CAPRIN

Intermediate Taxable Quarterly Commentary

SECOND QUARTER 2017

Macro Overview

Much of the global tension that grabbed headlines in the first part of the quarter eased following Emmanuel Macron's decisive victory over his anti-establishment counterpart Marine LePen in the French Presidential election. Here in the US, President Trump's policy initiatives, most notably tax and healthcare reform, remained deadlocked in Washington while the administration faces an investigation surrounding its ties to Russia. In the markets, stocks continued to push higher as both the Dow and S&P were up over 3% in the quarter and continued to break record levels. Corporate earnings showed strength in Q1, and many estimates for Q2 look even better. However, the mature bull market in equities has made many pundits highlight just how expensive stocks have become with the S&P 500 P/E ratio hovering around 25. Unlike earnings, hard economic data did not prove as resilient. Q1 GDP, although stronger than first reported (1.4% vs. 0.7%), did little to improve on the longer term trend of growth malaise. An unexpected slowdown in retail sales throughout the quarter along with softer jobs numbers has now dampened forecasts for a robust Q2 rebound. The Federal Reserve raised rates as advertised in June and their updated interest rate forecasts were little changed, leading the yield curve to flatten further as the long-end remained anchored by weaker inflation expectations. Core CPI softened to 1.9% in April and again in May pushing the yr/yr number to 1.7%, down from 2.3% in January. The Fed has taken notice of slowing inflation but continues to voice that one more rate hike (most likely December) is warranted. Also contributing to a lack of inflation during Q2 was the price of oil which fell 8% during the quarter and is down 17% from the start of the year. Looking ahead, we are closely monitoring whether hard economic data will support the need for an additional rate hike later this year, about the same time the Fed wishes to start reducing its balance sheet.

Composite Characteristics

INTERMEDIATE TAXABLE

AS OF: 6/30/2017

Duration: 3.70 yrs

Yield-to-Worst: 2.15%

Yield-to-Maturity: 2.16%

Maturity: 4.43 yrs

Market Dynamics

June 2014 marked a post financial crisis low in investment grade credit spreads as low rates, central bank buying programs and improving corporate fundaments fueled investor demand for any available yield. That yield seeking rush compressed the Barclays US Credit OAS index to approximately +98 basis points only about 5 bps higher than where IG credit traded just before the crisis. Fast-forward to 2017 and we find ourselves in an eerily similar environment. ECB bond buying programs are alive and well (for now), and although one could argue corporate credit fundamentals have actually softened, the sharp rally in equities from late 2016 has again sent spreads back to near those record lows. For the quarter, spreads drifted lower by approximately 9 basis points to finish June at +108 basis points just about 10 bps above the 2014 tights. While we do not anticipate a meaningful disruption to current spread levels in the immediate future, we are cautious of a risk market that may be overly optimistic of significant tax reform and/or increased federal infrastructure spending within the next 6 to 12 months. As always, Caprin's disciplined and conservative approach to credit selection and maturity positioning aims to dampen potential volatility as this myriad of market drivers evolves.

Performance Notes

As discussed in previous commentaries, this strategy's emphasis on quality corporate credits has remained a positive contributor to performance through much of 2016 and into 2017. However, we remain deliberate and measured in our credit selection as this rally in risk and spread based assets does appear to be more mature. Strategy duration positioning remains near neutral, but the overweight to the corporate credit sector continues to add yield over and above the benchmark, helping compensate for our more conservative curve positioning when compared to Aggregate benchmarked strategies. We continue to see significant rate risk limited in the near to medium term as uncertainty surrounding both monetary and fiscal policy remains.

FIGURE 1: 10-YR US TREASURY YIELD
Source: Bloomberg

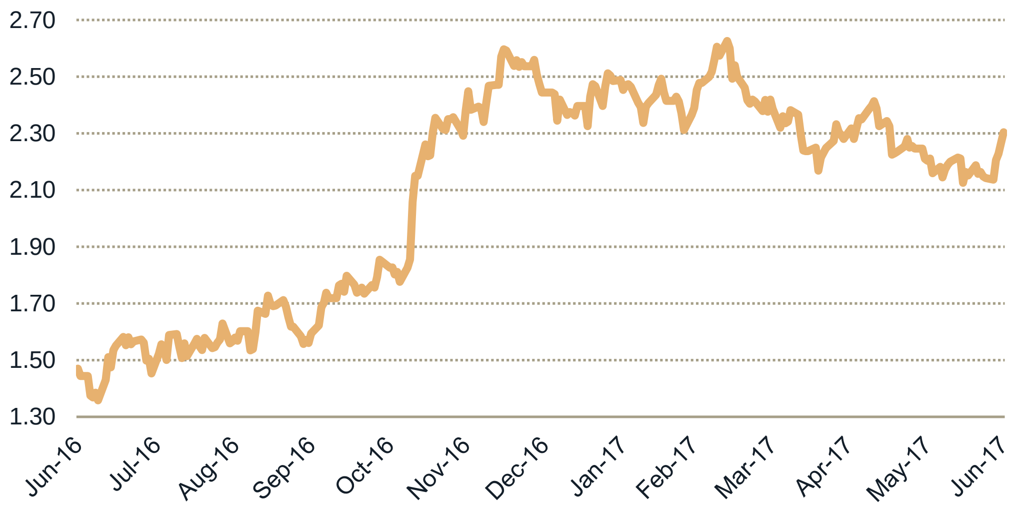
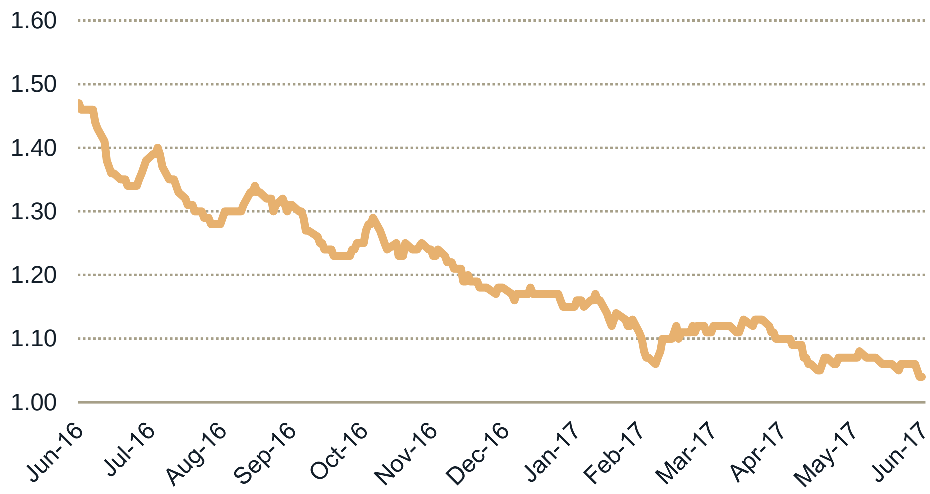


FIGURE 2: BARCLAYS US CREDIT INDEX OAS
Source: Bloomberg



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Contact Information

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