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Q2 2015 SHORT MATURITY QUARTERLY COMMENTARY

SHORT MATURITY MUNI COMPOSITE CHARACTERISTICS

AS OF: 6/30/2015

Duration: 1.55yrs
Yield-to-Worst: 0.92%
Yield-to-Maturity: 0.95%
Maturity: 1.67yrs

LOW DURATION TAXABLE COMPOSITE CHARACTERISTICS

AS OF: 6/30/2015

Duration: 1.54yrs
Yield-to-Worst: 1.16%
Yield-to-Maturity: 1.16%
Maturity: 2.46yrs

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: The front-end of the yield curve faced increased volatility over the quarter as expectations of future Federal Reserve action were regularly adjusted to meet incoming economic data. Although trading in wide yield ranges over the period, 2, 3, and 5 year U.S. Treasury Notes ended only moderately higher compared to the moves seen further out the curve. (Increases of 9, 12, and 27 basis points respectively) Looking ahead, second quarter GDP should help shed additional light on the potential timing of an initial Fed increase as the market looks to see if the generally improving data over the last three months will translate into more robust economic growth. Our outlook remains for increased volatility to continue through the remainder of the year with the potential for a noticeable flattening of the yield curve led by higher front-end yields.

Caprin Performance Notes: Despite a move higher in yields over the quarter, short maturity strategies generally still produced slightly positive total returns. An overweight to spread sectors versus the benchmarks helped offset modest negative price returns during most of the period. We continue to believe that high quality spread products inside of 4 years offer reasonable risk-adjusted yield versus government issues. As the quarter progressed, we modestly shortened maturity structures and duration profiles to help manage the risk associated with possible Fed-driven higher front-end yields.

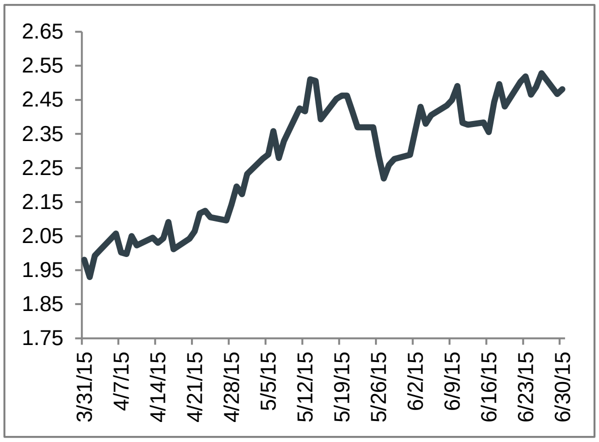

Figure 1: Spread between 2-Yr and 30-Yr US Treasury Yields
Source: Bloomberg

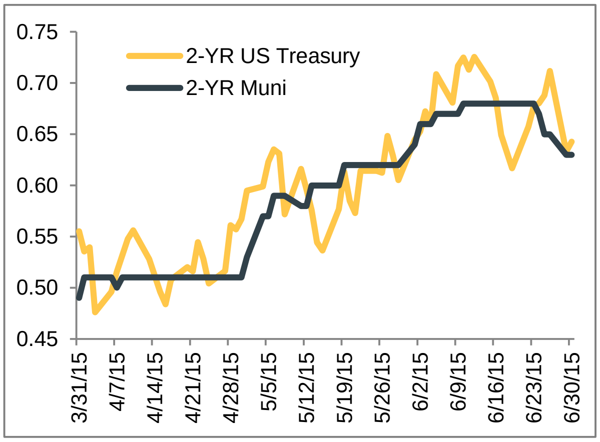

Figure 2: 2-Yr US Treasury Yields vs. 2-Yr Muni Yields
Source: Bloomberg; MMD

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