GALLIARD
Capital Management, Inc.
ARCHITECTS OF INVESTMENT SOLUTIONS

A MARKET NOTE FROM GALLIARD

March 26, 2020

Prior to March 1, we were commonly asked: "what" is Galliard? Now, the questions have turned to "How are the portfolios?" or "What is Galliard doing in light of the market volatility?" – and although those lines of questioning seem markedly different, their answers have a common thread.

Galliard Capital Management derives its name from a castle in France. Chateau Gaillard (pictured below), started by Richard the Lionheart in 1196, was built with a strong foundation on a strategic bend in the River Seine, coupled with the latest techniques and innovations Sir Richard brought back from his conquests in fighting the Crusades. Together, the strong strategic foundation coupled with the latest techniques and innovations, created an extremely formidable castle for the ages. Fast forward to 2020 as we here at Galliard Capital Management enter our 25th year of providing fixed income solutions to the institutional marketspace. From the day we opened in 1995, through the current market turmoil of today, we have applied the same strategic foundations coupled with the latest thinking in the fixed income markets, to provide a consistent, no surprises investment approach to our portfolios.

WHAT WE ARE SEEING IN THE MARKET AND WHAT WE ARE DOING

Global markets have been roiled by the rapid spread of COVID-19, with equities down -25% to -30% YTD across the board. Interest rate markets have responded as well, with the entire yield curve trading below 1% at one point, and 10-year and 30-year rates reaching unheard of lows of 0.31% and 0.70% respectively in early March (intraday lows). However, following the recent US Government and Federal Reserve initiatives (see below for more details), interest rates have calmed somewhat, with 10-year and 30-year rates settling in at 0.80% and 1.35% respectively. Equities have also rebounded to a limited degree. Spreads on everything from US Agency MBS to Corporates to Municipals moved wider over the last several weeks. Investment Grade credit is down 12.27% MTD (through March 24), while High Yield credit is down 18.17%. In securitized products, Asset Backed Securities (ABS) and Commercial Mortgage Backed Securities (CMBS) spreads have also suffered, with these sectors posting negative total returns MTD as well, down 3.50% and 6.91% respectively. As bad as this sounds, it is worth mentioning that high quality sector spreads (Investment Grade Corporates, CMBS, and ABS) have widened out roughly half as much as they did in 2008. Meanwhile, Agency MBS has benefited tremendously from the Fed's Quantitative Easing (QE) buying, posting a positive total return of 1.04% MTD.

Thus far, policy response has been focused on three things: slowing the spread of the virus, providing financial support to consumers and businesses, and providing liquidity so that banking and capital markets can continue to function. Governments across the world have enacted dramatic measures restricting travel, business, and social activity in a Hail Mary attempt to slow the spread of infection. At present, the US Government is debating ~$2 trillion of pandemic relief designed to relieve cash flow stresses at the consumer and business levels. (Putting that in perspective, that is ~10% of annual GDP, and so is clearly an unprecedented action.) The Federal Reserve has responded in equally dramatic fashion, cutting rates to 0%, establishing unlimited QE (and expanding it to include purchases of Agency CMBS), resurrecting lending facilities from its Financial Crisis playbook, and adding new programs such as the Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF). The implementation and success of these measures matters greatly in terms of slowing the spread of the coronavirus and supporting the economy until normal activity can resume.

While the severity of the current crisis is reminiscent of the financial crisis in 2008, the drivers are different. The previous crisis was largely the result of an overheated asset class (housing), poor underwriting quality, and an over leveraged financial system. The current crisis is the result of supply and demand shocks resulting from the global pandemic. As a result of regulatory changes following the Financial Crisis, bank balance sheets are already filled with "high-quality liquid assets" and they have limited room to add. Consequently, many investors rushing to liquidate positions have been met with little interest, and liquidity has become severely stressed. However, with recent Government and Fed policy action, Agency MBS spreads have calmed considerably and the corporate new issue market is being met with significant demand. Our portfolios are generally positioned for this type of risk-off scenario, given our high quality and shorter spread duration biases. Certain sectors will be impacted more than others as we move through this crisis, although the outcome for any sector is highly uncertain (we view energy, hospitality, travel, retail, transportation, and other consumer sectors as particularly vulnerable in the near-term). Therefore, we continue to evaluate opportunities across sectors based on both fundamental and relative value. However, that can be difficult to assess in this environment, so we are focusing mostly on sectors like Agency MBS and high quality, select new issue Corporates, and we are emphasizing liquidity, risk control and downside protection.

On a final note, COVID-19 has assuredly changed how we need to think about the inter-connectedness of society and how we do business. Our Business Continuity Plan has been fully implemented and almost all of our staff are now working remotely. We are happy to report that day-to-day work flow continues to function, virtually uninterrupted, except for the occasional "I love you" note dropped on the desk at home by the child who is not currently at school, or the periodic dog bark heard on a conference call from the loyal companion who can't help but announce the arrival of the mail carrier. Our client facing teams are working on creative ways, from conference calls to video chats, to provide you information. As we come into a quarter end cycle, we will work with all of you to adapt to changing needs that social distancing has put on all of us. In the meantime, please rest assured that all of us are working hard to live up to the Galliard name and bring you the consistent, no-surprises approach to fixed income management you have come to expect from us. We hope all of your families, coworkers, and friends remain safe during this unprecedented time.

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Senior Managing Principals

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