Short Maturity Muni and Low Duration Taxable

Commentary – First Quarter 2019

Macro Overview

Following a tumultuous end to 2018, U.S. equities rebounded in Q1 2019 on more resilient domestic economic activity. Globally however, growth slowed more meaningfully, especially in China and the Eurozone where lingering trade disputes and political uncertainty (Brexit) have exacerbated already weaker economic environments. Bond market performance was strong during the quarter as rates rallied across the curve. Yields on benchmark USTs were down 22bps, 28bps and 20bps in the 2yr, 10yr, and 30yr portions of the curve, respectively. The primary driver of lower yields was a stark reversal of policy expectations from the Federal Reserve. Entering the year the Fed was still signaling two interest rate hikes in 2019, however, following its March meeting, expectations were revised substantially lower, and language within the FOMC minutes now depicts a more dovish outlook for the U.S. economy.

- Our current economic outlook for the U.S. supports moderating performance for 2019. GDP estimates hover right above 2.0%, lower than 2018's 2.9% but certainly not recessionary.
- The bond market, as evidenced by the UST Forwards Curve, has also dovishly tilted its outlook. Forwards are now pricing an interest rate cut in late 2019.
- The spread between the 3 month T-Bill and 10yr Treasury turned slightly negative in late March and was arguably the most significant inversion so far in this cycle. This was short-lived and we believe calls for a recession based on this relationship have been pre-mature.
- Little tangible evidence of a genuine trade deal with China has emerged. However, should a deal be struck, it would likely help alleviate some near-term concerns regarding the health of the global economy.

Market Dynamics

Although market expectations for further Federal Reserve rate hikes had already fallen, it was not until the FOMC met in March that participants truly appreciated the about face in the committee's assessment. Chairman Powell cited a strong job market and respectable, albeit moderating, US growth. But the committee determined that persistently low inflation and recent risk market volatility called for no further rate increases in 2019. The FOMC continued to emphasize their assessment could change if data shows improvement in subsequent months, but the market only heard that a recession was now in play and rate cuts could be the next move. Our outlook does not call for either in the near-term, but we view the most recent communiqué as capping shorter maturity yields and supportive of our current extension positioning in these strategies.

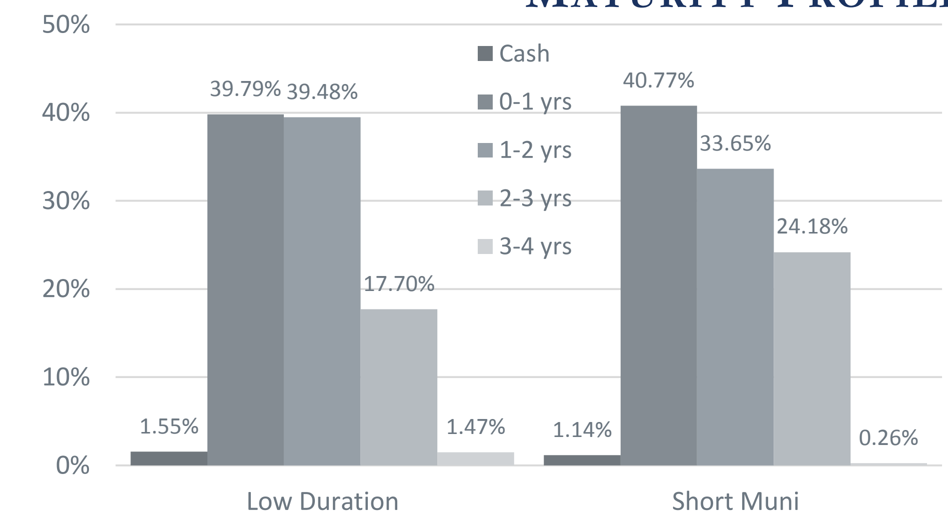
Low Duration

Duration: 1.23 yrs
Yield-to-Worst: 2.70 %
Yield-to-Maturity: 2.70 %
Maturity: 1.29 yrs

Short Muni

Duration: 1.32 yrs
Yield-to-Worst: 1.60 %
Yield-to-Maturity: 1.61 %
Maturity: 1.40 yrs

Maturity Profile



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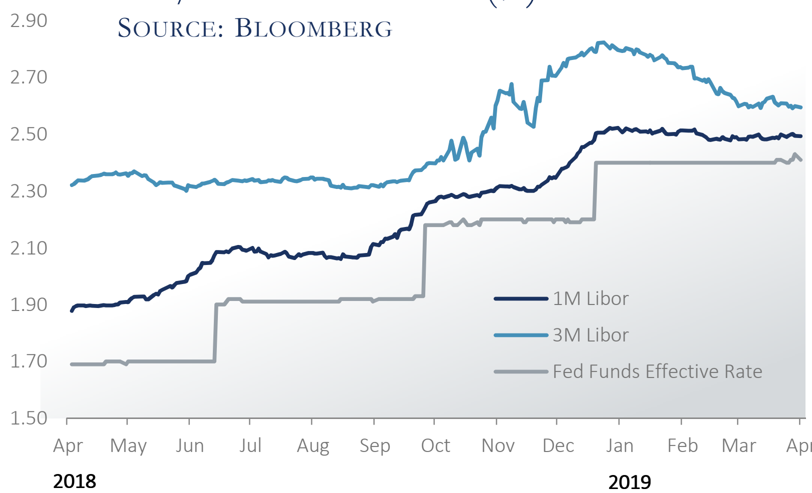
Performance Notes

Over the quarter both short taxable and tax-exempt yields continued their descent lower. The 2yr UST declined by 22bps after falling 33bps in Q4 2018, and the 2yr AAA Municipal benchmark was lower by 29bps after sliding 19bps the previous quarter. The overweight to investment grade corporates in low duration taxable, which had detracted from performance during year-end volatility, produced outperformance versus the benchmark as risk markets swiftly improved in 2019. While we remain cautious of further volatility, we still see a generally healthy investment grade corporate landscape. The maturity structure within short maturity muni continued to provide a consistent stream of reinvestment cash flows, and the focus on relatively higher yielding revenue sectors helped produce incremental income that resulted in outperformance to begin the year.

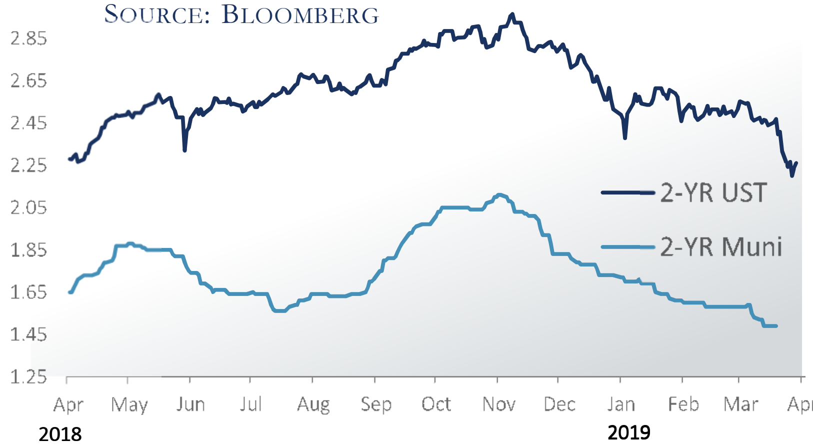
1M / 3M LIBOR Rates (%)

Source: Bloomberg



2 YR UST vs 2 YR Muni Yields (%)

Source: Bloomberg



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