CAPRIN

1 | How will the Fed's rate hikes affect you?

"Don't fight the Fed" is a mantra that has been instilled in most investment professionals for decades. Simply speaking it implies that, during times of central bank easing, investors should feel more confident taking on risk, be it equities, credit, or duration. But when the Fed decides the economy has the potential to overheat and begins to tighten monetary policy, investors should be cautious. Like most things for bond market participants, it's not quite that simple.

On December 13th the FOMC raised their short term borrowing rate for the third time in 2017 to a range of 1.25-1.50%. At the same time they reaffirmed their forecasts for three additional increases in both 2018 and 2019, potentially leaving us with a Fed Funds rates 150 basis points higher than today. If you asked investors whether they would be concerned about the effect an increase of that magnitude might have on their bond portfolio, many would say "yes". After all, a 10YR US Treasury bond that yields approximately 2.5% percent today could produce a total return somewhere in the neighborhood of -3.5% if its yield increased by 75 basis points over the course of 12 months. However, there are several factors that should help comfort investors this year.

Perhaps most important is the misconception that yields across the maturity spectrum move in unison. While the Federal Reserve does have authority to set the overnight lending rate for banks, its ability to affect yields further out the curve is limited. For example, let's look at the last Fed tightening cycle from 2004 to 2006. The Fed funds rate started out at 1.00% and increased every meeting to end at 5.25% in June '06. While this increase of 425 basis points did cause yields on short maturities to takeoff (2YR UST moved from 2.68% to 5.18%), intermediate and longer dated maturities remained relatively stable (10YR UST moved from 4.58% to 5.19%) and produced measurably higher total returns over the period.

Fig. 4 - US Treasury Curve Yield Shifts During Fed Tightening 2004-06[1]

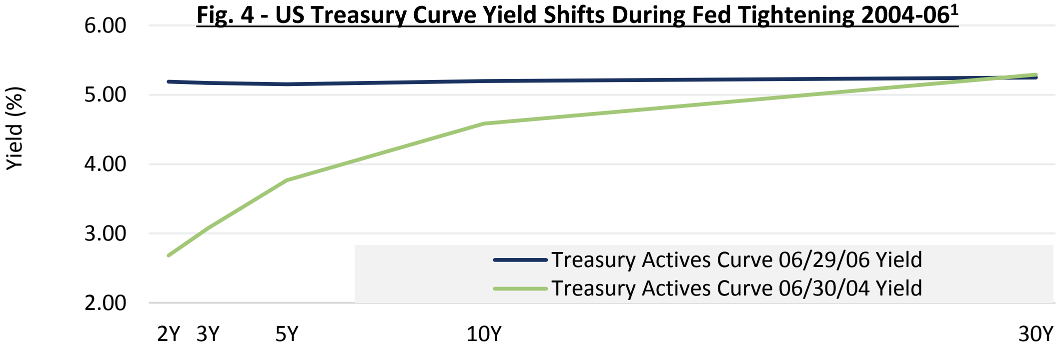


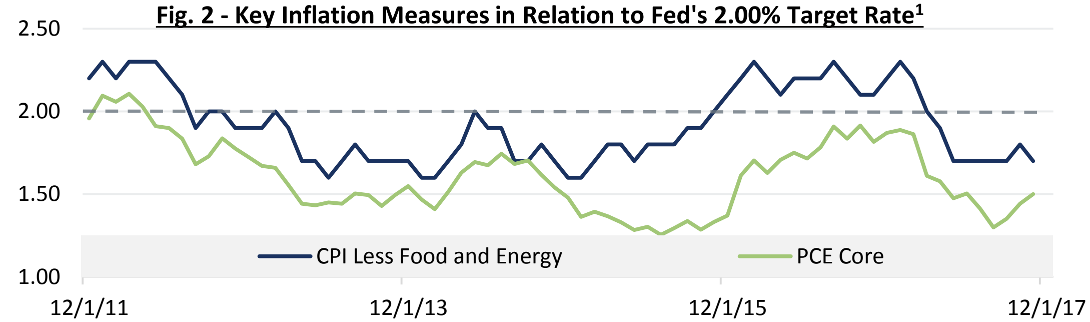
Fig 3 - BB Barclays U.S. Treasury Indices | 6/30/04 to 6/30/06[1]

	Total Return % (Period)	Annualized Return
1-3 YR	3.66	1.82
3-5 YR	3.05	1.51
5-7 YR	3.63	1.80
7-10 YR	4.78	2.36
10-20 YR	8.49	4.16
20+ YR	11.02	5.37

*** See page 2 for important disclosure information**

Supporting the case for another yield curve flattening like we experienced in '04 to '06 is a stubbornly soft inflation backdrop with price measures remaining well below expectations. A likely combination of demographics, technology, and globalization continue to reinforce the "lower for longer" thesis within intermediate and longer maturity yields. This has disrupted the Philips curve relationship between low unemployment and higher wages.

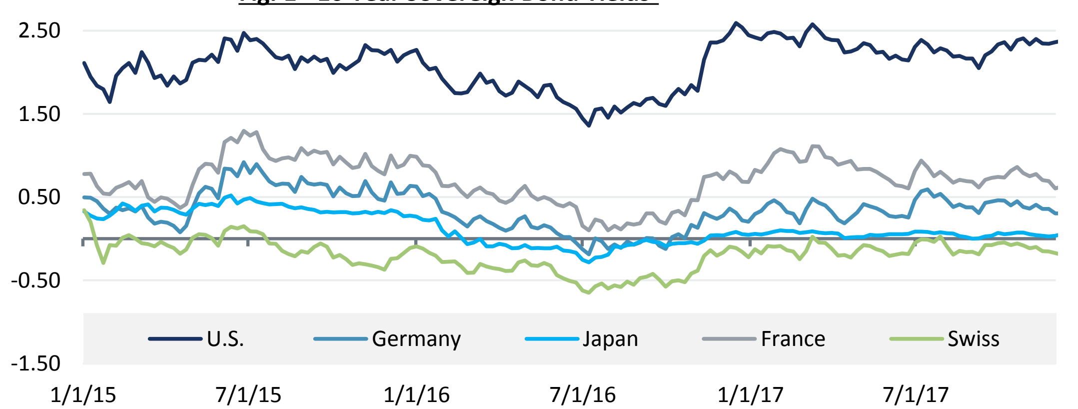
Fig. 2 - Key Inflation Measures in Relation to Fed's 2.00% Target Rate[1]



Additionally, global central banks remain exceptionally accommodative, and interest rates in countries like Germany and Japan remain near zero. This difference between rates in the U.S. and much of the developed world places significant relative value on much of the domestic bond market and further supports our current interest rate levels.

While 2018 will likely be another interesting year given the political arena and new leadership at the Federal Reserve, we do not see reason for concern across the interest rate landscape. We continue to believe Caprin's consistent investment discipline coupled with institutional level access to increasingly scarce bond inventory will again help advisors and clients navigate through this unique environment, while providing timely information and access to our dedicated team of investment professionals.

Fig. 1 - 10 Year Sovereign Bond Yields[1]



1) Source: Bloomberg, as of 12/29/17

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this piece, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion of information contained in this piece serves as the receipt of, or as a substitute for, personalized advice from Caprin Asset Management. To the extent that a reader has any questions regarding the applicability to their situation of any specific issue discussed above, they are encouraged to consult with the professional advisor of their choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.