SHORT MATURITY MUNI COMPOSITE CHARACTERISTICS

AS OF: 12/31/2014

Duration: 1.79yrs
Yield-to-Worst: 0.79%
Yield-to-Maturity: 0.82%
Maturity: 1.91yrs

LOW DURATION TAXABLE COMPOSITE CHARACTERISTICS

AS OF: 12/31/2014

Duration: 1.78yrs
Yield-to-Worst: 1.15%
Yield-to-Maturity: 1.15%
Maturity: 1.85yrs

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: Fed speculation continued to drive front-end curve activity as traders put Fed word choice about future policy under the microscope. Fed guidance changed little in the quarter, though a small change made in the December statement did seem to indicate a potential rate hike around mid-2015. Short rates endured significant volatility as rate doves and hawks wrestled. As we enter 2015, we expect this volatility to continue as traders sort out Fed policy timing after each Fed statement.

Caprin Performance Notes: Rate volatility due to Fed forecasting was the primary driver of performance in our shorter strategies. We were able to dampen some of the volatility and front-end weakness that resulted by emphasizing yieldier bonds whose added income helped provide a cushion. Spread volatility was muted relative to longer parts of the curve, and our tendency to favor higher-quality positions helped performance.

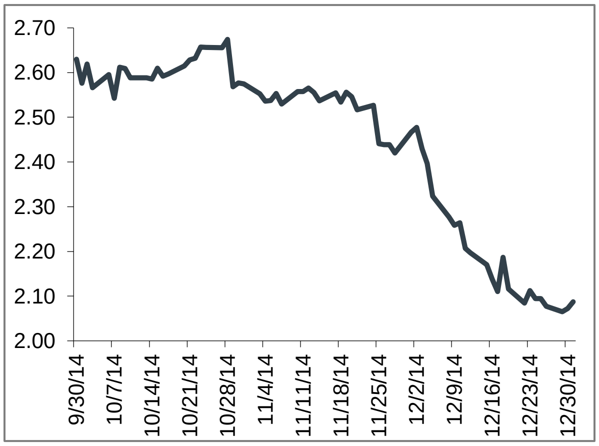

Figure 1: Spread between 2-Yr and 30-Yr US Treasury Yields
Source: Bloomberg

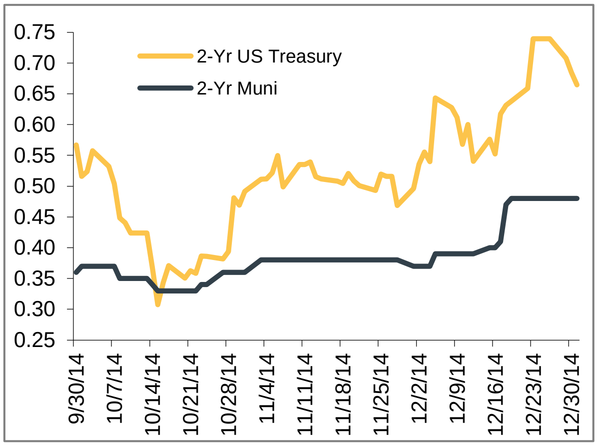

Figure 2: 2-Yr US Treasury Yields vs. 2-Yr Muni Yields
Source: Bloomberg; MMD

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