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Q1 2016 Intermediate Taxable Quarterly Commentary

MACRO

At the end of 2015 we concluded our macro overview by saying "we wonder if the 'gradual' estimates will be difficult to achieve while domestic and global headwinds abound." Our reflections were directed at the then just-released projection of a 1.4% year-end 2016 Fed Funds Rate driven by estimates of approximately four, 25 basis point (.25%) rate hikes. This view of an overly optimistic central bank was certainly not unique, but what caught many off-guard was the significant volatility and weaker tone that washed over markets to begin the New Year. Equity and other risk assets were quickly plagued by renewed concerns over "true" Chinese growth prospects and that government's ability to continue its deliberate support of an already over-leveraged and inflated system. The rout, already well established, in commodities made new bottoms with crude oil prices declining nearly 30% by late January, and touching a 12 year low of approximately $26 per barrel. Yields on the 10-yr US Treasury, in concert with the aggressive risk-off move, declined nearly 60 bps from its 2015 close, to a level (1.65%) not seen since the same time a year prior, and credit spreads generically moved to their widest level in four years. As the quarter drew on though, markets did eventually find footing with the slowing of negative headlines from Asia and crude oil prices that stabilized on rumors of OPEC production cuts. Federal Reserve members unsurprisingly erred on the side of caution when they met in March, choosing not to pursue a rate increase while also making significant downward revisions to their short and intermediate-term rate outlooks. Now just two, 25 basis point (.25%) hikes are implied for 2016. We certainly see this as a more realistic expectation given the uninspired growth prospects both domestically and abroad but continue to question if even this may be hard to achieve.

MARKET DYNAMICS

Investment Grade credit spread volatility was the main theme for the Intermediate Taxable strategy in the first quarter. By the middle of February, Markit's IG CDS Index and Barclay's Cash Bond Spread Index had both moved to their widest levels since June 2012 amidst speculation of slowing global economic growth and continued commodity pressure. Almost as quickly as it happened, the trade reversed and widespread demand for credit came back in vogue. In under a month we were back to late 2015 levels, and the momentum continues to favor tighter spreads. Outside of the energy sector, earnings forecasts have remained rather consistent suggesting this movement was more technically driven. The ECB announced in March the addition of non-financial EU corporates to their bond purchases, which sparked a rally that ultimately bled into US credit and has remained intact. The policy's effect is twofold – lower EU yields promote the relative value trade into US credit, and participants seeking to invest are "crowded out" by the central bank and forced across the pond to get money to work.

PERFORMANCE NOTES

Undeterred by the aforementioned volatility, our general credit overweight remained intact across Intermediate Taxable portfolios through the quarter, and our deliberate name selection proved resilient in helping post composite performance in line with to slightly better than benchmark. Exposure to the taxable municipal sector continues to be beneficial as spread compression and light supply helps the sector post additive risk adjusted performance. Credit metrics will remain a primary focus as we enter the first earnings season of 2016 and start to receive a more up-to-date picture of corporate results and future expectations.

INTERMEDIATE TAXABLE COMPOSITE CHARACTERISTICS

AS OF: 03/31/2016

Duration: 3.68 yrs

Yield-to-Worst: 1.59%

Yield-to-Maturity: 1.60%

Maturity: 4.33 yrs

FIGURE 1: 10-Yr US Treasury Yield
Source: Bloomberg

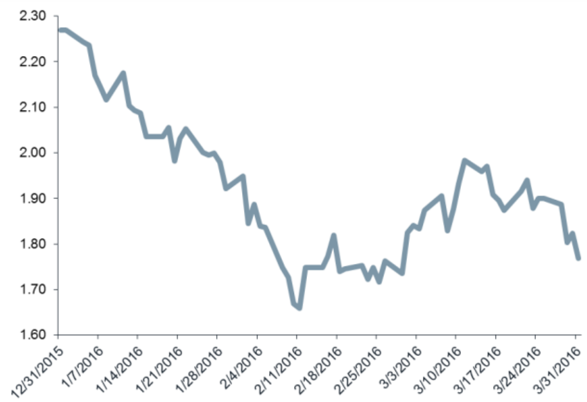
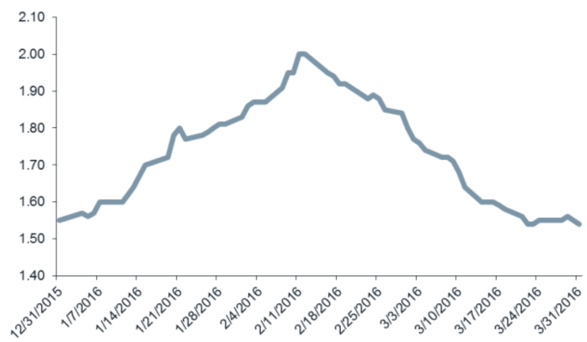


FIGURE 2: Barclays US Credit Index OAS
Source: Bloomberg



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