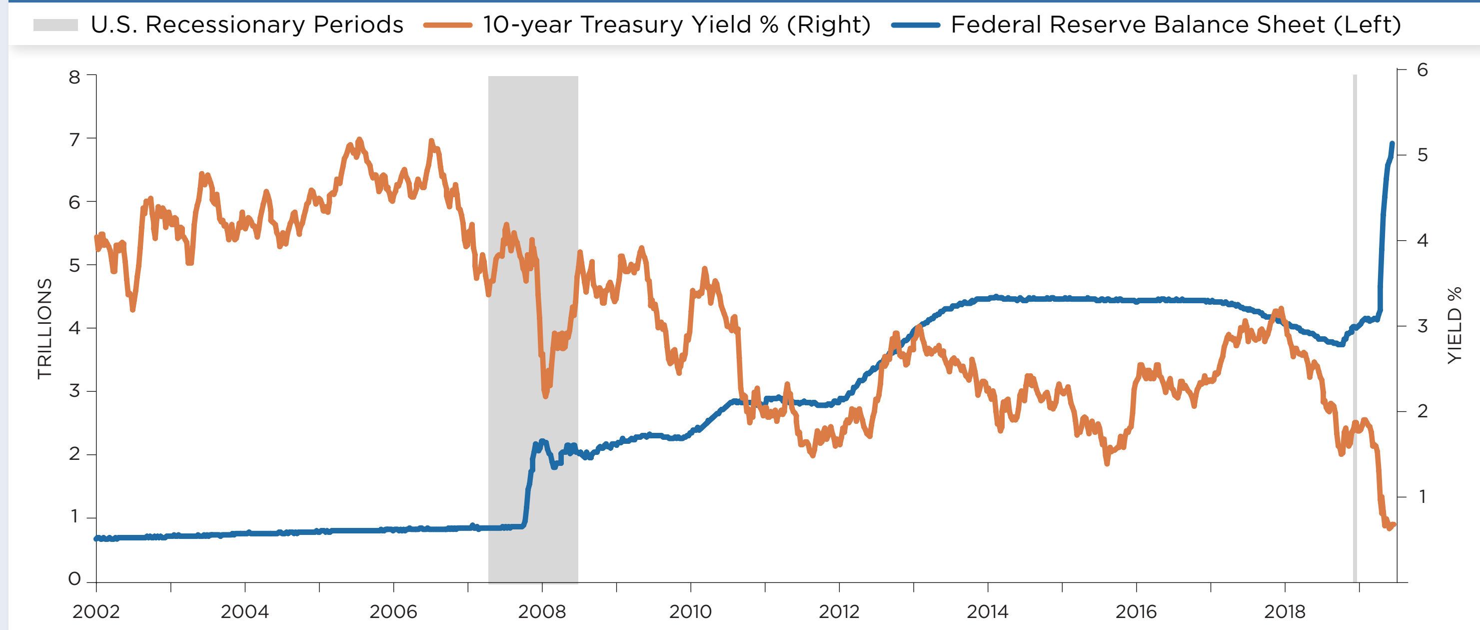

Source: FactSet, Edward Jones. 10-year U.S. Treasury bond rate.

QUARTERLY MARKET OUTLOOK: **THIRD QUARTER 2020**

Fixed-income Outlook

Interest rates have fallen to historic lows amid the economic downturn and ramped-up central bank stimulus. The rebound in GDP should offer modest support, but we expect rates to remain relatively low for an extended period. At the same time, our expectation for ongoing equity market volatility means a diversified allocation to fixed-income investments offers valuable downside protection for portfolios, in our view.

Low rates linger on – Ten-year interest rates are near 0.60%, slightly above the record low touched earlier this year. We think sizable Fed stimulus programs and subdued inflation will keep interest rates relatively low for an extended period. The Federal Reserve has expanded its balance sheet above $7 trillion to support the economy and credit markets through the pandemic. We doubt this will be unwound rapidly as the economic recovery will be gradual.

Credit stress warrants diversification within bond portfolios – Corporate debt levels were already at their highest since the late 1980s, and the economic shutdown is likely to result in an uptick in defaults this year.
The Fed has pledged extraordinary support as a way to provide a financial bridge over this crisis. We expect the Fed to remain committed to credit market support, which we think should support investors' confidence in maintaining appropriate – but diversified – bond allocations.

Policy responses have longer-term implications – In addressing the more immediate threat from the pandemic, potential longer-term implications have been created, namely a bloated Fed balance sheet and rising federal budget deficits/debt. We don't see runaway inflation or a government default playing out, but we do think inflation and interest rates will eventually rise from current levels.

▶ *Action for Investors*

During the recent sell-off, bonds provided a modest positive return, stabilizing portfolios. We recommend a neutral fixed-income allocation in line with your long-term target, and we favor the stability of higher-quality investment-grade bonds. An increased allocation to high-yield bonds can help add yield while benefiting from a sustained economic recovery.

Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.

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