Short Maturity Muni and Low Duration Taxable Quarterly Commentary

Fourth Quarter 2017

Macro Overview

Equity markets rode yet another strong earnings season and tax reform anticipation higher during the quarter, capping off an already solid year. Unemployment continued to decline, and labor market slack diminished further, but a lack of underlying inflation and subdued wage growth kept intermediate and longer-term yields in check. For the quarter, the US Treasury curve saw significant flattening with front-end rates rising as much as 40 basis points (driven by Fed policy) while the long bond was lower in yield by 13 basis points (lack of inflation). Jerome Powell was nominated to be the next Federal Reserve Chair, with the change largely interpreted as a continuation of dovish leaning leadership at the central bank. Powell, who became a FOMC member in 2012, has never dissented on a vote since he took office.

- The ECB modestly tightened monetary policy by reducing asset purchases but remains accommodative overall. UST yields, even at current levels, remain attractive relative to other sovereign debt.
- The FOMC continues to forecast 3 hikes in '18, with low inflation, which the committee still views as transitory, rising near their 2% target.
- Balance sheet reduction will be slow and deliberate and in the near-term will not put significant pressure on intermediate and longer yields.
- Looking ahead we see two key questions for 2018. Can tax reform help perpetuate the already mature bull market in equities, and will the Fed be able to continue down its forecasted path of deliberate rate normalization in the face of modest price pressures?

Market Dynamics

As anticipated, the Federal Reserve continued down the path of gradual rate normalization in December, raising their short-term borrowing level for the third time in 2017. The Federal Funds rate now stands at 1.25%-1.50%, and the committee reiterated their forecast for three additional 25 basis point increases in 2018 and 2019. While the new leadership at the Fed will be of interest in the New Year, we do not currently anticipate Chair Powell's stance on future monetary policy to be materiality different from his predecessor. We continue to see a supportive economic growth and employment picture allowing the committee to proceed for the time being. However, if low levels of inflation persist well into 2018, it will become increasingly difficult for the Federal Reserve to justify further tightening. The slope of the yield curve has already flattened to levels not seen in more than a decade, and while we respect the central bank's forecasted path, we will be closely watching for whether signs of anticipated price pressures can actually emerge in the coming year.

Low Duration

Composite Characteristics

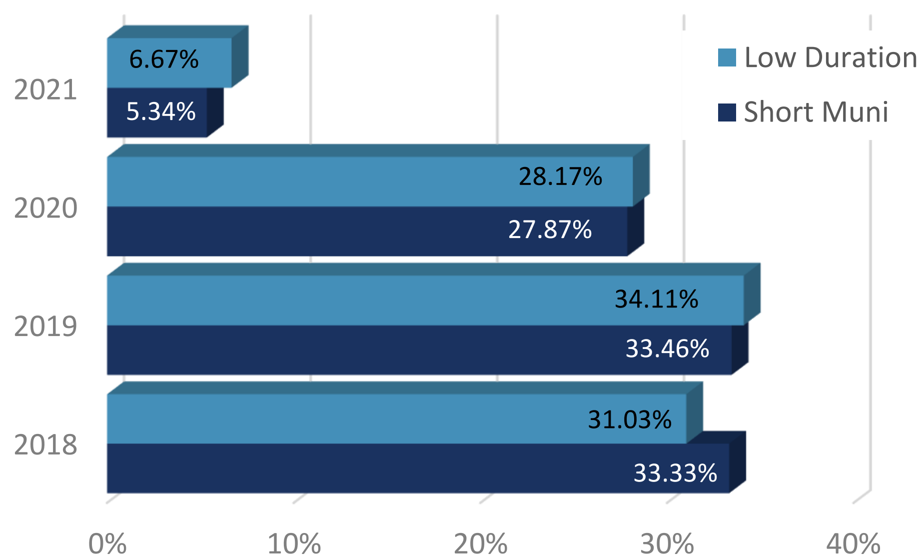
Duration: 1.51 yrs
Yield-to-Worst: 2.01%
Yield-to-Maturity: 2.01%
Maturity: 1.57 yrs

Short Muni

Composite Characteristics

Duration: 1.44 yrs
Yield-to-Worst: 1.61%
Yield-to-Maturity: 1.63%
Maturity: 1.51 yrs

Maturity Profile



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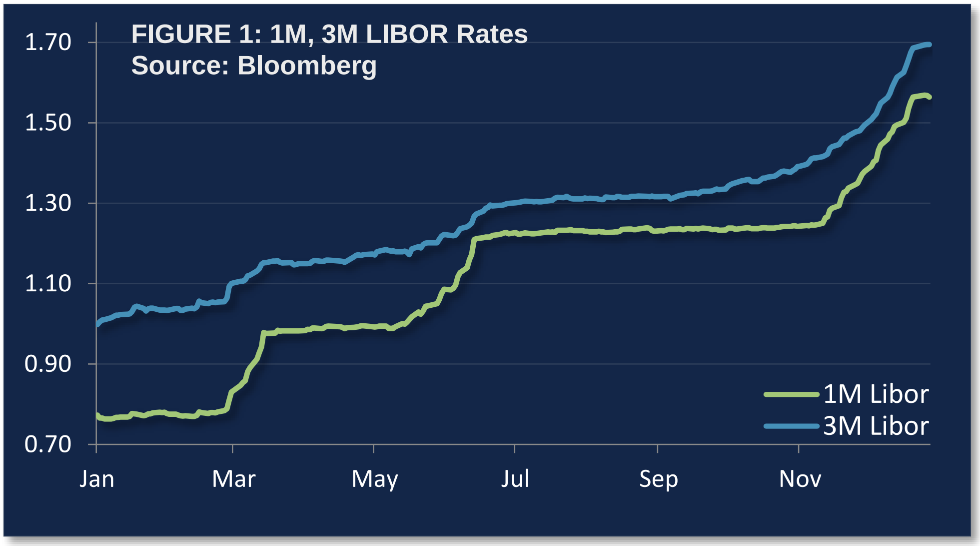
Performance Notes

Through the quarter short maturity yields rose in anticipation of further rate increases by the Federal Reserve. The 2YR US Treasury note yield started the quarter at approximately 1.5% and ended the year near 1.9%. Despite this 40 basis point move higher in rates, the low duration taxable and short maturity municipal strategies were only modestly impacted as yield income helped offset softer price movements. Looking into 2018, we see an environment where investment-grade credit in both the corporate and municipal markets should remain relatively stable, and we continue to maintain an overweight to strategic yield sectors that help produce incremental income over and above the benchmarks. Within the low duration taxable strategy we continue to favor a modestly shorter position on the curve given higher FOMC forecasted short-term rates, and we see the more laddered structure of the short maturity municipal strategy continuing to benefit from a consistent stream of cash flow.



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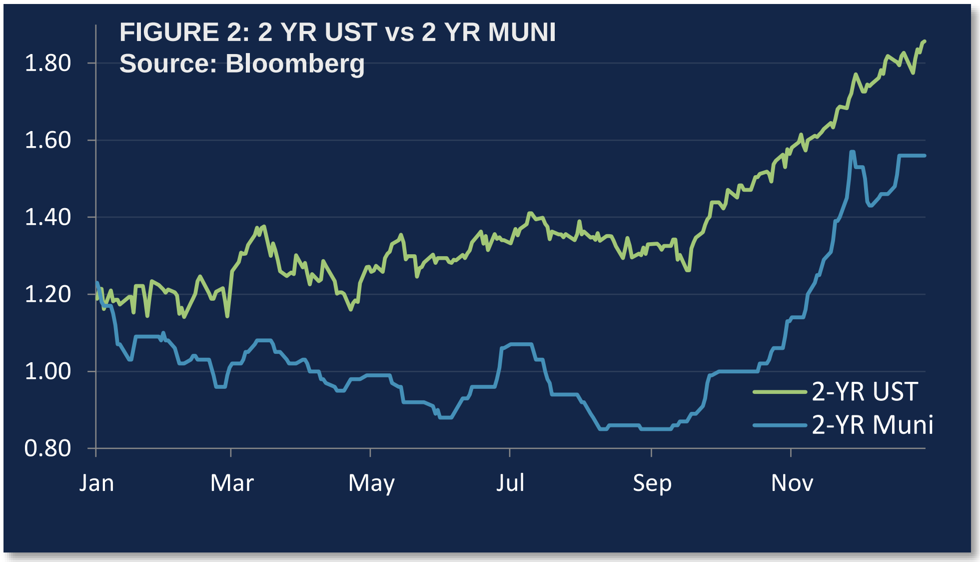

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