Intermediate Muni Quarterly Commentary

SECOND QUARTER 2016

Macro Overview

Look at where we are today and try to recall the fixed income landscape at the beginning of April. Economic outlooks were improving as we rebounded off February equity market lows, and Federal Reserve officials, despite lowering their rate forecasts, were still talking up the possibility of several hikes by the end of 2016. Media attention was heavily focused on the then Presidential primaries that now seem to be setup for a very interesting November, and little attention was being paid to a British referendum still months away. The first stumble came in early June as market participants were caught off-guard by a significantly weaker jobs picture painted by the May Nonfarm payroll report. The 38K jobs added during the month was the weakest print since September 2010, and moved the year to date average below 150K (2015 average was approximately 230K). With as much emphasis and praise as the Federal Reserve had given this reasonably strong trend, it was of little surprise that they decided to forgo a further rate increase at the conclusion of their June meeting. Chair Yellen noted in her statement that, in addition to the troubling jobs release, the Central Bank was also cautious regarding the upcoming British EU exit vote, and to say markets were unprepared for the result of that vote would be an understatement. With a “Leave” vote in the clear majority, markets reacted violently with double digit declines in Asian and European stocks, slightly more modest declines in US stocks, and significantly lower yields globally. The Pound dropped to multi-decade lows as UK Prime Minister Cameron’s resignation announcement added even further uncertainty as to who would lead the country through the first Eurozone departure since its 1999 inception. More questions than answers still remain, and the longer term implications for Europe remain unclear. Volatility in risk assets will likely persist, while global yields will remain depressed until, at the very least, more clarity is achieved.

Composite Characteristics

INTERMEDIATE MUNI –
STATE SPECIFIC

AS OF: 06/30/2016

Duration: 4.56 yrs

Yield-to-Worst: 1.27%

Yield-to-Maturity: 1.52%

Maturity: 6.83 yrs

Market Dynamics

Municipal issuance remained elevated throughout the quarter but was easily absorbed as the demand for tax-exempts was at times insatiable. As global sovereign yields grinded lower, muni’s followed, outperforming their US Treasury counterparts, especially in longer maturities. For the quarter, yields on the 10YR and 30YR AAA MMD decreased 35 and 67 basis points respectively, while comparable Treasury yields in those years decreased by 30 and 33 basis points. As the long-end of the yield curve saw an impressive rally, shorter maturities could not keep pace, and the resulting curve flattening took the 2-to-30 year municipal curve spread to 144 basis points, an 8-year low. Near zero and negative yields seen across much of Europe and Japan have forced foreign investors into US Treasuries, and this demand has now trickled down into the muni space. Foreign investment, which really became apparent during Q1, continued throughout Q2; and although the currency hedge has become expensive, muni’s offer these investors a safe place somewhat insulated from the whipsaw trading of other fixed income markets. Looking ahead we do not see factors that will facilitate higher yields or a meaningfully steeper curve. And, as we enter the historically slower summer months, should demand remain robust, we expect Municipals to remain a strong performer within asset allocation strategies.

Intermediate Muni Quarterly Commentary Continued

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Performance Notes

Maturity and duration positioning across the yield curve remained the largest contributor to performance over the quarter. Our generally neutral duration targeting and overweight to maturities in the 10 to 15 year portion of the curve led to composite performance generally in-line with the benchmark for the quarter. At this point we continue to see limited pressure on intermediate and longer term yields as prospects for global growth and inflation remain muted. However, we also continue to view that the limited incremental yield available in longer dated municipals, past 15 years, does not adequately compensate investors for the added interest rate risk when considering the strategy's emphasis on capital preservation.

FIGURE 1: TOTAL MUNICIPAL ISSUANCE QTD DIFFERENCE ($Bln)
Source: Bloomberg

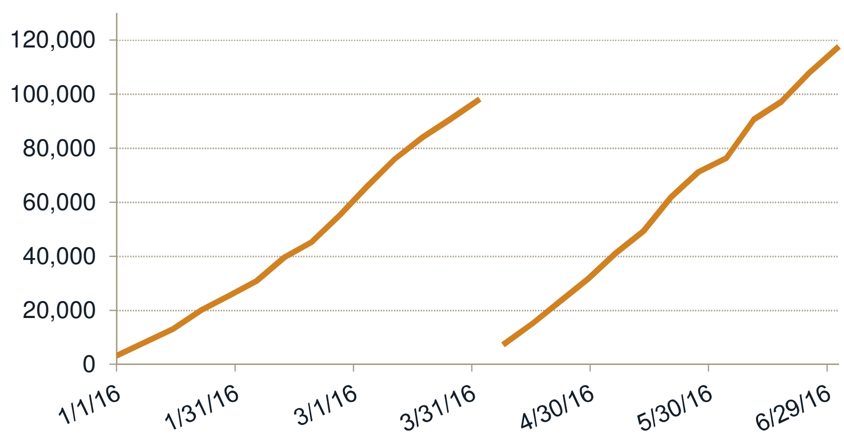
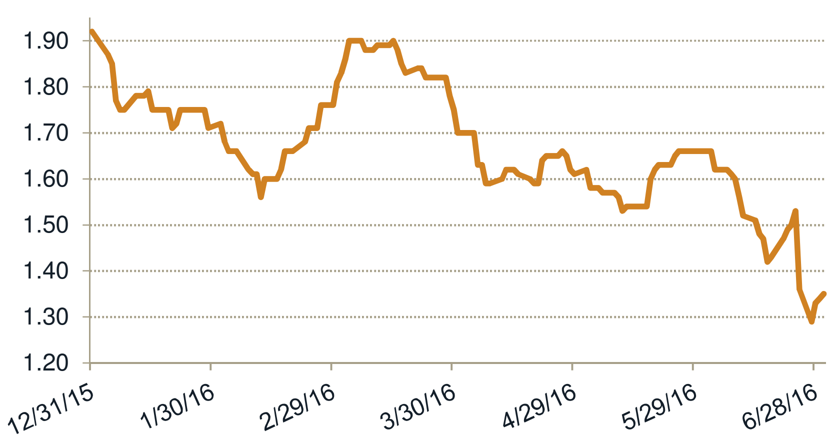


FIGURE 2: 10-YEAR MMD AAA MUNI YIELD
Source: MMD



On the credit front, President Obama signed the

Puerto Rico Oversight,

Management, and Economic Stability Act Promesa) into law. The measure creates an independent board appointed by Obama which will be responsible for managing Puerto Rico's debt restructuring. The legislation did not prevent the second default (this time on GO debt), which occurred right before quarter end.

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