CAPRIN

Intermediate Taxable Quarterly Commentary

THIRD QUARTER 2016

Macro Overview

As we entered the third quarter, Brexit still dominated headlines as markets attempted to predict what the eventual fallout would look like for Britain, the Eurozone and the rest of the world – the fact is, we still don't know. US Treasury yields finally found a bottom after the 10-yr benchmark traded below 1.40% in the days following the 4th of July holiday. From there, Treasuries traded in a relatively tight range, eventually pushing higher, led by the front-end of the curve. Yields on 3-yr, 10-yr, and 30-yr Treasuries were up 18, 13, and 3 basis points, respectively. The typically quiet summer months of July and August saw headlines turn to the upcoming presidential election where Donald Trump surprisingly secured the Republican nomination and Hillary Clinton finally put away a pesky challenge from Bernie Sanders. The fodder between the two camps has consumed news cycles with the expectation for it to escalate further heading into November.

Outside of politics, central banks and their policies paved the way for traders. In early September, a hawkish twist from Mario Draghi disappointed markets as he downplayed the chance for further stimulus out of the ECB. Meanwhile the BOJ, which reportedly considered the strategy of helicopter money, undertook the unconventional policy of yield curve control in its latest attempt to spur economic growth. Here at home, the Fed entered the quarter with a less accommodative tone after it was unwilling to raise rates in the first half of the year. However, a weak Q2 GDP print (1.1%) and a revision lower in Q1 (0.8%) coupled with ongoing global uncertainty and stubbornly-low inflation sidelined their effort. Hawks who pointed to a strengthening labor market (monthly NFP avg. 182K YTD) believe the Fed may have missed its chance in September, and with the November meeting right in front of the election, most predict December will be the Fed's only chance to raise in '16.

Composite Characteristics

INTERMEDIATE TAXABLE

AS OF: 09/30/2016

Duration: 3.75 yrs

Yield-to-Worst: 1.60%

Yield-to-Maturity: 1.61%

Maturity: 4.67 yrs

Market Dynamics

Other than a short bout of volatility in the days surrounding the British referendum, credit spreads as measured by Investment Grade CDX spent much of the quarter in a rather tight 5 basis point range, while the cash bond market continued on its persistent march to tighter levels. The Barclays US Credit OAS Index that began the quarter at 147 basis points finished September lower by more than 15 basis points to close at spread levels not seen since June '15. As mentioned in our previous quarterly overview, we remain cautious about continued credit tightening given our fundamental assessment of a corporate landscape that is in the later stages of a cycle. Technical buying pressure and subsequent spread compression seen of late has been a function of continued global central bank accommodation despite sluggish corporate revenue trends and shareholder friendly repurchasing programs. The strategy's weighting to corporate credit has remained a significant contributor to performance and yield heretofore but could begin to see a moderate reduction if this trend intensifies. As always, Caprin's disciplined and conservative approach to credit selection and monitoring aids in reducing the potential volatility if and when these tides shift.

Performance Notes

An overweight to the corporate credit sector remained intact across the strategy throughout the quarter. Caprin's deliberate credit selection process continued to help provide enhanced income while mitigating the volatility often associated with lower quality corporate issuers. This positioning led to composite performance generally above benchmark for the quarter while duration and yield curve positioning remained relatively neutral. The strategy's overweight to high quality taxable municipals was also additive on a risk adjusted basis when compared to returns from similar maturity US agency holdings.

FIGURE 1: 10-YR US TREASURY YIELD
Source: Bloomberg

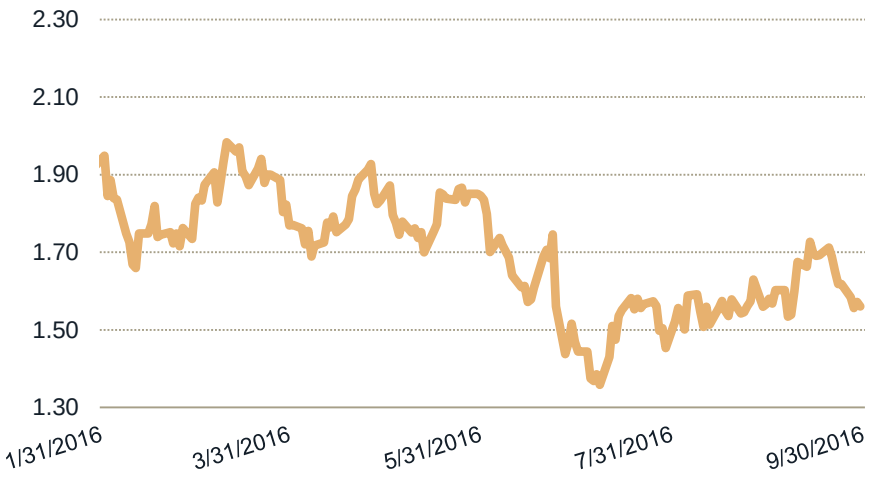
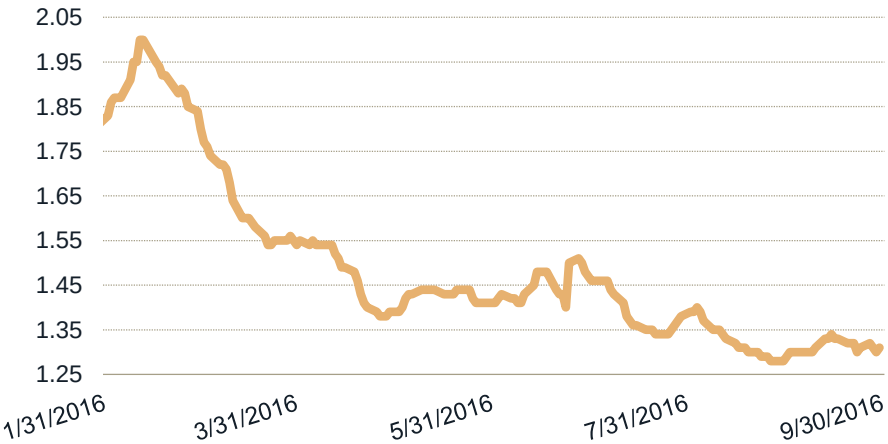


FIGURE 2: BARCLAYS US CREDIT INDEX OAS
Source: Bloomberg



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