CAPRIN

Short Maturity Muni and Low Duration 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

SHORT MATURITY MUNI

AS OF: 09/30/2016

Duration: 1.41 yrs

Yield-to-Worst: 1.07%

Yield-to-Maturity: 1.10%

Maturity: 1.47 yrs

LOW DURATION TAXABLE

AS OF: 09/30/2016

Duration: 1.66 yrs

Yield-to-Worst: 1.10%

Yield-to-Maturity: 1.10%

Maturity: 1.71 yrs

Market Dynamics

The front-end (3-yrs and in) of most USD denominated yield curves had quite the quarter as traders and money managers digested policy posturing, recovered from the Brexit scare, and encountered repercussions of historic money market reform. Yields experienced a measured rebound on the heels of kicking the Brexit can into 2017 and the stream of 'data' and rhetoric returned as primary drivers of sentiment. On top of this volatility, one and three month Libor benchmark rates shot higher driven by the implications of Brexit (at some point) and the exodus of money market balances from soon-to-be 'non-$1 NAV' funds. Short Treasury yields were higher but held below mid-2nd quarter levels as confidence remained fleeting relative to when the Fed would actually raise rates. With improving risk outlooks, credit spreads tightened and credit sectors performed well as investors sought incremental income in a favorable environment. Buying opportunities though required patience and discipline as availability ebbed and flowed with market sentiment. The muni sector, as expected, remained softer on the front-end as it tends to lag given the market participants and nature of trading.

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Performance Notes

Managing around global political reform and monetary policy change was particularly challenging over the quarter. Despite this, performance in Caprin low duration and short focused strategies proved rather resilient. As a frame of reference, maturity and sector defined ETFs in the form of Short Maturity Government (SHY), Short Maturity Credit (CSJ), and Short Maturity Muni (SHM) posted returns of -0.15%, 0.05%, and -0.24% respectively over the quarter. Our continued credit overweight and disciplined name selection within the corporate sector was additive to the low duration strategies as it was the best performing of the aforementioned components. Within the short maturity municipal strategy, a continued focus on relatively higher yielding but sound revenue issuers provided incremental income that helped offset slight price pressure in the face of particularly heavy new issue supply.

FIGURE 1: 1M, 3M LIBOR RATES
Source: Bloomberg

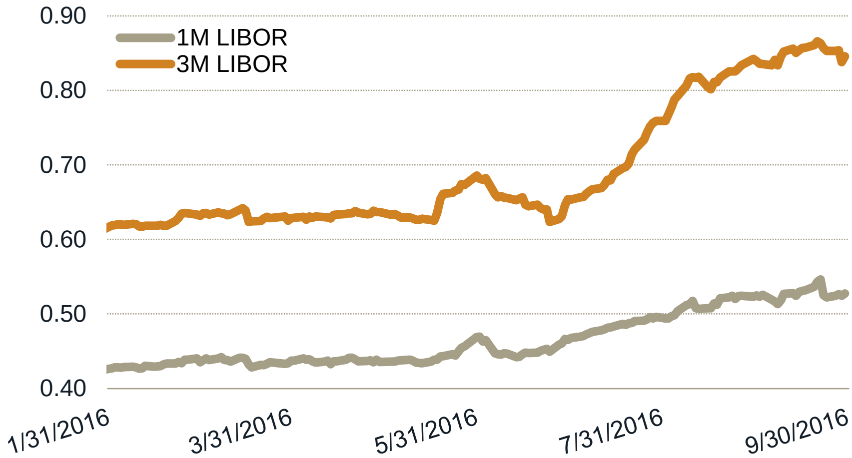
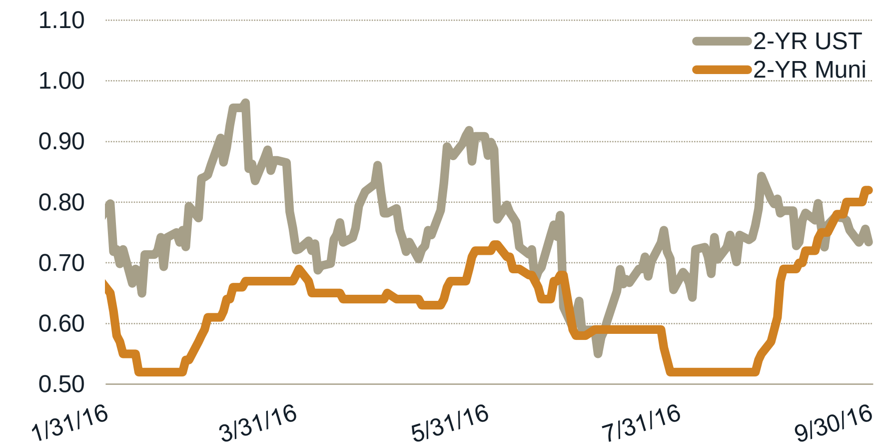


FIGURE 2: 2-YR US TREASURY YIELDS VS. 2-YR MUNI YIELDS
Source: Bloomberg; MMD



"Within the short maturity municipal strategy, a continued focus on relatively higher yielding but sound revenue issuers provided incremental income that helped offset slight price pressure in the face of particularly heavy new issue supply."

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