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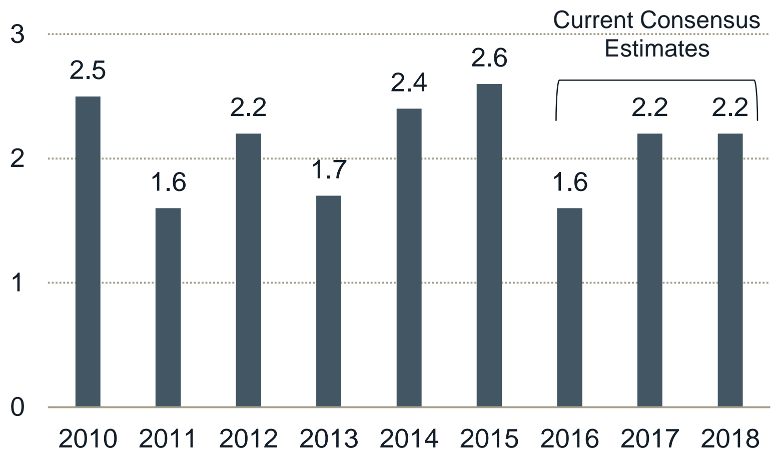
Caprin Strategy Positioning Update

Where Do We Go From Here?

As we discussed in our last update, we continue to view trading in the fixed income markets following November's historic election as based largely on near-term sentiment. The idea of improving growth and modest inflation driven by fewer regulations and fiscal stimulus could prove beneficial to the US economy over the next decade. However, in practice we see the viability of the new administration's initiatives as significantly lower than the market is anticipating. As history has shown, there will likely be lengthy and substantial legislative hurdles to clear, and global economic headwinds will dampen the effectiveness of what are now only rough proposals. (FIGURE 1)

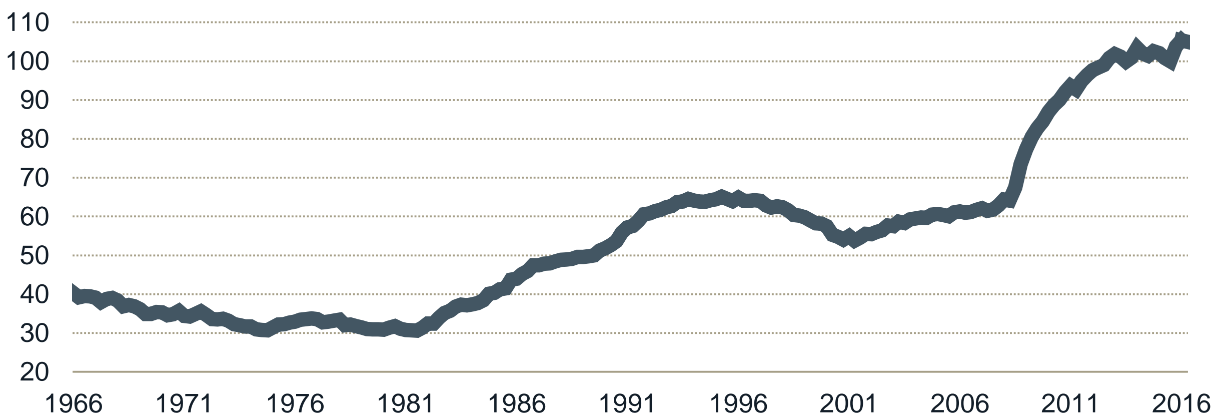
In the near-term, we anticipate that the market continues to trade with some degree of heightened volatility as speculators reposition around each cabinet appointment and economic release. As we saw last week, bold, market-moving statements from the administration are likely to remain the focus. Remarks from Treasury Secretary Nominee Mnuchin of sustained 3%-4% GDP growth derived from tax and trade policy are a prime example and remain, in our opinion, very difficult to achieve given what we know about the state of the economy. While tax reform under President Reagan in the early '80s proved to be a significant driver of growth, we are in a very different era. Today, we are faced with a US debt burden that is remarkably larger than thirty years ago, with pronounced shifts in generational consumption preferences and with a labor force that is already producing at historically high levels. (FIGURE 2)

FIGURE 1 | U.S. ANNUAL REAL GDP GROWTH %



Source: Bloomberg L.P.

FIGURE 2 | FEDERAL DEBT: TOTAL PUBLIC DEBT AS PERCENTAGE OF GDP



Source: Federal Reserve Bank of St. Louis

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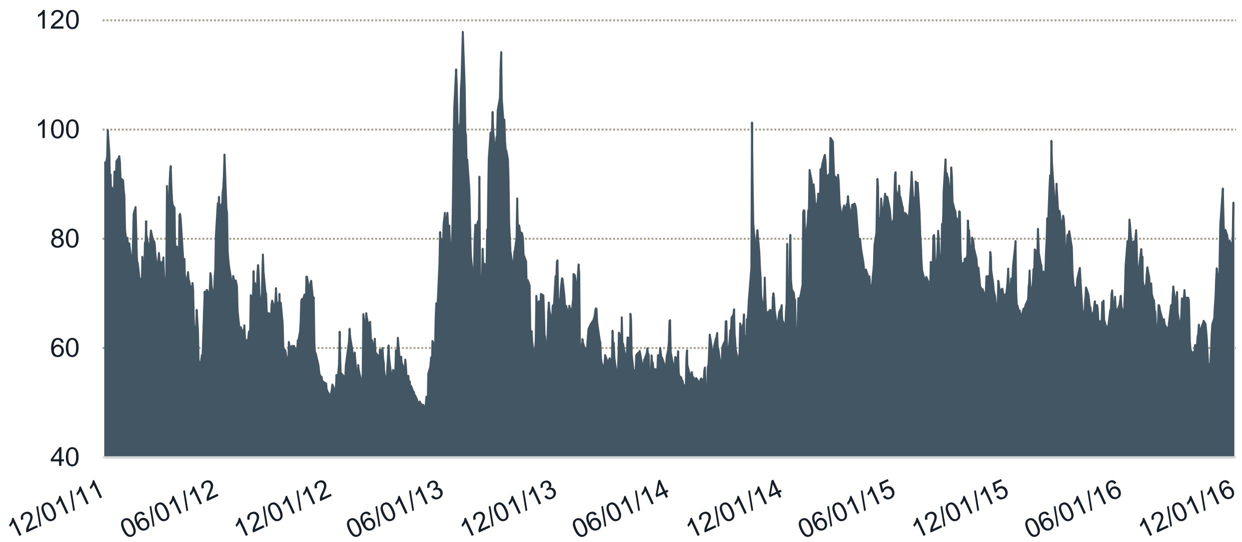
Although a rate increase from the Federal Reserve at its December meeting is now all but certain, we expect the overall path of tightening to be gradual and cautious. A highly rate sensitive housing market and a formidable rally in the US dollar will both weigh on the central bank's thinking in the coming year. A topic we remain focused on is the Federal Reserve balance sheet and any discussion by the new administration surrounding its future. While we expect a gradual reduction of assets, more aggressive rhetoric on the timing and possible sale of securities will be a significant factor in our future outlooks.

Caprin's current assessment of longer term fundamentals, as noted above, suggests an interest rate environment not significantly different than we have experienced over the past three years. Admittedly, that period has produced spectacular lows and optimistic highs, yet we see a 10 year Treasury mostly range bound between 2% and 3%. As a manager focused on delivering lower volatility core bond solutions, we see the possibility for additional exaggerated interest rate movements over the near-term as sentiment based trading continues to dominate the market. Consequently, it is reasonable to expect some incremental risk profile adjustments where applicable as we seek to dampen potential volatility. (FIGURE 3)

FIGURE 3 | MERRILL LYNCH MOVE INDEX – IMPLIED US TREASURY VOLATILITY



Source: Bloomberg L.P.

As always, please feel free to reach out to our investment team to discuss your accounts or if you have any questions about our strategies.

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