Short Maturity Muni and Low Duration 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

As market participants grappled with issues to close out the year, the Federal Reserve's expected rate path was at or near the top of the list. Coming into November, the market was still generally expecting one or two rate hikes for 2019, and Fed Funds futures priced roughly a 60% chance for a March increase. By the end of 2018, that probability had dropped to below 5% as the market shifted expectations in spite of FOMC views of a job market and economy on sound footings. Growth may indeed slow somewhat in 2019, but for now the FOMC still expects gradual rate increases over the next 12 to 24 months. Our outlook remains somewhat cautious given the Fed's messaging but does incorporate a more limited upside in yields should volatility and a cooling of economic indicators become the mantra for 2019.

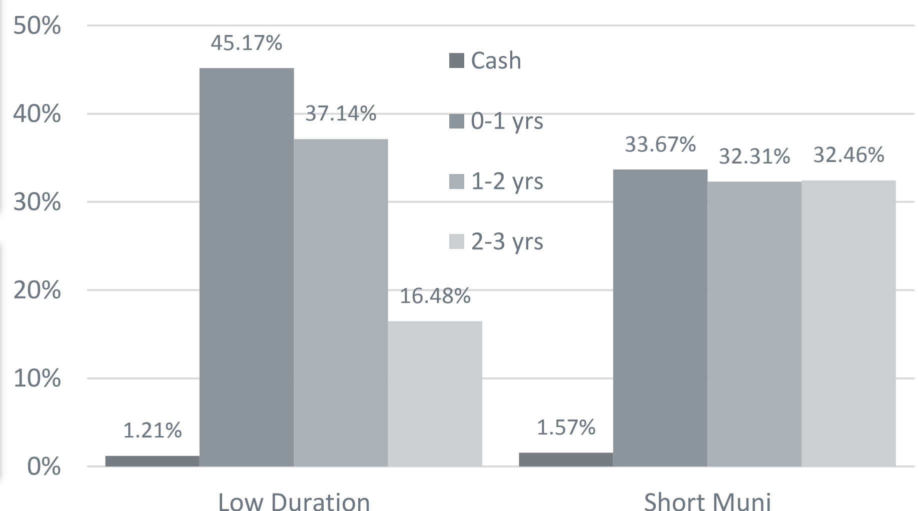
Low Duration

Duration: 1.08 yrs
Yield-to-Worst: 2.86 %
Yield-to-Maturity: 2.86 %
Maturity: 1.12 yrs

Short Muni

Duration: 1.37 yrs
Yield-to-Worst: 1.93 %
Yield-to-Maturity: 1.94 %
Maturity: 1.45 yrs

Maturity Profile



Short Maturity Muni and Low Duration Taxable

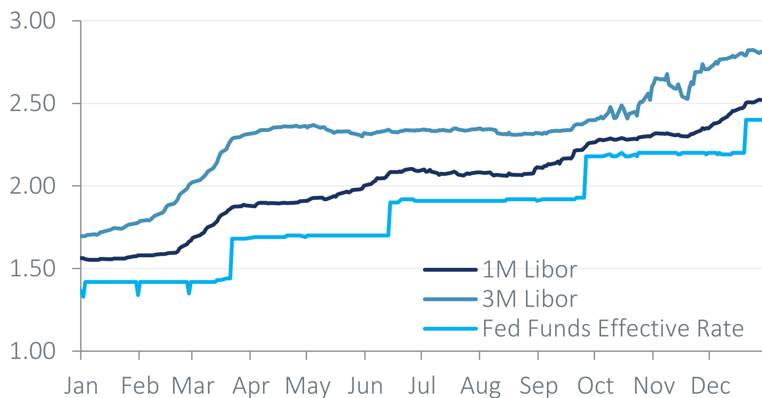
Commentary – Fourth Quarter 2018

Performance Notes

For the first time since Q2 2016, the 2yr US Treasury yield declined over a quarter, ending Q4 2018 lower by 33bps. Short-term municipal yields also fell along with their taxable counterparts, albeit to lesser extent, with the 2yr AAA muni benchmark lower by 19bps. In low duration taxable, a shorter maturity profile combined with the overweight to investment grade corporates detracted from performance, but the strategy produced stable positive returns and ended with full-year performance at or slightly better than benchmark. Within short maturity muni, the more laddered structure continued to provide a consistent stream of reinvestment cash flows, while a focus on relatively higher yielding revenue sectors helped produce incremental income that resulted in solidly positive total returns for the year.

1M, 3M LIBOR Rates

Source: Bloomberg



"Our outlook on short rates remains somewhat cautious given the Fed's messaging but does incorporate the …

the likelihood of a more limited upside in yield

… should volatility and a cooling of economic indicators become the mantra for 2019. ."

2 YR UST vs 2 YR MUNI

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.