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Q4 2014 INTERMEDIATE MUNI QUARTERLY COMMENTARY

STATE SPECIFIC COMPOSITE CHARACTERISTICS

AS OF: 12/31/2014

Duration: 4.71yrs
Yield-to-Worst: 1.69%
Yield-to-Maturity: 2.03%
Maturity: 6.52yrs

Strategic Overview

Macro: The most highly anticipated event of 2014 – the end of Fed tapering – happened in October, ending an era of unprecedented economic stimulus. Fed officials long telegraphed the end of the asset purchasing program, allowing US yields to absorb the news easily. After tapering ended, focus shifted seamlessly to Fed statements and press conferences as traders tried to determine the Fed hike timeline. Volatility ensued as Fed officials used statements deemed overly hawkish or dovish relative to market expectations. Traders became highly conscious of the phrase 'considerable time,' verbiage the Fed left unchanged in Q4. This quelled much of the fear and reassured markets that the hike was still off in the distance. Economic struggles in Europe and Asia and their impact on US markets moved to the fore for the remainder of 2014. While the US recovery gained modest momentum, European and Asian countries considered expanded QE to help avoid recession. This global slowdown sent G-7 bond yields plummeting and re-ignited a powerful rally in US fixed income. Foreign investors flooded into the haven of US Treasuries and, capturing significant relative value, drove yields to 18-month lows in mid-December. Inflationary pressures vanished, encouraging particularly strong performance in longer maturities. Against almost everyone's forecasts, intermediate and long bond prices finished 2014 far higher than where they started.

Market Dynamics: Muni Issuance gained momentum heading into year-end after 2014 supply failed to meet buyers' demand. Between Thanksgiving and Christmas, issuance exploded with more than $30bln in new deals in just a two-week period. Despite the increase in supply, prices continued higher due to strong demand from eager Muni buyers and stronger US Treasury activity. Non-existent inflationary pressures and a flattening US Treasury curve also sent Muni prices higher as investors traveled out the yield curve and credit spectrum. Consequently, sectors like hospitals, power and housing performed well.

Caprin Performance Notes: We positioned portfolios to the longer side of our neutral duration range and adjusted portfolios' yield curve exposure to reflect the aforementioned market dynamics. The lack of inflation pressures and the favorable relative value trade suggested slightly longer maturities would be additive to performance. We simultaneously lightened exposure in the first years of the yield curve where Fed policy speculation resulted in consistent pressure toward higher yields. This profile boosted performance over the period as longer maturity yields fell and the yield curve flattened. Income remained at the forefront and we added to our revenue sector allocation. This decision added to total return reflecting overall Muni market sentiment.

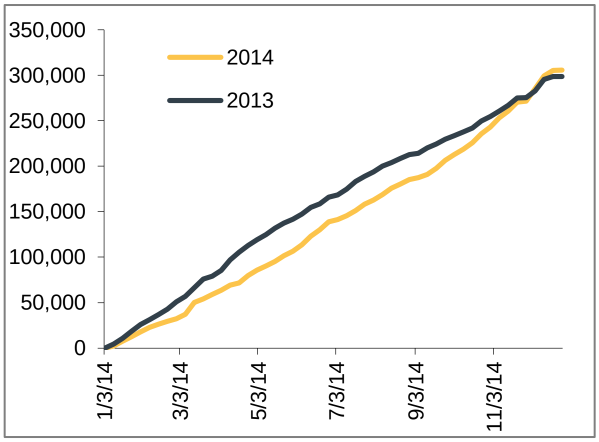

Figure 1: Total US Muni Issuance 2013 vs. 2014 ($mlns)
Source: Bloomberg

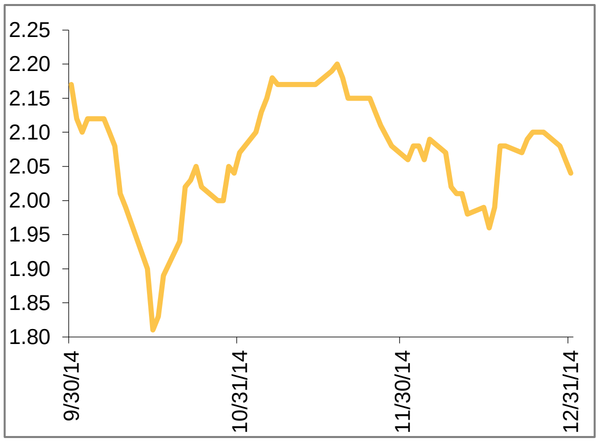

Figure 2: 10-Year MMD AAA Muni Yield
Source: MMD

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