knowledge preserves wealth

@Caprin_Asset

Q3 2014 INTERMEDIATE MUNI QUARTERLY COMMENTARY

STATE SPECIFIC COMPOSITE CHARACTERISTICS

AS OF: 9/30/2014

Duration: 4.72yrs
Yield-to-Worst: 1.69%
Yield-to-Maturity: 2.01%
Maturity: 6.43yrs

Strategic Overview

Macro: US Treasuries spent Q3 stuck in a narrow range, anxiously awaiting signals from the Federal Reserve. As expected, the Fed continued winding down its asset purchasing programs. However, rate hike speculation established itself as a key driver of activity in US debt markets. Traders wondered if the strong Q2 GDP print (+4.6%) coupled with declining unemployment numbers (to 6.1%) would give the Fed sufficient confidence to remove its longer-term rate guidance and prepare markets for an accelerated timeline. In the end, that would not be the case – weak inflation and labor participation data overshadowed the Q2 GDP rebound. Still, ahead of the September Fed meeting, 10-year US Treasury yields crept up to 2.62%, a threshold that has proven itself time and again as a significant point of resistance. In the weeks following the Fed's renewal of their dovish status, US Treasury yields tumbled towards the lower regions of their trading channels. A hostile geopolitical picture and slumping economies in Europe and Asia only added to the energized demand for haven assets. Developments in Ukraine, Gaza, Syria, Iraq and Hong Kong demanded close surveillance and still weigh heavily on market tone. Q3 ended with a decisively 'risk-off' bias, suggesting tighter Fed policy likely remains a distant concern.

Market Dynamics: YTD Municipal issuance is down roughly 10% in 2014 versus the same period last year. Demand remains robust in the tax-exempt space as illustrated by persistent Muni bond fund inflows in Q3 and oversubscriptions in most new deals (i.e. more orders than available bonds). As a result, credit spreads remain compressed to historically tight levels. Puerto Rico credit concerns quieted as Q3 progressed, though we expect Puerto Rico-related volatility will reemerge as the forbearance agreements signed in August are set to expire early next year. In the meantime, we expect the Commonwealth to strive for a low profile. We do not own any debt guaranteed by Puerto Rico or its agencies.

Caprin Performance Notes: We maintained a neutral duration profile throughout Q3 and actively sold positions that 'rolled' shorter than two years, reinvesting that cash into bonds with 10-14 year maturities. This served intermediate portfolios well given the Muni outperformance in the long end of the curve. Yields in the front end do not offer enough value to hold to maturity and expose investors to front-end volatility driven by Fed speculation. Fervent demand pushed buyers down the credit spectrum leading to lower-rated Munis outperforming their more highly-rated counterparts. Our exposure in the hospital, power and essential revenue sectors benefited portfolios, and we still look to a wide variety of revenue sectors to help combat the low yield environment.

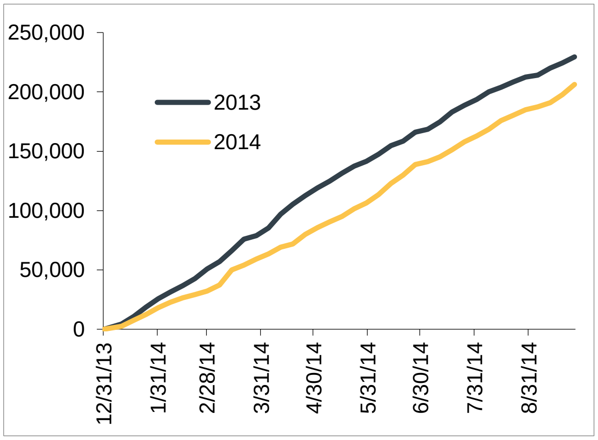

Figure 1: Total US Muni Issuance YTD 2013 vs. 2014 ($mlns)
Source: Bloomberg

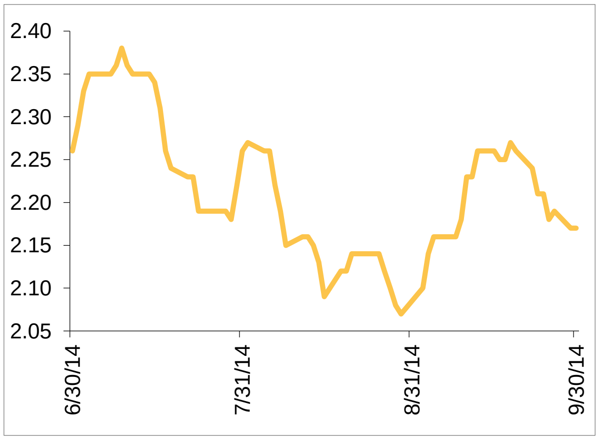

Figure 2: 10-Year MMD AAA Muni Yield
Source: MMD

1802 Bayberry Court, Suite 202
Richmond, Virginia 23226
804] 648-3333
CAPRINBONDS.COM

Media Contact:
aplotkin@caprinbonds.com