Intermediate Maturity Taxable

Commentary – First Quarter 2018

Macro Overview

The first quarter of 2018 began with a bond selloff finding yields on benchmark 2YR, 10YR and 30YR US Treasuries up 38, 33, and 23 basis points, respectively. The front-end move was fueled by the FOMC rate hike in March and by more interest rate increases forecast for 2019 and 2020 (up to three and two hikes, respectively). This was the first meeting with Jerome Powell as Chairman and financial markets generally believe his policy guidance will remain in-line with his predecessor. Equity volatility also roared back during Q1 after what can be described as a complacent 2017. The VIX index reached a high in February last seen during the summer 2015 flash crash fueled by Chinese growth and credit concerns. Both the DJIA and SPX finished the quarter off approximately 1–2%.

- The Fed will likely pursue two (possibly three) more interest rate increases this year. This will continue to pressure the front-end of the yield curve but a lack of inflation should help contain intermediate and longer-term interest rates.
- Increased US Treasury issuance to accommodate the Fed balance sheet unwind and address the growing deficit may pressure intermediate and longer maturities.
- Bouts of equity volatility are likely to persist as the market dodges global trade tensions and a disruptive DC landscape. Sustained volatility could trigger a broader risk-off trade and support re-allocations to fixed income.

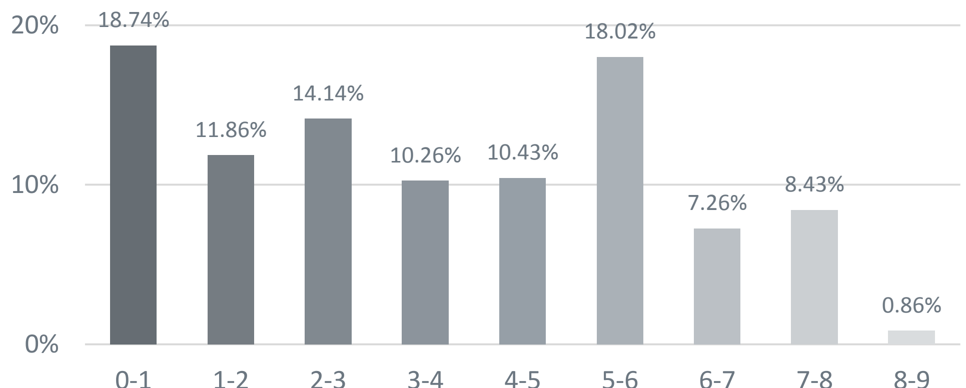
Market Dynamics

As equity markets hit new highs over the second half of ’17, corporate spreads continued their march back to pre-crisis lows. The return of volatility during the first quarter drove credit spreads wider for the first time since early ’16 but the Bloomberg Barclays US Aggregate Credit Index only retraced to last fall’s relatively tight levels. Our nearer term view still sees corporates supported by an improving global growth backdrop, healthy earnings, and a more favorable tax code. We view this recent retracement as generally healthy for the credit market but remain mindful of risk assets that have a renewed focus. Heightened global tensions regarding trade and political conflict, and a Federal Reserve trying to balance rate normalization and overly restrictive borrowing costs are at the forefront of concerns in the coming months.

Composite Characteristics

Duration: 3.71 yrs
Yield-to-Worst: 2.96 %
Yield-to-Maturity: 2.96 %
Maturity: 4.56 yrs

Duration Profile



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Performance Notes

Corporate bond holdings were a modest detractor over the quarter as spreads rose, but the incremental income produced versus US Government bonds helped buffer the overall impact. Duration and yield curve positioning was shortened modestly as the FOMC reiterated forecasts for three 25 basis point rate increases in both '18 and '19. While this may result in an even flatter yield curve and not be fully absorbed in intermediate and longer dated bonds, we view the larger reductions of the Federal Reserve balance sheet and a significant increase in deficit driven U.S. Treasury issuance as potential disruptors to the supply/demand balance. This shift, if significant enough, could see a modest drift higher in yields across the curve as we move through the year.

"Our near-to-medium term view still sees the corporate credit market generally supported by an …

improving global growth backdrop, healthy earnings, and a more advantageous tax code

… for many corporations."

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