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Q3 2015 INTERMEDIATE MUNI QUARTERLY COMMENTARY

STATE SPECIFIC COMPOSITE CHARACTERISTICS

AS OF: 9/30/2015

Duration: 4.47 yrs
Yield-to-Worst: 1.61%
Yield-to-Maturity: 1.89%
Maturity: 6.06yrs

Strategic Overview

Macro: Volatility reigned again in the third quarter of 2015. Greece finally submitted to creditor demands and reached a deal to remain in the Eurozone, calming months of anxiety over the fallout from a “Grexit”. However, global growth concerns triggered a flight to quality into U.S. Treasuries. Yields on the benchmark 5-yr, 10-yr and 30-yr Treasury fell 34bps, 38bps, and 35bps, respectively during the quarter. Signs of economic slowdown in China (the world’s second largest economy) coupled with sporadic intervention by the Chinese government to stabilize equity markets forced U.S. equities lower. The Dow Jones Industrial Average fell 7.58% during the quarter, headlined by an approximate 1,900 point decline over six days in late August. Emerging markets continued to be plagued by falling commodity prices, a stronger dollar, and the potential for higher U.S. interest rates. Domestically, the U.S. economy continued to progress, although at a sluggish rate. Second quarter GDP ended with a final revision up to 3.9%, after an insignificant 0.6% pace during Q1. Growth was driven largely by personal consumption, business fixed investment and government spending, but not without the caveat of meaningfully higher inventories. On the jobs front a strong positive trend stalled abruptly as the September Nonfarm payroll print came in at 142k, 60k less than estimated, with significant downward revisions to prior months. Commodity softness continued with the price of crude falling 24% during Q3 to trade around $45 barrel, and core PCE (the FOMC’s favorite measure of inflation) remained stubbornly below their 2% target. All of this together was enough for the FOMC to delay hiking interest rates during a highly-anticipated September meeting. Although an October hike has been all but taken off the table, we expect heightened volatility during the latter part of Q4 as the FOMC remains vocal about its desire to raise rates by year end.

Market Dynamics. The first half of the year was dominated by elevated supply as the market digested heavy refunding issuance in front of what many believed to be an FOMC interest rate hike before Labor Day. Although supply plunged in September (down 27% vs. 2014), we still believe that primary issuance will total approximately $400 billion by year’s end – a level not seen since the expiration of Build America Bonds in 2010. From a credit view, Puerto Rico received the bulk of headlines as the government rushed to restructure $72 billion of outstanding public debt. A tentative agreement between Puerto Rico Electric & Power Authority (PREPA) and 35% of its bondholders (largely hedge funds) was reached in September, but talks seemed to dissolve after bond insurers could not agree to the ambiguous details. Overall, the broader market largely dismissed the potential fallout from Puerto Rico as much of the debt is now held by hedge funds and other high yield investors. Unfunded pension liabilities remain at the forefront of the credit landscape with several high-profile states (Illinois, New Jersey, Pennsylvania) having well publicized problems, while others like Virginia, North Carolina, Tennessee have been proactive in addressing potential shortfalls. We continue to find the most value in the primary market and expect issuance to increase going into the 4th quarter. Within our core states we view higher-rated general obligation bonds, well-established higher education institutions, select hospital credits, and bonds backed by dedicated revenue streams to be most attractive and the best fit for our strategy objectives.

Caprin Performance Notes: Yield curve positioning was the key performance driver over the quarter as our neutral targeting generally returned results in-line with benchmarks. Given our near-term outlook for limited upside pressure in intermediate- to longer-term rates, we have remained comfortable with this neutral duration positioning and exposure to the longer end of our maturity ranges. Longer-term yields may again rise and test near term trading ranges, but we do not see the foundation for a significant move given the lackluster global growth picture and absence of inflation. The market’s recent rally has repriced the Fed Funds liftoff into early 2016, so an FOMC action in 2015 that is contrary to these expectations would be disruptive to most financial markets. We remain cognizant of this risk and continue to fine tune our maturity selections within the context of our neutral duration target.

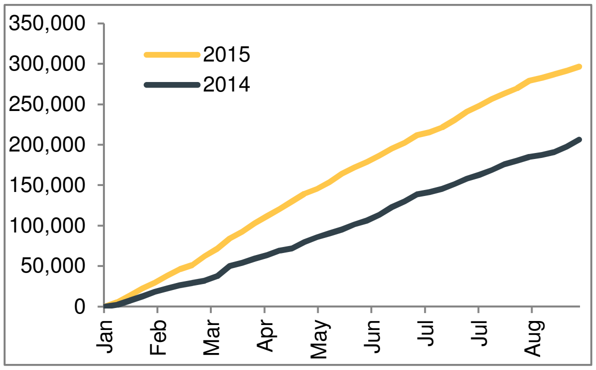

Figure 1: Total US Muni Issuance 2014 vs. 2015 ($mlns)
Source: Bloomberg

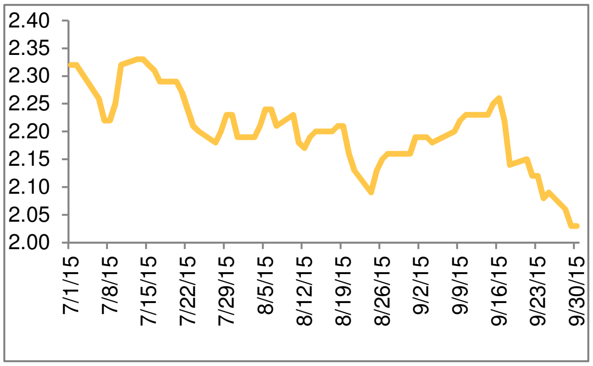

Figure 2: 10-Year MMD AAA Muni Yield
Source: MMD

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