Intermediate Maturity Taxable

Commentary – Fourth Quarter 2018

Macro Overview

Volatility across risk markets in December served as the defining chapter of the quarter and the year. Equities posted their worst December since the Great Depression (1931), with the S&P falling approximately 10%, and 14% for the quarter. US Treasuries were the primary beneficiary of this rout as investors sought a safe haven. The 10yr UST rallied 55bps from 3.23% in early November to end the year at 2.68%. Despite this backdrop, the Federal Reserve increased rates by 25bps at their December meeting, the fourth rate hike of 2018. While that move was largely anticipated, markets were expecting a pause in future hikes, but the FOMC reiterated its gradual increase approach. As trade disputes and the government shutdown linger, we believe volatility will be front and center until some tensions subside.

- US growth, aided by fiscal policy, meaningfully improved in 2018 but will likely moderate in 2019 as tariffs and tighter financials conditions weigh on output. Recession does not seem likely.
- Based on Fed Funds futures, 2018 ended with no rate hikes priced in for calendar year 2019. The Fed dot plots still suggest 2 hikes for the year.
- Further curve flattening and inversion possible with front-end rates higher via Fed policy and intermediate to longer-term yields anchored by risk market volatility and trade concerns.

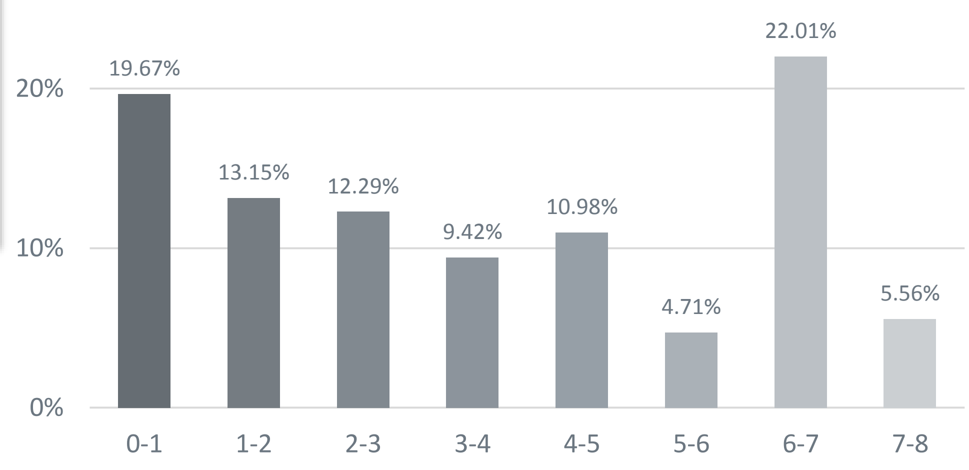
Market Dynamics

The quick shift in risk sentiment in Q4 lead corporate spreads higher as domestic equities briefly hit bear market territory. The Bloomberg Barclays US Aggregate Credit Index widened by 43bps over the period to close at +143bps, still well below 2016's level of +200bps when Chinese banking concerns dominated the credit markets. There was no single recent event or fear to point to but rather a broader concern that central banks may remove accommodation at the same time global growth decelerates. While we agree this is worthy of attention, we continue to see a domestic corporate landscape with many strong balance sheets, stable revenue streams, and sound credit fundamentals. In the near-term, we will be watching how new issues are placed and whether outflows from credit based mutual funds begin to taper as markets settle themselves.

Composite Characteristics

Duration: 3.49 yrs
Yield-to-Worst: 3.19 %
Yield-to-Maturity: 3.19 %
Maturity: 4.66 yrs

Duration Profile



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Performance Notes

As credit spreads moved measurably higher over the quarter, the strategy's overweight to investment grade corporate debt was a modest detractor to overall total return. However, Caprin's consistent approach to selecting higher quality corporate issuers with sound balance sheets helped buffer volatility versus higher beta credits and contributed to strong December returns to finish the year. Despite the late year volatility, our outlook does not call for a significant deterioration in high grade corporate credit health in the near-term. Economic growth may decelerate to some degree in 2019, but we do not see an imminent threat of recession. We will continue to pay close attention to the ongoing trade negotiations, Q1 earnings, and FOMC communications to help frame the cross-currents in the market as we enter the New Year.

10-YR US Treasury Yield
Source: Bloomberg

"Despite the volatility seen in risk and spread-based markets late in 2018, …

our outlook does not call for a significant deterioration

… in high grade corporate credit health in the near-term."

US Credit Index
Source: Bloomberg

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