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INVESTMENT MANAGEMENT

INVESTMENT INSIGHTS MONTHLY COMMENTARY

Meeder Fixed Income Strategies

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KEY TAKEAWAYS:

- High-yield and emerging market bonds led the risk on rally in December as yields of high-yield bonds fell to a record low of 4.18%
- Credit spreads narrowed across all major fixed income asset classes and mortgage rates reached a historic low of 2.67%
- Municipal bonds had a record year of issuance totaling over $475 billion
- Risk-on overweight was a positive contributor to Meeder fixed income portfolios

HIGH-YIELD AND EMERGING MARKET BONDS LED THE BOND MARKET IN DECEMBER

Despite a global rise in COVID-19 cases, December saw a continuation in the recovery for risk-on asset classes from their March sell-off. High-yield bonds have delivered an impressive return of 33.5% since their March 23rd lows, while emerging market bonds returned 22.9% during the same period. The high-yield bond sector saw record bond issuance of nearly $275 billion in 2020, as high-risk borrowers took advantage of low lending rates and strong investor demand for higher income. According to Bloomberg, high-yield bond ETFs saw over $20 billion of inflows in 2020. Default rates in high-yield bonds remained high at just under 7%, but defaults were primarily contained to energy and retail companies. These two sectors were under pressure before the COVID-19 related economic slowdown and, in our view, are unlikely to lead to contagion across other sectors within the high-yield asset class. With persistent investor demand, high-yield bond yields fell to 4.18% at the end of December, lower than its 20-year average of more than 8%. Rising U.S. Treasury yields could further tighten the already low yield differential between high-yield bonds and U.S. Treasuries.

EXHIBIT A: HIGH-YIELD BOND YIELDS ARE AT HISTORICALLY LOW LEVELS

Source: Bloomberg

As expected, the Federal Reserve remained accommodative at the end of 2020; however, their December FOMC meeting did note improvement in overall economic activity. The FOMC members are expected to remain patient on the rate front in the absence of inflationary pressures. We also expect the Federal Reserve to provide ample guidance before any changes are made to the current monetary policy. In addition to inflation, FOMC members will want to see a marked and sustained decline in unemployment figures, which given the second round of lockdowns, may remain high in 2021.

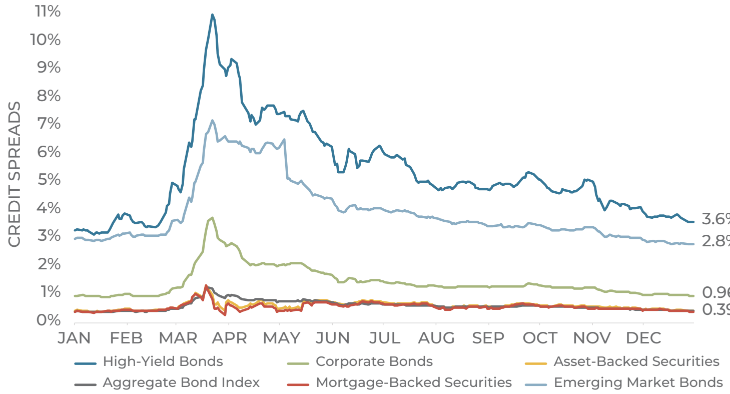
While inflation figures remained subdued in December, the incoming Democratic administration and Congress are widely expected to step up fiscal spending in 2021. This could push inflation premiums higher across the yield curve. While this scenario may be attractive to income-seeking investors, it could somewhat taper the appeal for risk assets with low yields.

CREDIT SPREADS NARROWED ACROSS THE BOARD AND MORTGAGE RATES MADE NEW RECORDS

Credit spreads, which are the difference between various asset class yields and the yields on Treasury bonds of comparable maturities, narrowed sharply across the board in 2020 after spiking in March. Narrow spreads typically mean that the compensation for taking credit risk is very low, making them relatively unattractive.

In December, the credit spread between high-yield bonds and U.S. Treasury bonds narrowed the most among fixed income assets, decreasing by 52 bps during the month, followed by emerging market bonds, asset-backed securities, mortgage-backed securities, and investment-grade corporate bonds, respectively.

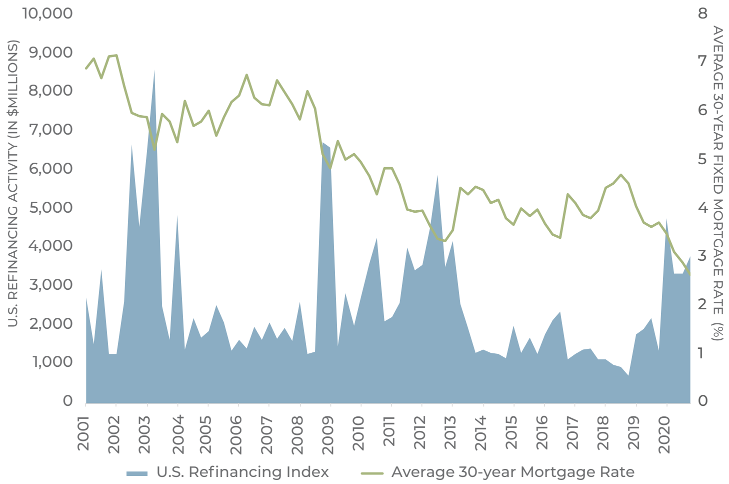
EXHIBIT B: FIXED INCOME ASSET CLASS SPREADS NARROWED IN 2020



Source: Bloomberg

According to Bloomberg and the National Association of Realtors, mortgage rates reached their all-time low in 2020, with the average 30-year mortgage rate reaching 2.67% in December, while existing home sales reached its highest level since 2006. U.S. mortgage refinancing activity also picked up significantly in 2020, reaching its 2013 levels, as homeowners took advantage of historically low lending rates.

EXHIBIT C: 30-YEAR MORTGAGE RATES REACHED HISTORIC LOWS AND REFINANCING ACTIVITY PICKED UP



Source: Bloomberg, Freddie Mac

Yields for mortgage-backed securities and U.S. investment-grade bond market benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index, remained relatively unchanged from November. Mortgage-backed and agency securities accounted for around 30% of the Federal Reserve's purchases at the end of 2020, supporting the higher demand and lower yield for mortgage-backed securities. As of the December FOMC meeting, the U.S. central bank plans to continue its current pace of asset repurchases to support liquidity and stability in the markets.

MUNICIPAL BONDS SAW RECORD ISSUANCE

U.S. Municipal bond issuance increased by 11.5% in 2020, ending the year at an all-time high of $475.5 billion. Issuance for the month of December totaled $42.5 billion, slightly behind November's issuance.

Tax-exempt municipal bonds ended December yielding near 1.075%, above the 10-year Treasury, with about half the duration exposure. Municipal tax-exempt, taxable, and high-yield bonds completed the year in positive territory.

Municipal bonds have had an uncorrelated performance and risk profile relative to equities and riskier fixed income assets in prior recessionary periods, with their tax advantages adding to the asset class's appeal. With a Democratic majority in the Senate, House, and the White House, there is an expectation for higher taxes, increasing the potential for continued strong demand of municipal bonds in 2021.

PORTFOLIOS POSITIONING AND PERFORMANCE

Meeder's proprietary quantitative fixed income models successfully navigated our portfolios' exposure out of risk assets in early March and back into them in April, helping minimize risk and enhance return potential in our portfolios. Our models continued to favor risk-on sentiment in the market during the month of December and Meeder fixed income portfolios maintained their risk-on overweight positions to close the year.

OVERWEIGHT HIGH-YIELD CORPORATE BONDS

Our portfolios remained overweight to high-yield bonds in December. High-yield bonds were up roughly 1.88% during the month, significantly outperforming investment-grade bonds. These positions were a strong contributor to portfolio performance.

OVERWEIGHT USD-DENOMINATED EMERGING MARKET BONDS

The overweight to emerging market bonds during the month also contributed to portfolio performance, as the sector benefited from the U.S. dollar's weakness in December. Although emerging market yields have moved lower during 2020, this asset class continues to provide relatively attractive income opportunities in our portfolios.

U.S. TREASURIES AND INVESTMENT-GRADE BONDS

Investment-grade bonds, represented by the Bloomberg Barclays Aggregate Bond Index, were up just 0.14% during the month of December and intermediate-term U.S. Treasuries were up just 0.05%. The underweight to these two sectors in favor of risk-on assets contributed to the Meeder fixed income portfolios' relative performance.

DURATION POSITIONING

Meeder fixed income portfolios' duration remained in line with the benchmark(s).

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Fixed Income asset classes are represented by the following indexes: Bloomberg Barclays .S.U.S. Agg Total Return Value Unhedged USD, Bloomberg Barclays .S.U.S. Corporate Total Return Value Unhedged USD, Bloomberg Barclays .S.U.S. Corporate High Yield Total Return Index Value Unhedged USD, Bloomberg Barclays EM USD Aggregate Total Return Index Value Unhedged USD, Bloomberg Barclays .S.U.S. Treasury Index, Bloomberg Barclays .S.U.S. Mortgage Backed Securities (MBS), Bloomberg Barclays .S.U.S. Agg ABS Total Return Value Index, Bloomberg Barclays U.S. Securitized: MBS/ABS/CMBS/Covered .R.T.R. Index Value Unhedged USD, Freddie Mac US Mortgage Market Survey 30 Year Homeowner Commitment National, MBA US Refinancing Index, Bloomberg Barclays Municipal Bond TR Index Value Unhedged USD, Bloomberg Barclays Municipal Taxable Bonds TR Index Value Unhedged USD, Bloomberg Barclays Municipal High Yield .R.T.R. Index Value Unhedged USD.

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