



SHORT MATURITY MUNI AND LOW DURATION 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

Few surprises were seen over the quarter as it relates to the well-telegraphed, deliberate approach the Federal Reserve continues to take for monetary policy adjustments. Although many market participants dissected the most recent September statement for any clue that might offer an alternative path (ending sooner) to higher short-term rates, the committee pressed forward with its third 25 basis point increase of the year. At the same time, they also reaffirmed their forecasts for a fourth hike in December, and at least three additional increases in 2019. We agree there are potential large macro factors that could derail the committee’s desire to stay ahead of risk asset bubbles and slowly mounting inflationary pressures. However, the current backdrop of strong domestic growth and a historically tight labor market are more than sufficient for the Fed to carry out their plan well into 2019.

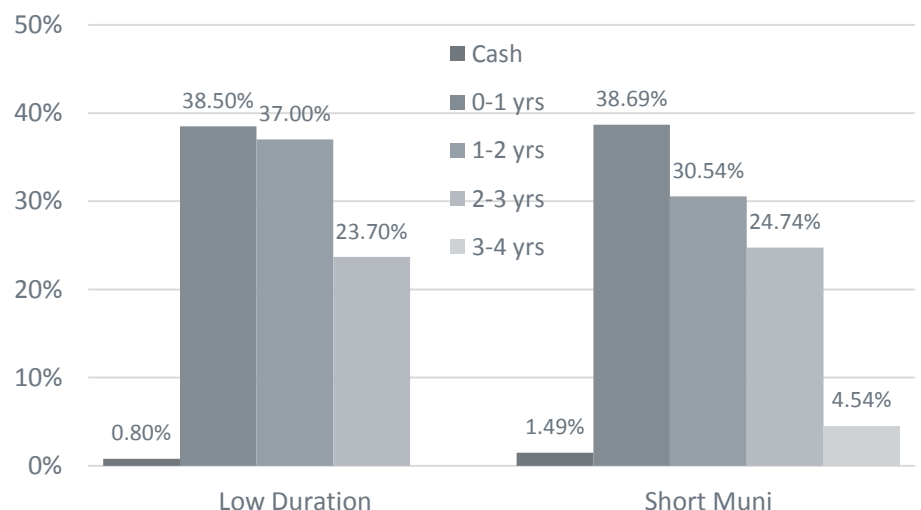
LOW DURATION

Duration: 1.25 yrs
Yield-to-Worst: 2.82 %
Yield-to-Maturity: 2.82 %
Maturity: 1.30 yrs

SHORT MUNI

Duration: 1.30 yrs
Yield-to-Worst: 2.16 %
Yield-to-Maturity: 2.17 %
Maturity: 1.37 yrs

MATURITY PROFILE





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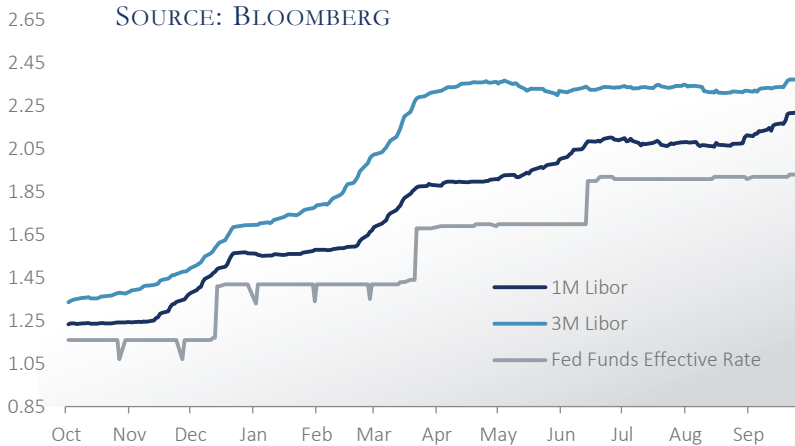
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PERFORMANCE NOTES

Yields on both short maturity US Treasuries and municipals rose steadily over the quarter as the FOMC continued to gradually lift their Federal Funds target. The 2YR US Treasury rose by 30 basis points over the period while the 2YR AAA muni benchmark was higher by 33 basis points. Despite this move in the front-end of the curve, both Caprin short maturity muni and low duration taxable strategies produced positive total returns. In low duration taxable, a shorter maturity and duration profile combined with an overweight to IG corporate debt versus the benchmark were additive to buffer price pressures while maintaining portfolio yield. Within short maturity muni the more laddered structure continues to provide a consistent stream of reinvestment cash flows, while a focus on relatively higher yielding revenue sectors helps produce incremental income.

1M, 3M LIBOR RATES

SOURCE: BLOOMBERG



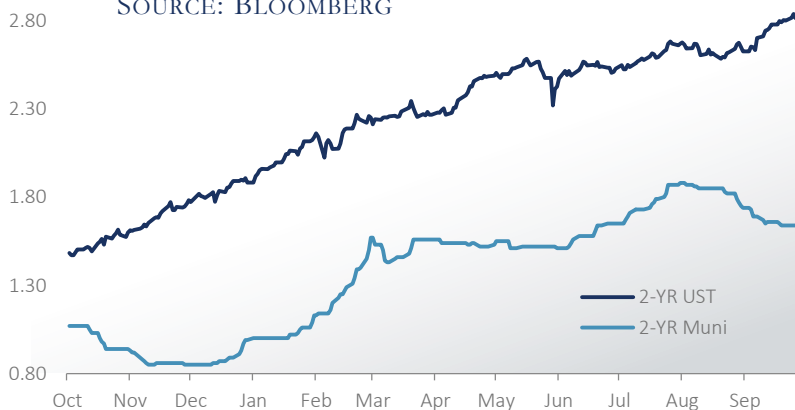
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2 YR UST vs 2 YR MUNI

SOURCE: BLOOMBERG



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