Intermediate Maturity Taxable

Commentary – Second Quarter 2019

Macro Overview

The U.S. economy proved resilient in the face of slowing global growth during Q1, however, Q2 was a different story as more mixed economic data began to emerge. Employment remained respectable during the quarter, but leading indicators like ISM slowed on trade war uncertainty. Inflation continued its descent as Core PCE (the Fed's preferred inflation indicator) dropped to 1.6% after beginning the year at 1.95%. The drop in inflation expectations and a dovish FOMC were the primary catalysts for lower rates during the period. Yields on the front-end dropped as much as 50bps, while the intermediate and longer portions of the curve were lower by 40bps and 30bps, respectively. The rapid decline in rates over the quarter signaled market expectations for future rate cuts. It now appears that the Fed may succumb to the pressure, though perhaps not to the degree the market would prefer.

- The Fed removed "Patient" from its most recent statement, and the FOMC now seems primed to cut rates at an upcoming meeting. Current market probabilities for a cut in July '19 are at nearly 100%.
- FOMC remains constructive on the US job market and overall growth but acknowledged that business fixed investment has moderated. Still sees GDP growth in '19 at approximately 2.0%.
- Trade and geopolitical tensions will likely drive intermediate and longer-dated bond yields heading into Q3. Fed uncertainty seems to be less of a factor for the time being.

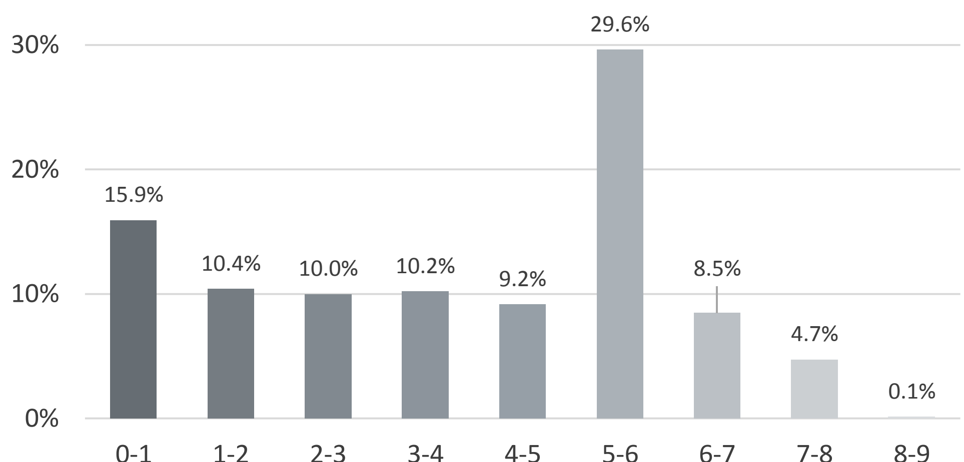
Market Dynamics

Despite rising tensions on the trade front and in the Middle East, credit spreads here at home were reasonably stable over the course of the quarter. In fact, the Bloomberg Barclays US Aggregate Credit Index managed to close out the period a few basis points tighter compared to Q1 (+107bps on 6/30 vs. +113bps on 3/29). Helping to keep corporate debt in favor was a constructive risk environment with equity indices reaching all-time highs. The Federal Reserve reassured markets that it was ready and willing to help keep the expansion alive by lowering interest rates as soon as July. With a more dovish tone from the FOMC, we believe that while bouts of volatility will likely remain, investment grade credit will generally benefit in the near to medium-term from lower rates and yield seeking investor behavior.

Composite Characteristics

Duration: 3.87 yrs
Yield-to-Worst: 2.38 %
Yield-to-Maturity: 2.39 %
Maturity: 5.54 yrs

Duration Profile



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Performance Notes

Performance for the quarter was generally in-line with the benchmark as late period outperformance from the strategy's overweight to corporate credit helped offset a slight drag in May when tariff and Fed fears were at their peak. On a year-to-date basis, the strategy's consistent selection of larger, liquid, and well-capitalized issuers has provided incremental yield and total return versus the benchmark and continues to position portfolios to weather the more volatile late cycle period that we seem to have entered. Our outlook still does not see a significant deterioration in high grade corporate credit health in the near-term, and we believe our issuer selection disciplines will continue to contribute incremental yield to the strategy.

10-YR US Treasury Yield (%)

Source: Bloomberg

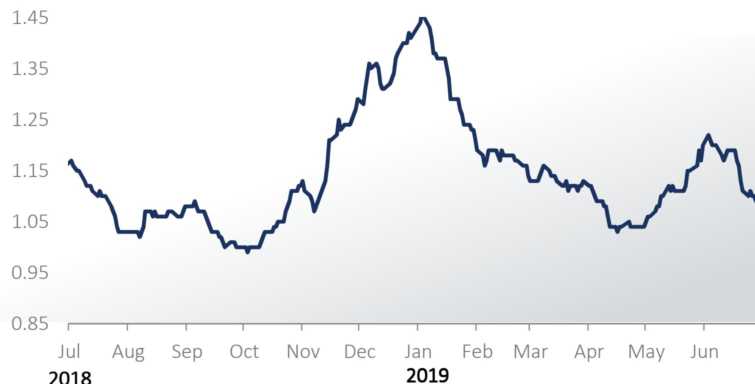
"On a year-to-date basis the strategy's consistent selection of well capitalized issuers

has provided incremental yield and return

and continues to position portfolios for a more volatile late cycle market."

US Credit Index – Spread (%)

Source: Bloomberg



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