

Intermediate Taxable Quarterly Commentary

FOURTH QUARTER 2016

Macro Overview

The fourth quarter of 2016 will forever be remembered and defined by Donald Trump's implausible U.S. Presidential election upset of Hillary Clinton. The immediate market reaction saw stocks lower and bond prices higher, but that lasted only a few hours overnight and reversed once markets measured what President-elect Trump's mandates might do to future growth, inflation, and interest rates. Fundamentally little changed in the days and weeks that followed, however, money began to pour out of bonds and into stocks, igniting a euphoric equity rally heading into year-end. The world appeared to price in every positive outcome from Trump's proposals while ignoring the significant hurdles or unintended consequences stemming from his policies. We continue to view trading in the fixed income markets based largely on near-term sentiment. As history has shown, there will likely be lengthy and substantial legislative hurdles to clear even with Republican control of Capitol Hill. The Republican Party has arguably never been more divisive than it is currently, not to mention that power shifts in Washington are seldom without unanticipated incidents.

Outside of politics, the Federal Reserve as predicted raised the benchmark lending rate 0.25% in December and updated their projections to show a slightly more accelerated pace of rate hikes in 2017. We expect the overall path still to be gradual and cautious but can appreciate the Fed's desire for a greater rate cushion for whatever the next economic cycle may hold. Another topic capable of rattling markets is the size and potential shrinking of the Federal Reserve's balance sheet and any hints from the new administration about getting that underway. While we expect a gradual reduction of assets, more aggressive rhetoric on the possible sale of securities will be significant for all financial markets.

Market Dynamics

Despite the pronounced move to higher rates over the period, credit spreads continued to march lower, reinforcing a trend that had persisted through much of the year. The Barclays US Credit OAS Index declined by 13 basis points over the quarter and ended nearly 40 basis points below where it began 2016. Spreads now represent levels not seen since early 2015 as the market continued to benefit from accommodative buying programs out of the ECB and renewed US equity market optimism following November's historic election. The strategy's emphasis on higher quality corporate credits remained a significant contributor to performance over the quarter and year, but we approach 2017 with some caution as it relates to the potential impact of higher interest rates and a very strong US dollar on near-term corporate earnings. Though prospects of a less restrictive corporate tax structure and increased infrastructure spending could help accelerate sluggish domestic growth (and put additional downward pressure on spreads), many uncertainties still surround the new administration's proposals. As these factors evolve, Caprin will stay the course with our disciplined and conservative approach to credit selection and maturity positioning in pursuit of a lower volatility profile.

Composite Characteristics

INTERMEDIATE TAXABLE

AS OF: 12/31/2016

Duration: 3.43 yrs

Yield-to-Worst: 2.15%

Yield-to-Maturity: 2.15%

Maturity: 4.46 yrs

Performance Notes

Yield curve positioning in the strategy moved to a moderately more defensive position to start 2017 in light of market sentiment and pronouncements implying a tighter monetary policy. We continued our overweight to the corporate credit sector throughout the quarter and maintained the positioning into 2017 as risk assets remain in favor. We like the higher income levels generated by spread products, though we remain mindful about the strength and longevity of this credit rally. As we witnessed in early 2016, events that change the outlook for credit-driven products can surface swiftly. Our deliberate selection process continues to emphasize issuers with lower volatility expectations and seeks to assist in maintaining income levels even as market sentiment shifts.

FIGURE 1: 10-YR US TREASURY YIELD

Source: Bloomberg

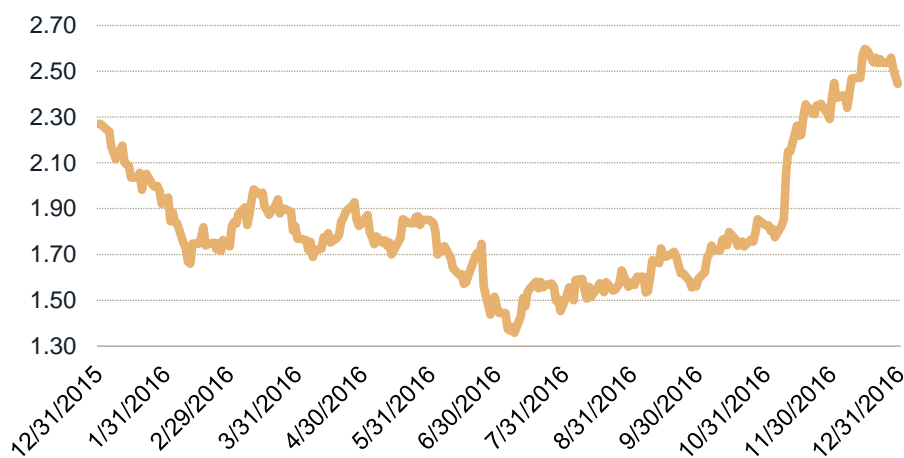
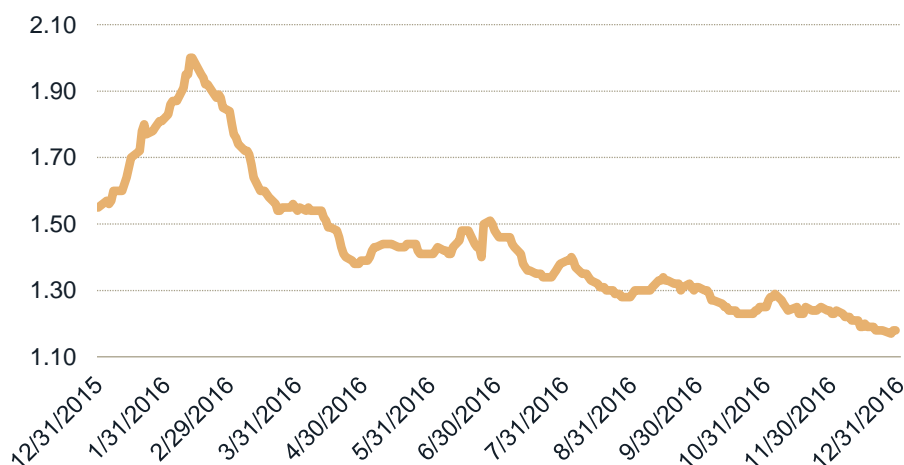


FIGURE 2: BARCLAYS US CREDIT INDEX OAS

Source: Bloomberg



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