

Intermediate Taxable 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.

Market Dynamics

Even with market participants laser focused on the potential event risk surrounding further Fed action and the British Referendum, credit spread volatility remained rather muted through the quarter. The Barclay’s US Credit Index actually tightened over the period, moving from 154 basis points down to 147 by the close of June and continuing a very tight trading range established after the wide levels seen in February. We continue to think that, despite spreads remaining at near historical lows, there is a general lack of fundamental data to support them, leaving much of the recent strength to be technically driven. With the persistence of a historically low interest rate landscape globally, the hunt for yield has intensified. This has pushed both domestic and foreign buyers into IG corporate credit for the yield advantage over US government backed securities. Given the uncertainty in how the UK’s exit will effect markets and the ECB’s future action, the likelihood remains that robust foreign buying will continue to support the domestic credit market in the near-to-medium term.

Composite Characteristics

INTERMEDIATE TAXABLE

AS OF: 06/30/2016

Duration: 3.82 yrs

Yield-to-Worst: 1.46%

Yield-to-Maturity: 1.47%

Maturity: 4.42 yrs

Intermediate Muni Quarterly Commentary Continued

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Performance Notes

Our general credit overweight remained intact across the Intermediate Taxable strategy through the quarter. Deliberate name selection continues to help provide enhanced income while limiting the volatility often associated with higher beta corporate issuers. This positioning led to composite performance in line with to slightly better than benchmark for the quarter. Exposure to the taxable municipal sector continues to be beneficial as spread compression and limited supply helps the sector post additive risk adjusted performance. Credit metrics will remain a primary focus as we soon enter the second quarter earnings season of 2016 and get an updated picture of corporate results and future expectations.

FIGURE 1: 10-YR US TREASURY YIELD

Source: Bloomberg



FIGURE 2: BARCLAYS US CREDIT INDEX OAS

Source: Bloomberg



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Contact Information

1802 Bayberry Court, Suite 202
Richmond, Virginia 23226
804] 648-3333
CAPRINBONDS.COM
Media Contact:
aplotkin@caprinbonds.com

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