Intermediate Maturity Taxable

Commentary – Third Quarter 2018

Macro Overview

US Treasury yields marched steadily higher over the quarter led by the front-end of the curve as the Federal Reserve implemented its third interest rate hike this year in September. The yield curve continued to bear flatten as short-term rates (1YR) were higher by 36 basis points while the long-end of the curve (30YR) was higher by 22 basis points. Risk assets performed well especially in the U.S. as both the S&P and DJIA were up approximately 7% for the period. A steady supply of strong economic releases (Q2 GDP, NFP, and wage growth) helped fuel the rally in equities, while a continued lack of long-term global inflation expectations prevented intermediate and longer-term interest rates from moving meaningfully higher. Looking ahead, we continue to see the likelihood of gradual and deliberate rate normalization as recent FOMC statements have upgraded the committee's assessment of US growth to "strong".

- Final Q2 GDP came in at 4.2%, the first time it has bested 4% since 2014. Q3 GDP expectations appear stout with Atlanta Fed GDP Now forecasting 4.1%.
- Job growth has been strong year-to-date and the third quarter was no exception with Nonfarm Payrolls averaging 190k during the quarter.
- The Fed is on track to raise rates for the 4th time this year in December (currently ~75% probability) while the most recent Fed Dot Plots suggest an additional 3 hikes in 2019.
- Markets have largely ignored the potential impacts of ongoing trade disputes which could curb growth both abroad and here in the US.

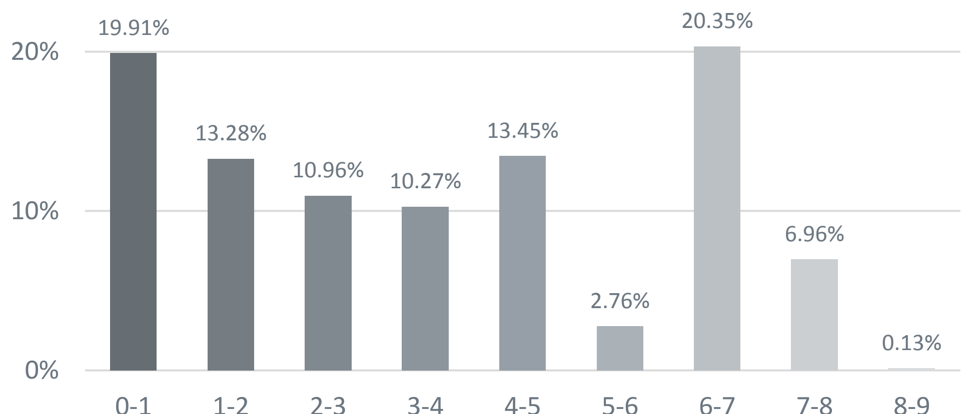
Market Dynamics

Following a moderate retracement to higher corporate credit spreads in Q2, one could have easily assumed that the late summer weakness in emerging market debt and the escalated trade tensions would have perpetuated that trend. However, domestic risk markets were reasonably quick to shrug off the negative news and return to a broad rally that actually left the Bloomberg Barclays US Aggregate Credit Index tighter by 17 basis points over the third quarter (closing at +100bps), and the S&P 500 setting a new high in late September. Looking towards Q4 and early '19 we continue to see an environment where IG credit should remain reasonably supported by better than anticipated domestic growth and continued tax reform benefits. That being said, we are cautious of the medium-to-longer term effects of Chinese tariffs if they begin to pressure corporate margins and earnings. Consumption and confidence are key domestic factors to watch for the sustainability of favorable economic prospects.

Composite Characteristics

Duration: 3.52 yrs
Yield-to-Worst: 3.24 %
Yield-to-Maturity: 3.24 %
Maturity: 4.68 yrs

Duration Profile



Intermediate Maturity Taxable

Commentary – Third Quarter 2018

Performance Notes

With US Treasury yields rising over the quarter and corporate credit spreads tightening on the heels of a firm risk market rally, the intermediate taxable strategy was well positioned. Overall performance during the period was ahead of benchmark with a shorter maturity and duration profile (early '18 adjustment) and an overweight to IG corporate debt both being additive to total return. Although cautious of potential spread widening catalysts mentioned above, our outlook does not see a significant deterioration in corporate credit health in the near-term. We continue to view our ability to select large, higher quality corporate issuers with sound balance sheets as way to buffer potential volatility and still provide incremental yield versus US Treasury and GSE backed positions.

10-YR US Treasury Yield
Source: Bloomberg

"Looking towards Q4 and early '19 we continue to see an environment where …

Investment Grade credit should remain reasonably supported

… by better than anticipated domestic growth and continued tax reform benefits."

US Credit Index
Source: Bloomberg

Contact Us

804.648.3333

WWW.CAPRINBONDS.COM

Media Contact:
aplotkin@caprinbonds.com

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.