Intermediate Municipal Quarterly Commentary

CAPRIN

Third quarter 2017

Macro Overview

U.S Treasury rates were on the rise to begin the 3rd quarter but quickly reverted on weaker than expected data. By August, elevated geopolitical tensions, lower inflation, and a more dovish tilt from the Federal Reserve sent yields across much of the curve to YTD lows. Hurricane Harvey, the first of three major hurricanes to hit the US mainland and its territories this season, wreaked havoc on Houston and surrounding areas, and will play a significant factor in upcoming economic readings. Treasury yields began to recover in September on the heels of rising Chinese inflation, stronger commodity prices, and the Fed's apparent desire to raise rates once more in '17. In a long anticipated move, the central bank also announced its plan to reduce balance sheet assets beginning in October.

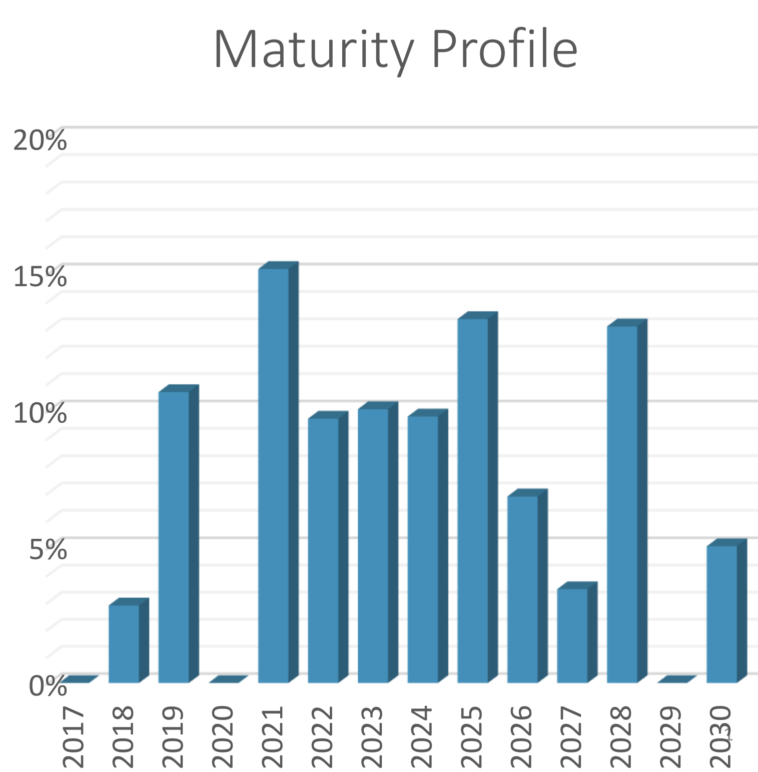
- The Fed wants balance sheet reduction to run quietly in the background, which we believe will be the case near-term.
- News headlines come and go, but the underlying issues do not. Geopolitical tensions surrounding North Korea (among others) will not simply vanish; they remain market moving events.
- Initial excitement surrounding tax reform appears to be fading, and markets will take notice of another policy setback for the Trump administration.

Composite Characteristics

AS OF: 9.30.17
Duration: 4.43yrs
Yield-to-Worst: 1.73%
Yield-to-Maturity: 1.95%
Maturity: 6.44 yrs

Market Dynamics

Municipal yields largely took their cues from Treasuries in the intermediate-to-longer portions of the curve but significantly outperformed on the front-end. Front-end ratios remained near historical lows for most of the quarter as investors, weary of extending duration, parked cash in shorter maturities. Fund flows into the muni space remained steady throughout the quarter and were met with very limited supply. On the credit front, Hartford, CT openly discussed bankruptcy and cautioned investors that it favored restructuring, while Puerto Rico faced further duress after getting hit by two massive hurricanes. Looking forward, the Trump administration will attempt to pass substantive tax reform. Reform will be difficult to achieve in the 4th quarter, but should it get done, the outcome is expected to be largely neutral to the municipal market.



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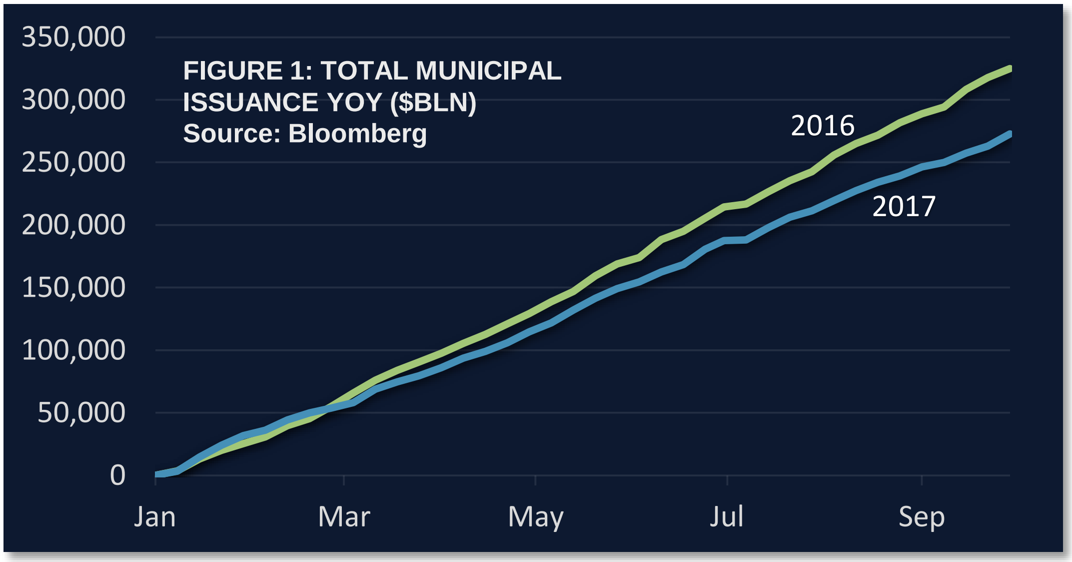
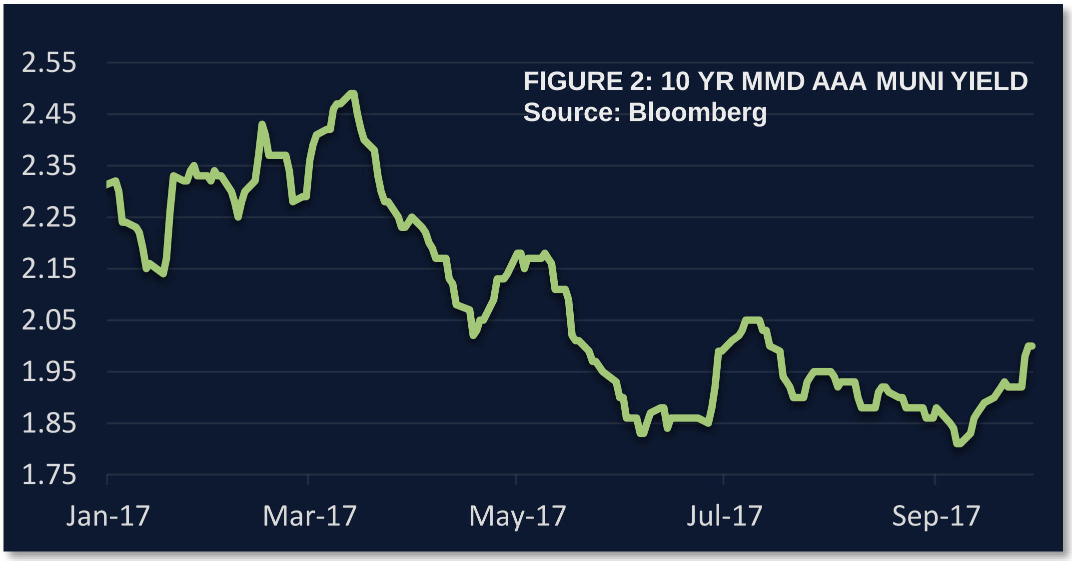
Performance Notes

Quarterly performance was generally in-line to slightly below benchmarks as our more refined exposure to longer maturities was a detractor during the July/August rally; however, it proved beneficial during the back-up in rates heading into quarter-end. For the period, the front-end of the curve saw yields lower by 6 bps at both the 2 and 3 year spots, while maturities 5 to 10 years were flat to slightly higher. While we see supply picking up somewhat heading into October, we still expect net negative issuance for the year. Should demand remain steady, which we believe, municipals will be in a sound position heading into year-end. However, since many of the potential market-moving initiatives remain gridlocked in DC, we believe overall yield direction will likely be taken from US Treasuries.





"Heading into year-end…

the most impactful item for muni investors is tax reform.

…although details at this point remain scarce, we believe most of the proposals should not disrupt the market."

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