



# INTERMEDIATE MATURITY TAXABLE



## COMMENTARY – SECOND QUARTER 2018

### MACRO OVERVIEW

Short rates continued to drift higher over the quarter as the FOMC hiked in June for the second time this year. Record low unemployment and moderately stronger inflation readings in early May pushed yields on the 10YR UST to 3.12%, a seven year high, while the 30YR UST touched 3.24%, an approximate four year high. However, a nationalist’s party election threat in Italy reminded investors of just how fragile the EU remains and a modest flight to quality ensued. Economic data in June did little to push rates out of the new lower range with intermediate yields finishing a bit more than 10 basis points higher on the quarter. Even with the second rate hike this year and a seemingly more hawkish outlook on the economy and inflation from the Fed, a flatter yield curve remains the norm for now.

- The spread between the 2YR UST and 30YR UST is currently 39bps, tightest since the summer of 2007. The front-end of the curve will continue to react to Fed policy while the long-end is currently contained by trade tensions and subdued inflation.
- The likelihood of gradual and deliberate rate normalization is apparent with the probability of a September Fed rate hike at approximately 70%, with an additional hike in December at nearly 50%.
- Increasing trade disputes could threaten global economic growth and could offset the economic gains derived from tax cuts here in the U.S.
- Low unemployment (4.00%) has yet to lead to meaningful wage pressures.

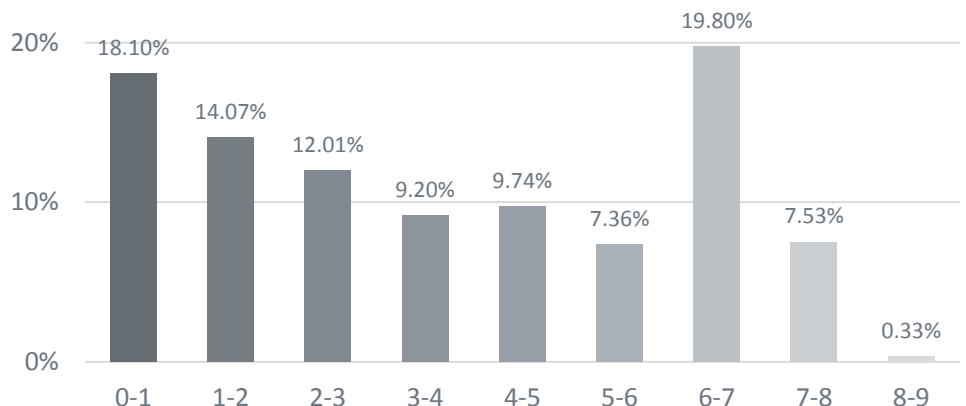
### MARKET DYNAMICS

Modestly higher interest rates, choppy equity markets, and robust corporate supply led to further widening of investment grade credit over the quarter. As mentioned in our last strategy update, the move in spreads continues to be very orderly, with the Bloomberg Barclays US Aggregate Credit Index closing the period at +116 basis points, still within 2017 ranges. From a technical standpoint corporates could still face modest spread pressure from here as higher absolute rates have shifted some of the buying away from intermediate and longer-dated risk products, and heightened corporate acquisition activity should continue to keep supply elevated. With this said, corporate credit health remains sound and has actually strengthened of late, with revenue, earnings, and gross leverage metrics all improving in 2018 (JP Morgan). We continue to view this modest retracement in spreads as healthy for the taxable markets, and one that in the near-to-medium term can offer some incremental yield and renewed value in corporate debt.

### DURATION PROFILE

#### COMPOSITE CHARACTERISTICS

Duration: 3.57 yrs  
 Yield-to-Worst: 3.13 %  
 Yield-to-Maturity: 3.14 %  
 Maturity: 4.36 yrs





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### PERFORMANCE NOTES

Although corporate spreads were wider on the quarter, the return impact was modest as the sector’s incremental yield versus US Treasury and GSE positions continued to help offset the softness. Overall performance during the period was in-line to slightly ahead of benchmark as the strategy’s adjustment to a shorter maturity and duration profile early in the year was advantageous as yields crept higher in April and May. Looking forward, our outlook for interest rates continues to call for higher front-end yields with the FOMC recently upgrading their forecasts to four 25 basis point rate increases in '18 and three in '19. Intermediate and longer maturities are unlikely to move higher in lockstep as global trade tension and still low inflation help buffer elevated supply from U.S. Treasury issuance and a shrinking Fed balance sheet.

#### 10-YR US TREASURY YIELD

SOURCE: BLOOMBERG



“We continue to view this modest widening of corporate spreads as ...

healthy for the taxable markets, and one that in the near to medium term can offer some incremental yield

... and renewed value in corporate bonds.”

#### US CREDIT INDEX

SOURCE: BLOOMBERG



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