Short Maturity Muni and Low Duration Taxable

Commentary – Third Quarter 2019

Macro Overview

The notable decline in interest rates during the second quarter, driven primarily by market anticipation of Federal Reserve rate cuts, extended into Q3. The FOMC followed through over the period (July & September) with two 25bps cuts primarily implemented to offset downside risks from ongoing trade disputes, with weaker global growth and stubbornly low inflation already weighing on their minds. Treasury yields plunged in August with the 10-yr yield touching 1.47% while the 30-yr hit an all-time low of 1.95%; trading below 2% for the first time ever. Interest rates did push higher in the first part of September amid rumors that positive developments were being made ahead of October U.S.-China trade talks. However, the longer-term trend of lower yields quickly reemerged with heightened political discord surrounding the current impeachment inquiry.

- FOMC statement continued to show optimism around the job market and overall growth, however the decision to cut rates was based on "implications of global developments for the economic outlook as well as muted inflation pressure"
- Median Fed Dot forecasts suggest no further action by the Fed, however the dispersion of dots indicates there could be more cuts coming in Q4. Fed Fund futures call for two additional cuts (October & December)
- Significant uncertainty surrounds the rare impeachment inquiry as it is likely to impact everything from trade talks to global financial markets to polling for the 2020 elections

Market Dynamics

The two 25bps rate cuts delivered by the FOMC over the quarter had already been priced into the market during the quick slide in short-term yields to end Q2. More important to front-end investors was how the FOMC would communicate their plan for any further action. As it stands now, the committee remains comfortable with the growth and employment outlook for the U.S. but will certainly be influenced by the future state of trade negotiations, impeachment proceedings, and, most importantly, risk-market sentiment. Our current outlook sees the Fed possibly lowering rates again by year-end and then pausing to digest whether further action is warranted. Regardless, a cautious Fed will continue to keep short maturity yields suppressed in the near- to medium-term and further support the measured extension of portfolio holdings.

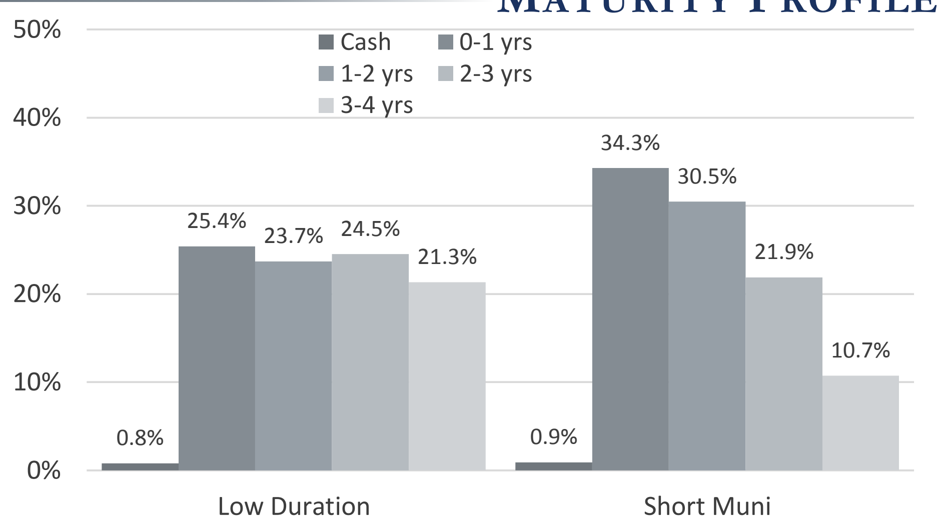
Low Duration

Duration: 1.87 yrs
Yield-to-Worst: 1.92 %
Yield-to-Maturity: 1.93 %
Maturity: 1.99 yrs

Short Muni

Duration: 1.45 yrs
Yield-to-Worst: 1.41 %
Yield-to-Maturity: 1.43 %
Maturity: 1.54 yrs

Maturity Profile



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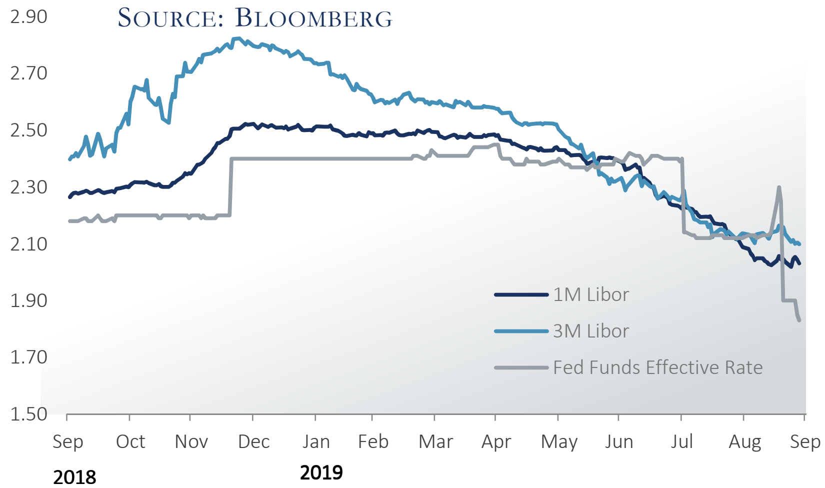
Performance Notes

Both the short maturity municipal and low duration taxable strategies saw better than benchmark performance for the quarter and have produced positive total returns for the year in excess of 2.0% and 3.5%, respectively. Short maturity municipal continues to target reinvestment in the 3-4 year range where Muni-to-UST ratios are more attractive. Additionally, we continue to find incremental yield opportunities within our preferred municipal revenue sectors. Within the low duration taxable strategy, the overweight to investment-grade corporate debt was again additive by providing incremental yield for the portfolios against a backdrop of stable spread levels. Deliberate maturity extensions through the quarter have helped generate positive price returns as short rates have steadily declined over the year.

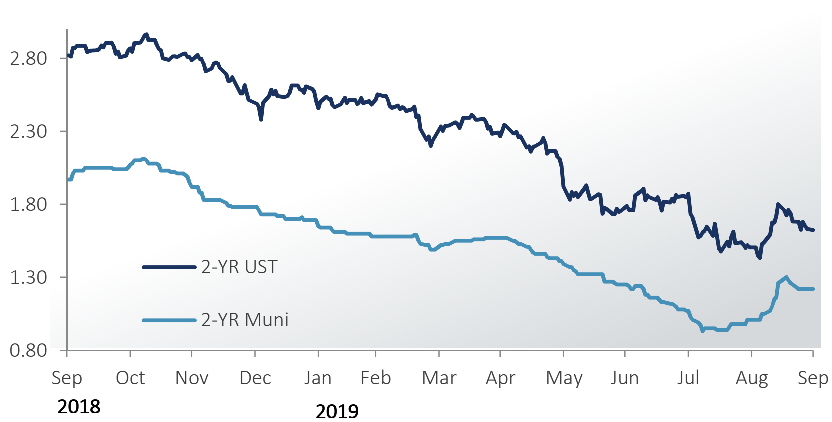
1M / 3M LIBOR Rates (%)

Source: Bloomberg



2 YR UST vs 2 YR Muni Yields (%)

Source: Bloomberg



"The Federal Reserve implemented the much anticipated redirect of it's 2016-2018 higher rate policy

and began lowering rates this quarter

in an attempt to sustain the current expansion."

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