Caprin Asset Management, L.L.C.

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Capitalizing on Uncertainty

Over the past several quarters, the United States has seen a marked moderation in economic growth. Several factors are linked to this transition, but none so significantly as the slowing housing market. Since the housing market peak in 2005, we have seen fewer existing homes being sold and fewer new homes starting construction month-to-month (Figure 1). We all remember the booming housing market with sky-rocketing prices and easy mortgage money. As foreclosures have increased along with the slower market in general, many mortgage lenders have instituted tighter credit standards. Fortunately, so far, the consumer remains committed to spending and growth in jobs is solid, suggesting that the economy is poised for a soft landing – not a recession.

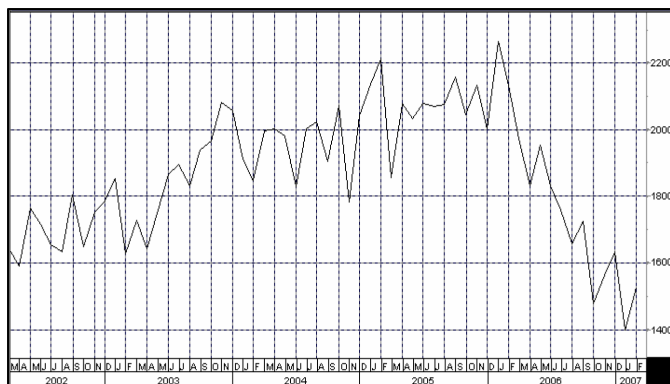

Figure 1. Monthly housing starts over past five years
Source: Bloomberg

The Federal Reserve and its chairman, Ben Bernanke, seem to agree. The committee held its Federal Funds Rate at 5.25% for the third consecutive quarter. In its statement, the committee suggested our economy would continue to grow modestly in the near term and that core inflation, a focal influence on the Fed's recent decisions, would likely recede. Indicating a lower risk of future inflation signals a significant policy change, and, therefore, we think it is reasonable to expect the Federal Reserve will lower its target rate to 5.00% later this year.

The capital markets continue to digest and react to conflicting analyst forecasts, contradictory economic data releases, and continued disagreement over the next move for the Fed Funds Rate. This lack of a consistent theme has caused interest rates to remain in a trading range for several months with no indication that they will break out in one direction or another. The financial markets are seeking a clearer view of the economy's strength and the Fed's policy.

Highlights:

- **BOND MARKET RALLIES IN RESPONSE TO EQUITY MARKET SURPRISES**
- **SLOWING ECONOMY LED BY HOUSING MARKET DECLINE**
- **CAPRIN REALLOCATING LONG AND SHORT MATURITIES**
- **MANAGED BOND PORTFOLIOS HAVE DAMPENING EFFECT ON OVERALL PORTOLIO RISK**

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To protect our client portfolios from unexpected shifts in market conditions, Caprin is reducing portfolio holdings in longer and shorter maturities and reallocating these funds to the 7- to 10-year maturity range. This decision, made after careful analysis of the current environment, will help maintain portfolio return and, therefore, the investor's income while reducing the portfolio's exposure to a decline in value should interest rates rise for longer maturity bonds. Our target duration of 4.25 years — modestly longer than our benchmark — remains the same as set on February 5th by Caprin's Investment Committee as we consolidate our maturities in the intermediate range.

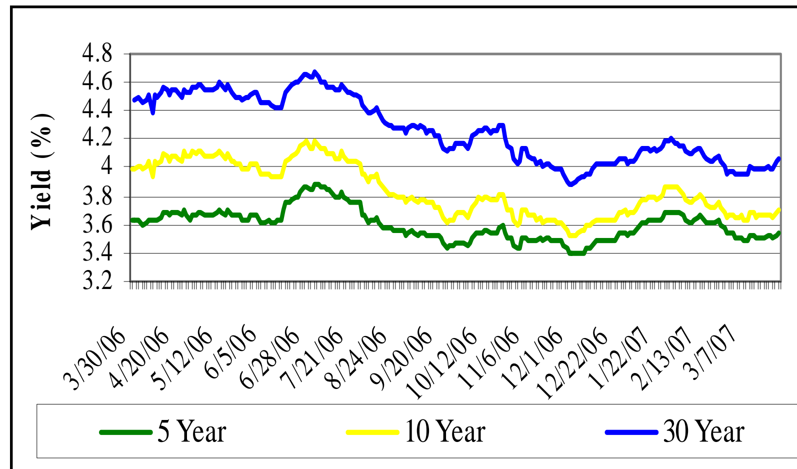

Figure 2. Historical Perspective on the Municipal Market - AAA GO Yields

A key aspect of Caprin's investment philosophy is our ongoing assessment of market conditions and our proactive adjustment of portfolios as conditions warrant. As economic and policy trends work through this transition period, we remain committed to those strategies appropriate for the return and income objectives of our client portfolios.

"The best offense is a strong defense..."

On February 26th, Chinese stock markets dropped 9% in value in one day, followed by a pronounced two-day drop in domestic U.S. markets. Since 2003, stocks have seen a slow and relatively steady increase in value; and a correction to this trend was not unexpected. The knee-jerk reaction we saw to the Chinese market's decline shows how quickly equity markets can destabilize.

One of the best defenses an investment portfolio can have against the peaks and valleys of stock prices is a bond portfolio that can provide a dampening effective for turbulent equity markets.

Prudent investors are mindful of the risk in their *overall* portfolio and typically allocate an appropriate percentage of their investments to fixed income for this reason. Additionally, when stock prices are falling, the value of bonds will generally increase thus helping preserve wealth when other investments are performing poorly. By including a managed bond portfolio in their investment allocation, investors can manage their exposure to investment risk, strive for an asset allocation that produces their desired returns and a stream of income.

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this piece, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion of information contained in this piece serves as the receipt of, or as a substitute for, personalized advice from Caprin Asset Management. To the extent that a reader has any questions regarding the applicability to their situation of any specific issue discussed above, they are encouraged to consult with the professional advisor of their choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.