Short Maturity Muni and Low Duration Taxable Quarterly Commentary

SECOND QUARTER 2016

Macro Overview

Look at where we are today and try to recall the fixed income landscape at the beginning of April. Economic outlooks were improving as we rebounded off February equity market lows, and Federal Reserve officials, despite lowering their rate forecasts, were still talking up the possibility of several hikes by the end of 2016. Media attention was heavily focused on the then Presidential primaries that now seem to be setup for a very interesting November, and little attention was being paid to a British referendum still months away. The first stumble came in early June as market participants were caught off-guard by a significantly weaker jobs picture painted by the May Nonfarm payroll report. The 38K jobs added during the month was the weakest print since September 2010, and moved the year to date average below 150K (2015 average was approximately 230K).

With as much emphasis and praise as the Federal Reserve had given this reasonably strong trend, it was of little surprise that they decided to forgo a further rate increase at the conclusion of their June meeting. Chair Yellen noted in her statement that, in addition to the troubling jobs release, the Central Bank was also cautious regarding the upcoming British EU exit vote, and to say markets were unprepared for the result of that vote would be an understatement. With a “Leave” vote in the clear majority, markets reacted violently with double digit declines in Asian and European stocks, slightly more modest declines in US stocks, and significantly lower yields globally. The Pound dropped to multi-decade lows as UK Prime Minister Cameron’s resignation announcement added even further uncertainty as to who would lead the country through the first Eurozone departure since its 1999 inception. More questions than answers still remain, and the longer term implications for Europe remain unclear. Volatility in risk assets will likely persist, while global yields will remain depressed until, at the very least, more clarity is achieved.

Composite Characteristics

SHORT MATURITY MUNI

AS OF: 06/30/2016

Duration: 1.36 yrs

Yield-to-Worst: 0.88%

Yield-to-Maturity: 0.90%

Maturity: 1.40 yrs

LOW DURATION TAXABLE

AS OF: 06/30/2016

Duration: 1.52 yrs

Yield-to-Worst: 0.94%

Yield-to-Maturity: 0.94%

Maturity: 1.56 yrs

Market Dynamics

Short maturity and money market yields experienced their fair share of volatility throughout the quarter as they continued to be whipped around by the speculation over future US monetary policy and the aforementioned geopolitical risk trading. After climbing to a 1.08% at its peak in late May, the 3YR US Treasury yield fell all the way back to a 0.69% by quarter end. The US Treasury curve continues to flatten as the spread between the 2YR and 10YR has declined by another 16 basis points in just the first few trading sessions of the new quarter. Short dated municipals continue to underperform their taxable counterparts in this environment as tax-exempt yields seem to be stickier at these new lows. Front-end yields in general seem to have found some support following the frantic safe-haven Brexit buying but will likely remain volatile as we head into the second half of the year with a large trading range now established.

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Performance Notes

Within the low duration taxable strategy, maturity targeting remained relatively conservative through the quarter as guidance from the Federal Reserve continued to indicate the likelihood of further rate increases in ’16. Despite this, adjustments remained underway to reflect our general outlook for overall reduced rate pressures over the near-to-medium term. In the Short Municipal strategy, we continue an overweight in more robust yield sectors such as hospitals, housing, and other direct revenue stream issuers that we believe provide sound credit metrics and incremental income in this still challenging yield environment.

FIGURE 1: SPREAD BETWEEN 2-YR AND 30-YR US TREASURY YIELDS
Source: Bloomberg

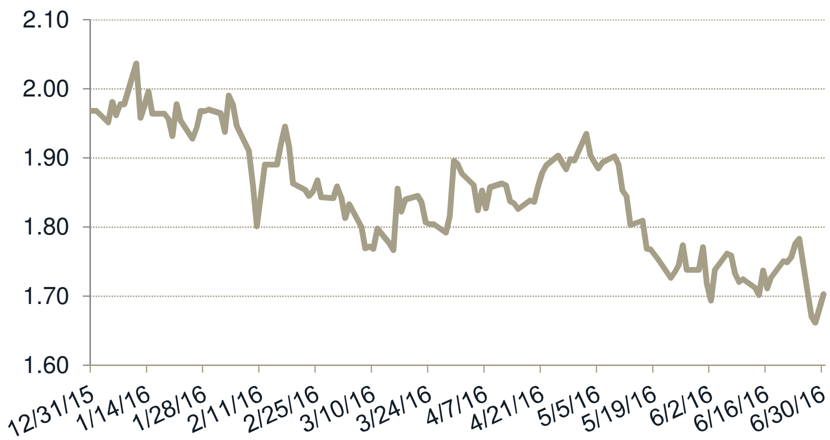
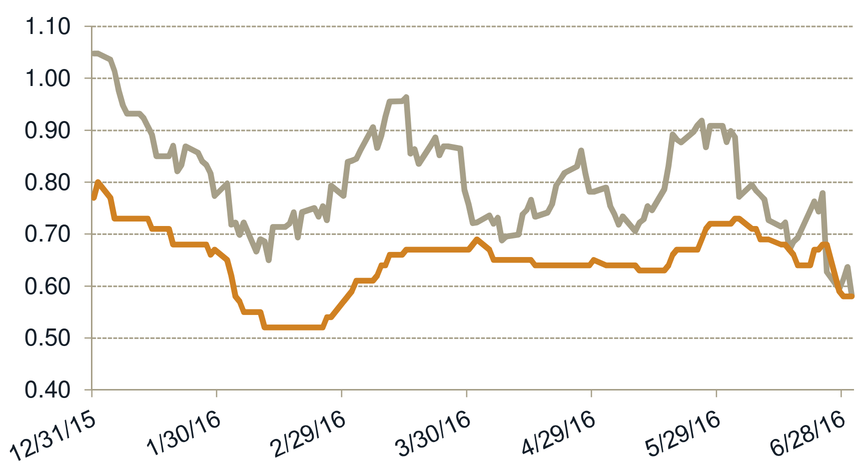


FIGURE 2: 2-YR US TREASURY YIELDS VS. 2-YR MUNI YIELDS
Source: Bloomberg; MMD



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