Short Maturity Muni and Low Duration Taxable

Commentary – Fourth Quarter 2019

Macro Overview

2019 wrapped up with renewed optimism for a possible phase one trade deal between China and the United States. This, in part, helped U.S. equities stage an impressive Q4 rally, bringing returns for the full year above 30% (S&P 500). The Federal Reserve continued easing during the quarter, cutting overnight interest rates an additional 25bps at their October meeting. In total, the Fed cut rates 3 times (75bps cumulative) during the year, a stark reversal from their policy stance heading into 2019. Bond yields ended Q4 marginally higher; however, for the calendar year rates were lower by approximately 90bps on the front-end of the curve and nearly 80bps out 10 years. Looking ahead, the Fed appears to be on hold while the U.S. economy remains on stable footing, but global economic weakness persists.

- Recent geopolitical risks in the Middle East and any renewed political posturing ahead of signing a trade deal are the most likely catalysts for market volatility heading into Q1 ‘20.
- Markets have largely dismissed the House’s decision to impeach the President, labeling it political gamesmanship. Popular narrative suggests there are not enough votes in the Senate to convict President Trump.
- The Fed remains constructive on U.S. job market and overall growth; their most recent forecast sees GDP up 2% in ’20. Fed Funds forecasts suggest the Fed will be on hold in ’20 with a single hike taking place in ’21.

Market Dynamics

With the Federal Reserve concluding what they described as mid-cycle “insurance” rate cuts, front-end market participants had one less variable to contend with to close out the quarter. In fact, short-term interest rates have since traded in a tight (~ 10bps) range as the market now sees no further action from the central bank through 2020. In fact, the market is pricing in less than a 20% chance that the committee moves off the current range of 1.50-1.75% over the next 12+ months. While our current outlook does not expect any near-term moves by the Fed, the bias would likely be toward lower rates given the potential risks facing the market. This stable to lower interest rate environment continues to support the strategies’ neutral-to-slightly long maturity positioning targets.

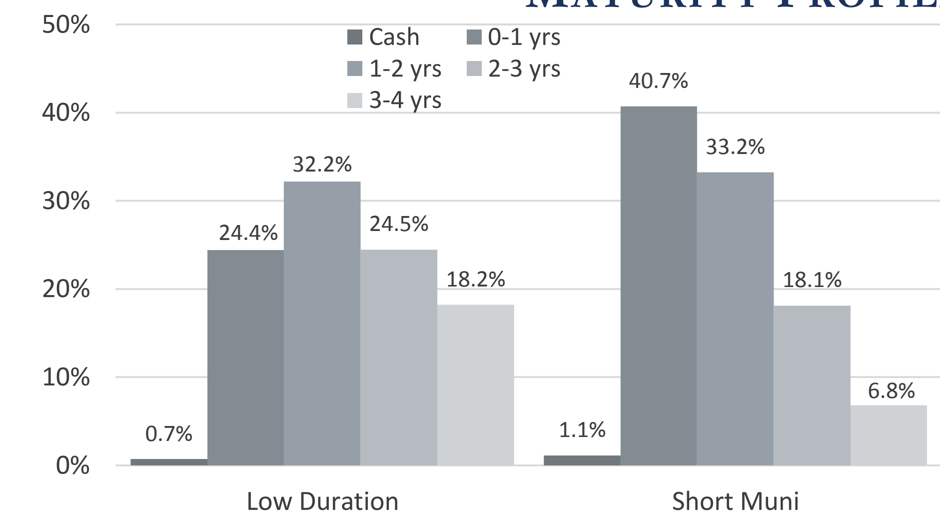
Low Duration

Duration: 1.87 yrs
Yield-to-Worst: 1.77 %
Yield-to-Maturity: 1.80 %
Maturity: 1.99 yrs

Short Muni

Duration: 1.37 yrs
Yield-to-Worst: 1.14 %
Yield-to-Maturity: 1.17 %
Maturity: 1.48 yrs

Maturity Profile



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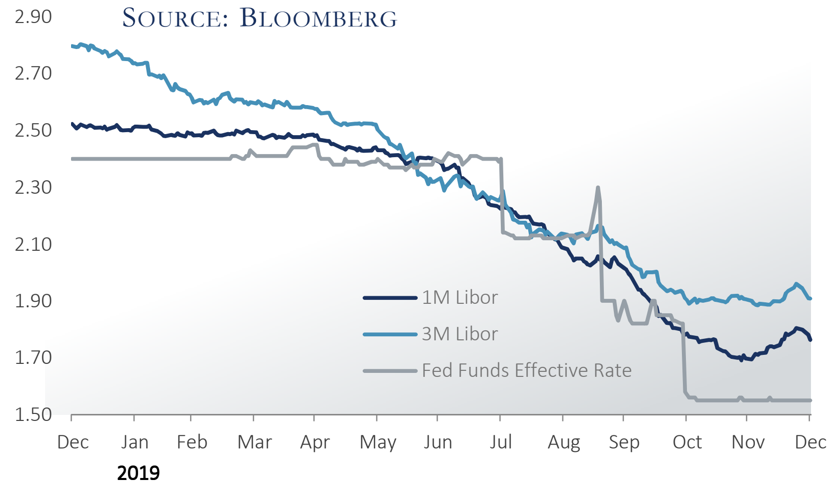
Performance Notes

For the quarter, the short maturity municipal strategy produced total returns slightly behind the benchmark as scarce front-end supply and strong demand limited opportunities to add yield. The low duration taxable strategy outperformed the benchmark over the period, benefiting from the strong year-end rally in risk assets that saw corporate spreads tighten further. For the year, the composites for both strategies saw better than benchmark performance. Short maturity municipal continues to target reinvestment in the 3-4 year range where Muni-to-UST ratios are more attractive. Within the low duration taxable strategy, deliberate maturity extensions throughout the year have helped generate positive price returns as short rates have steadily declined.

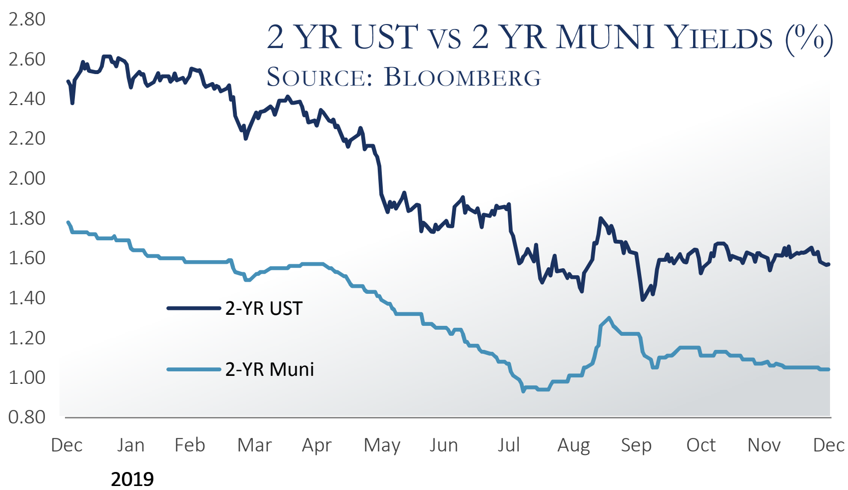
1M / 3M LIBOR Rates (%)

Source: Bloomberg



2 YR UST vs 2 YR MUNI Yields (%)

Source: Bloomberg



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