in June ($61.5 billion). YTD, issuance is up 48% to $245.1 billion while net issuance of refinancings is up a remarkable 80% to $101.4 billion. Recall, primary activity for 2019 increased 52% (+28% net issuance of refinancings), though that came against a 2018 whose full-year activity was the lightest since 2009 (2018's volume of $187 billion was a 43% decline compared to 2017's).

HY funds took in $6.1 billion in July, following the fourth-largest inflow month on record in June ($9.7 billion), the largest in May ($20.5 billion) and second largest in April ($17.1 billion). YTD, inflows stand at $34.7 billion, compared to an inflow of $18.8 billion in full-year 2019 and an outflow of $46.9 billion in full-year 2018.

**Index data from Barclays. Default, new issue and fallen angel data from J.P. Morgan. Flows data are Lipper as reported by J.P. Morgan.

Commodities
In July, the broad commodity market rallied by 3.78% as measured by the S&P GSCI and 5.70% by the Bloomberg Commodity (BCOM) Index. Precious metals (+10.30%) appreciated strongly as gold (+8.54%) and silver (+29.94%) rallied in the wake of global monetary and fiscal stimulus packages. Industrial metals (+6.73%) also rallied, with the best performer, zinc, up 13.14% and the economic bellwether copper up 6.68%. The energy sector increased 2.62%, with the best performer, Brent crude, up 4.93% while the weakest, unleaded gasoline, declined 0.77%. The agriculture sector increased 1.37%, with the best performer, coffee, up 17.77% while the worst, corn, declined 7.47%.

Emerging Markets Fixed Income
Emerging markets (EM) sovereign and corporate external bonds posted positive performances in July, continuing their strong positive performances from the second quarter. The positive performance of external EM debt was driven primarily by credit spread tightening, with lower U.S. Treasury yields and accrued interest also contributing.

The J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified credit spread tightened by 34 basis points (bps) over the month. The Treasury yield curve tightened, with two-year Treasury yields lower by 4 bps and 10-year Treasury yields lower by 13 bps.

Performance across all regions was positive in both the sovereign index and corporate index for the month, as measured by the J.P. Morgan EMBI Global Diversified and J.P. Morgan Corporate Emerging Markets Bond Index (CEMBI) Global Diversified indices. Latin America was the best-performing region in both the sovereign and corporate indices. The positive return in Europe was the least relative to the other regions in both indices.

The sovereign index outperformed the corporate index over the period as sovereigns significantly outperformed their corporate counterparts in Latin America, Asia and the Middle East. Outperformance was in part driven by the higher allocation to Latin America in the sovereign index relative to the corporate index and the sovereign index's longer duration relative to the corporate index in a period where rates fell. The investment grade (IG) subindex outperformed the high yield (HY) subindex in the sovereign index, while the IG subindex slightly underperformed the HY subindex in the corporate index.

Risk appetite for the second half of 2020 will largely be driven by the effectiveness of measures to contain the COVID-19 outbreak and reopen economies. The pandemic will continue to impact the global growth trajectory and influence fiscal and monetary policy responses from developed markets (DM) and EM central banks and governments. Other risk-appetite factors include escalating U.S.-China tensions, rising social unrest and the U.S. presidential election in November.

International Sovereign

Global government bonds, as measured by the FTSE World Government Bond Index (WGBI), posted positive returns in July. The positive performance was driven largely by foreign currency appreciation against the U.S. dollar, but a global rates rally also contributed.

As measured by the U.S. Dollar Index (DXY), the dollar weakened against all of its G10 peers and had its worst month on a percentage return basis since September 2010. The dollar sell-off took place against a backdrop of growing skepticism over the U.S. economic recovery, uncertainty over fiscal support from Congress and worsening COVID-19 infection rates. The Federal Reserve left rates unchanged at near zero. The Fed pledged to maintain this target “until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.” In addition, dollar liquidity swap lines and repo operations were extended through March 2021, but it is worth noting that the outstanding amount of dollars borrowed via these facilities continued to drop over the month as normalcy returned to global currency markets. Congress failed to pass a new fiscal relief package before federal jobless benefits expired at the end of July. U.S. Treasury rates, as measured by the 10-year Treasury yield, moved lower during the month.

The euro had its best month on a percentage return basis versus the dollar since September 2010. Risk sentiment improved as economic data recovered and European leaders agreed to a fiscal support program. Eurozone purchasing managers’ indices (PMIs) rebounded and indicated pickup in economic activity in July from a gross domestic product (GDP) contraction of -12.1% in the second quarter as European countries eased their COVID-19 lockdowns. Meanwhile, European leaders overcame internal disagreements and agreed to a 750 billion euro recovery package. The package of grants and low-interest loans will be backed by common bond issuance by the European Commission. The European Central Bank (ECB) kept the deposit rate at -0.5% and left its bond purchase program unchanged.

The Japanese yen strengthened versus the dollar. The Bank of Japan (BoJ) maintained its monetary policy stance, pledged to cap 10-year government bond yields at around zero and kept its asset purchase program unchanged. The BoJ lowered forecasts for economic growth and issued warnings of downside risk to economic activity and prices amid the uncertain outlook amid the pandemic. Tokyo and other urban areas experienced a surge in COVID-19 infections through most of the month.

Emerging markets (EM) currencies generally appreciated versus the dollar but lagged other developed markets (DM) currencies. EM countries benefitted from improved risk sentiment as capital flows stabilized and commodity prices broadly recovered. Many EM countries are still being challenged by rising COVID-19 cases, particularly Brazil and India. Investors remain concerned that many EM countries lack the fiscal and monetary space to offset the economic impact of the pandemic.

Infrastructure
Infrastructure assets performed well during July, generating a roughly 2% monthly return as credit spreads tightened and the US Treasury curve bull-flattened. Unsecured corporate bonds backed by utilities and industrial companies were the top performers in the infra space, as 20-year and 30-year Treasury rates rallied about 20 bps and investor demand continued to drive spreads tighter. Another standout sector was infrastructure assets in securitized form, namely bonds backed by payments for residential renewable energy systems such as solar power. This sector experienced some selling pressure in March due to its sensitivity to consumer repayment rates but has seen strong rallies the last two months due to better-than-expected remittance reports. Global shipping and transportation assets in securitized form contributed positive total returns on the month as well, but to a lesser degree as the COVID-19 pandemic continues to weigh on these sectors.

U.S. Equities
In July, the S&P 500 Index rallied 5.64%, defying double-digit unemployment and pandemic-induced earnings declines, and edged back into positive territory for the year (+2.38%).

The Nasdaq 100 Index continued its phenomenal run, increasing 7.41% in July and up 25.55% year-to-date (YTD).

Large-capitalization stocks continued to outperform small-cap stocks. The Russell 2000® Index, which tracks small-cap stocks, gained 2.77%, lagging the S&P 500 by 2.87%.

The three best-performing sectors of the market were utilities (+7.81%), communication services (+7.43%) and consumer discretionary (+7.19%). The three-worst performers were energy (-4.91%), real estate (+4.05%) and financials (+3.77%).

Global Equities
Global equities continued to rally in July as the economic data rebounded. The Morgan Stanley Capital International All Country World Index (MSCI ACWI) rose 5.33% in July. U.S. equities performed in line, with the S&P 500 Index up 5.64% and the Nasdaq Composite up 6.85%. The Dow Jones Industrial Average and the Russell 2000® indices underperformed and rose 2.51% and 2.77% respectively in July.

European equities significantly underperformed the broader market in July. The Euro Stoxx 50 Index declined 1.52%. Core European equities had mixed results with the DAX of German blue chips returning 0.02% and the French CAC 40 down 2.64%. On the periphery, Italian stocks as measured by the FTSE Milano Indice di Borsa (FTSE MIB) declined 1.13% and Spain's IBEX was down 4.4%. U.K. equities as measured by the FTSE 100 declined 4.2% in July.

Asian equities outperformed with the broad market in July. Japanese equities, as measured by the Nikkei, were down 2.59% in July. As measured by the Shanghai Stock Exchange Composite Index, Chinese equities rose 11.96%. Hong Kong's Hang Seng Index was up 1.50% for the month. South Korea's KOSPI was up 6.69%, Taiwan's TAIEX rose 10.73% in July.

Emerging market (EM) equities also outperformed the broad market in July with the help of weaker US dollars, with the MSCI EM Index returning 9.01%. Indian equities, as measured by MSCI India, were up 9.48% for the month. Brazil's Ibovespa was up 8.27% while Chilean equities, as measured by MSCI Chile, rose 10.66% in July. Russian equities, as measured by MSCI Russia, rose 3.05%.

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