INTERMEDIATE TAXABLE COMPOSITE CHARACTERISTICS

AS OF: 6/30/2015

Duration: 3.78yrs
Yield-to-Worst: 2.03%
Yield-to-Maturity: 2.03%
Maturity: 4.30yrs

Strategic Overview

Macro: The second quarter of 2015 was marked by significant interest rate volatility and a move to generally higher yields as market participants weighed domestic policy outlook influenced by international events. Over the period, the 10 Year US Treasury yield climbed approximately 50 basis points (.50%) as the Federal Reserve continued to lay the groundwork for what could be their first rate increase in nearly a decade. The Central Bank's shift to data dependency, which occurred late in the first quarter, was a key volatility driver and kept traders hyper-sensitive to each economic release and its impact on potential Fed action. Domestic growth indicators began to show some signs of improvement from a lackluster display earlier in the year, with perhaps the most notable being a small but important uptick in wage growth. Wage growth has been what many consider the missing link to future Fed action, and it may provide Chair Yellen and her colleagues a justification to tighten despite inflation remaining persistently below current targets. Overseas, an unwinding of what had become an unsustainable rally in European sovereigns saw German Bund yields rise from near zero to almost 1.00% by mid-June. This seemingly technical correction out of Europe put significant upward pressure on domestic yields simultaneously as relative value trades were adjusted accordingly. Looking forward we continue to see heightened volatility likely as the market moves closer to a potential Fed "lift-off" date and the Eurozone remains unstable.

Market Dynamics: Corporate issuance remained elevated in the quarter as heavy mergers and acquisitions activity coupled with still-low financing costs continued to produce an environment ripe for new deals. Through May approximately $750 billion in corporate loans were issued, up almost 14% over the same period in 2014. This elevated supply coupled with mounting tensions out of the Eurozone saw broad market spreads move higher. The investment grade corporate bond market, as represented by the Barclays U.S. Credit Index, saw spreads push from 124 to 137 basis points over U.S. Treasuries. The Utility sector, which we believe remains a sound risk-adjusted investment over the longer term, did underperform other sectors as record breaking issuance was seen through much of the quarter. Financials tended to be somewhat more insulated as revenues at many institutions continues to rise, and a push towards higher rates would ultimately further benefit financial results.

Caprin Performance Notes: Yield curve positioning and credit weightings were the key performance drivers over the quarter. A target duration at the longer end of our neutral range over much of the period was a modest detractor versus the benchmark. Our general overweight to high quality corporate issuers, although producing incremental yield versus the benchmark, underperformed U.S. Treasuries as spreads faced pressure later in the quarter. As interest rate volatility increased and the likelihood of Federal Reserve rate action later this year escalated, we slightly lowered curve and duration targets. Our outlook remains intact for a generally flatter yield curve by year-end with short maturities likely experiencing the greatest volatility. Longer term yields may continue to rise and test recent ranges, but they are still unlikely to move significantly higher given the fairly flat near-term trajectory of future tightening. However, with the increased volatility and a longer term view that economic conditions will be supportive of at least an initial Fed increase within the next several quarters, we think a duration target slightly short of neutral remains prudent at this time.

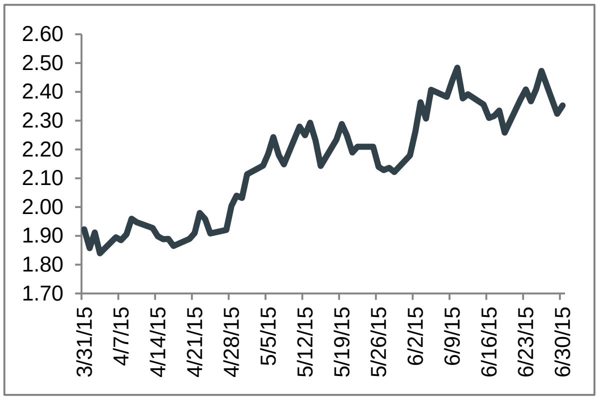

Figure 1: 10-Yr US Treasury Yield
Source: Bloomberg

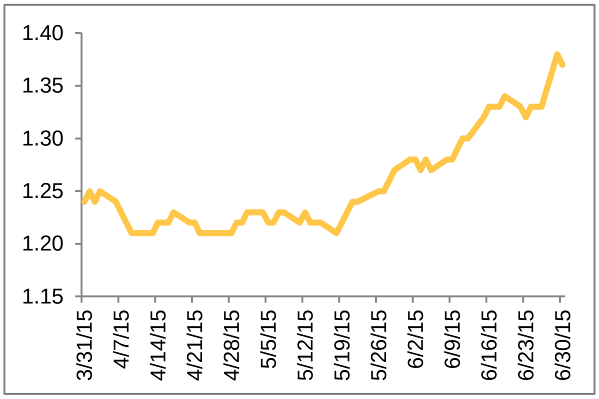

Figure 2: Barclays US Credit Index OAS
Source: Bloomberg

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