INTERMEDIATE TAXABLE COMPOSITE CHARACTERISTICS

AS OF: 9/30/2014

Duration: 4.02yrs
Yield-to-Worst: 2.01%
Yield-to-Maturity: 2.01%
Maturity: 4.57yrs

Strategic Overview

Macro: US Treasuries spent Q3 stuck in a narrow range, anxiously awaiting signals from the Federal Reserve. As expected, the Fed continued with winding down its asset purchasing programs. However, rate hike speculation established itself as a key driver of activity in US debt markets. Traders wondered if the strong Q2 GDP print (+4.6%) coupled with declining unemployment numbers (to 6.1%) would give the Fed sufficient confidence to remove its longer-term rate guidance and prepare markets for an accelerated timeline. In the end, that would not be the case – weak inflation and labor participation data overshadowed the Q2 GDP rebound. Still, ahead of the September Fed meeting, 10-year US Treasury yields crept up to 2.62%, a threshold that has proven itself time and again as a significant point of resistance. In the weeks following the Fed's renewal of their dovish status, US Treasury yields tumbled towards the lower regions of their trading channels. A hostile geopolitical picture and slumping economies in Europe and Asia only added to the energized demand for haven assets. Developments in Ukraine, Gaza, Syria, Iraq and Hong Kong demanded close surveillance and still weigh heavily on market tone. Q3 ended with a decisively 'risk-off' bias, suggesting tighter Fed policy likely remains a distant concern.

Sector Notes: Investment Grade (IG) Corporate spreads remained stable through Q3. IG CDX traded in a narrow range of 55-60 for most of the period, except for a two-week spike in late-July when the cumulative effect of global geopolitical tensions became too hard to ignore. Equities suffered similarly as the Russia-Ukraine situation escalated and the terrors of ISIS appeared on the front page. IG prices held up better than High Yield Corporates as investors looked to de-risk their holdings. Low supply and tightening spreads in the Taxable Muni space led to their outperformance versus US Treasuries, and we continue to utilize Taxable Munis for their incremental yield advantages.

Caprin Performance Notes: Exposure to Taxable Munis was additive to Intermediate Taxable performance in the quarter. Taxable Munis continue to offer attractive yield opportunities and stellar price performance as spreads continue to tighten. Investment Grade Corporates contributed to outperformance versus our benchmark, primarily due to the incremental yield the sector offers. Being long of our benchmark duration would have likely led to even stronger performance in the period given the more pronounced rally in that portion of the yield curve. However, we believed the uneven US recovery, uncertain Fed actions, and volatile geopolitical landscape supported a more measured approach. These threats still exist into Q4.

Figure 1: Spread Between 2-Yr and 30-Yr US Treasury Yields
Source: Bloomberg

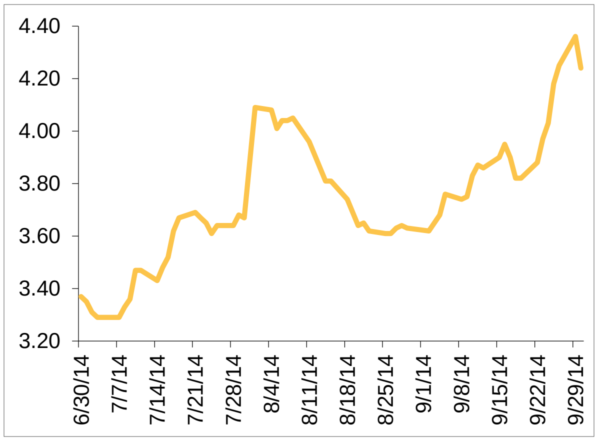

Figure 2: Barclays US Corporate High Yield OAS
Source: Bloomberg

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