Taplin, Canida & Habacht

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Fixed income market update

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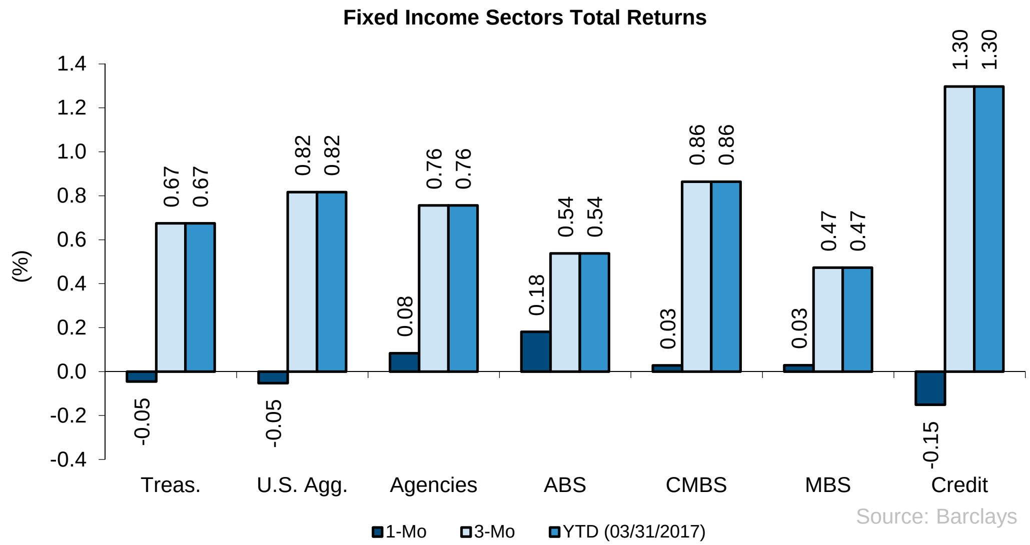
Fixed income market update

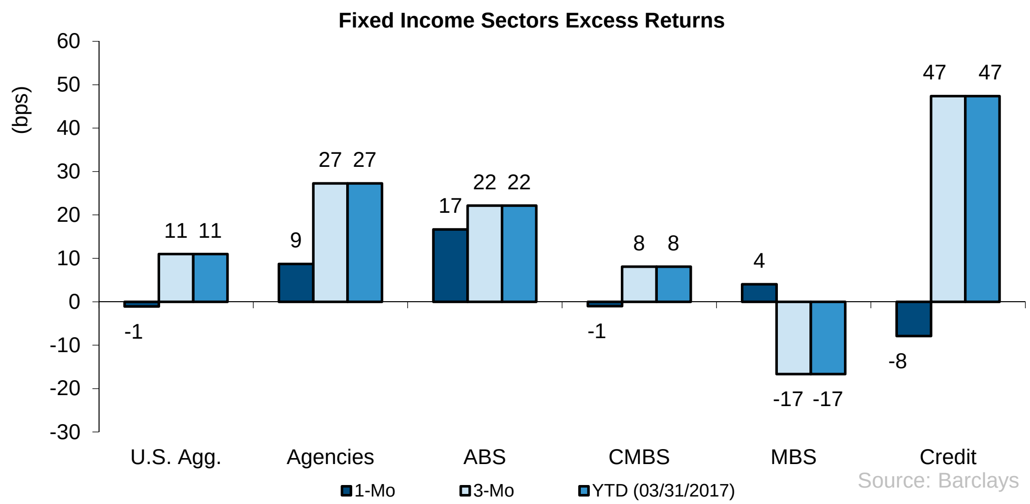
- For the quarter ended March 31, 2017, the Bloomberg Barclays U.S. Aggregate Bond Index returned 0.82%.

- U.S. Treasuries returned 0.67% during the quarter as the yield on the 10-year U.S. Treasury declined to 2.39% from 2.44% at the end of December. For the quarter, long Treasuries (+1.40%) outperformed intermediate Treasuries (+0.54%).

- Mortgage-backed securities (MBS) returned 0.47% during the quarter, underperforming duration-matched Treasuries by 17 basis points. The option adjusted spread (OAS) of the Bloomberg Barclays U.S. Mortgage Index widened 12 basis points to end the quarter at 27 basis points.



Source: Barclays



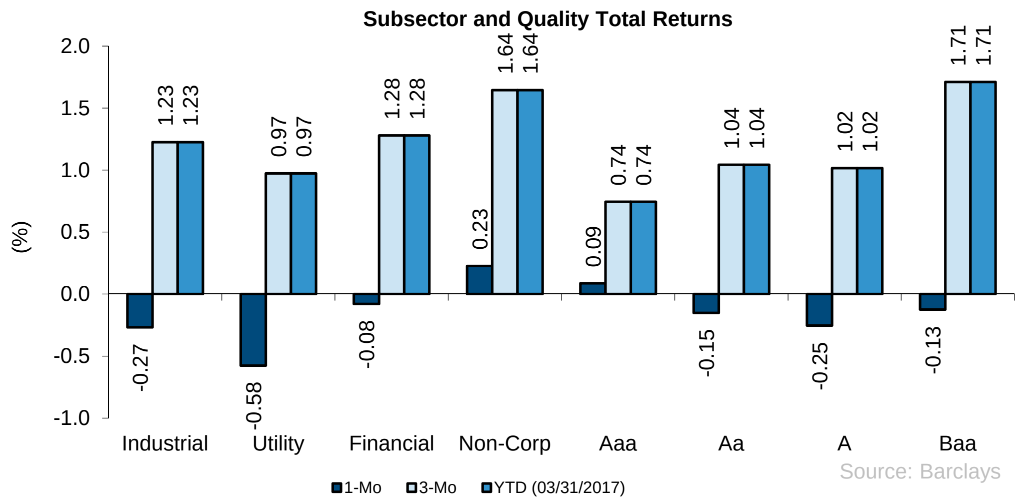
Source: Barclays

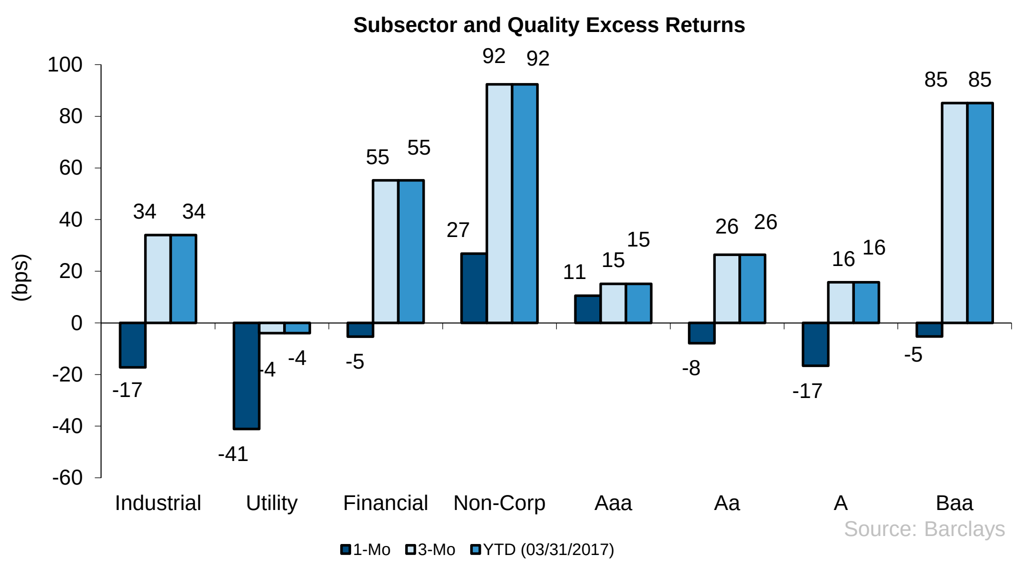
Fixed income market update (continued)

- Credit securities returned 1.30% for the quarter, outperforming Treasuries by 47 basis points on a duration-adjusted basis. The OAS of the Bloomberg Barclays U.S. Credit Index ended the period at 112 bps, 6 basis points tighter than at the end of December. For the quarter, long credit (+1.66%) underperformed intermediate credit (+1.14%) by 22 basis points on a duration-adjusted basis.

- For the quarter, on a duration-adjusted basis, non-corporates delivered 92 basis points of excess returns, outperforming financials, industrials, and utilities by 37, 58 and 96 basis points, respectively.

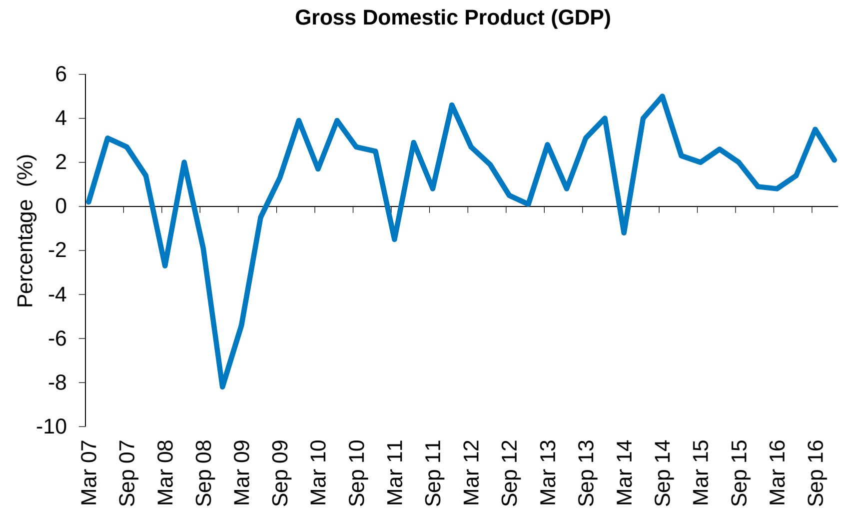
- BBB rated securities delivered 85 basis points of excess return for the quarter, outperforming AAA, AA and A rated securities by 70, 59 and 69 basis points of excess return, respectively. High yield delivered 214 basis points of excess return for the quarter.



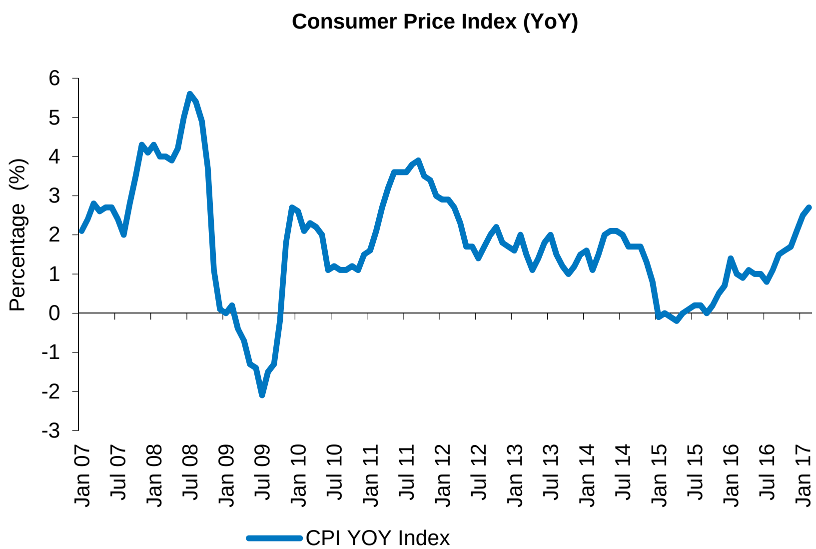


Economic update

U.S. gross domestic product (GDP) grew at a 2.1% annualized rate for the fourth quarter, a 0.2% increase from the prior estimate. Consumer spending grew 3.5%, revised higher from 3.0%, but was partially offset by higher net imports and decreased business investment. The Atlanta Fed's GDPNow forecasts 0.9% growth for the first quarter, a significant decrease from the 2.5% forecasted at the end of February.



Source: Bureau of Economic Analysis

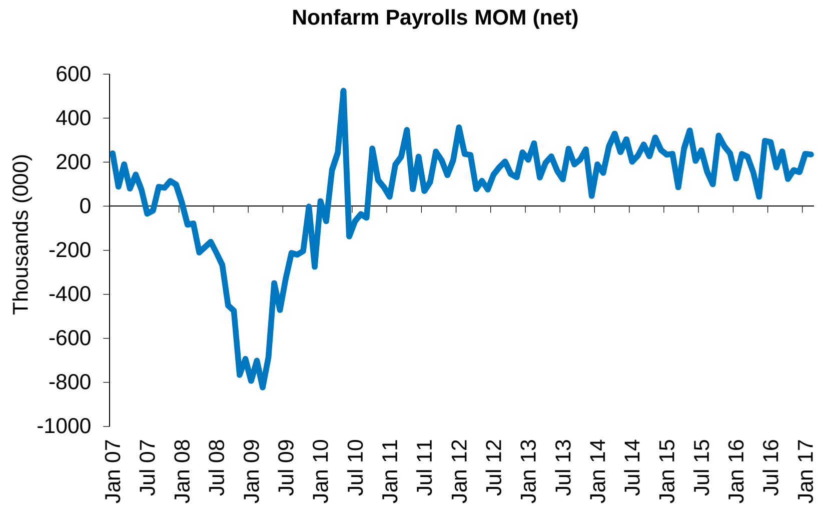


Source: Bureau of Labor Statistics

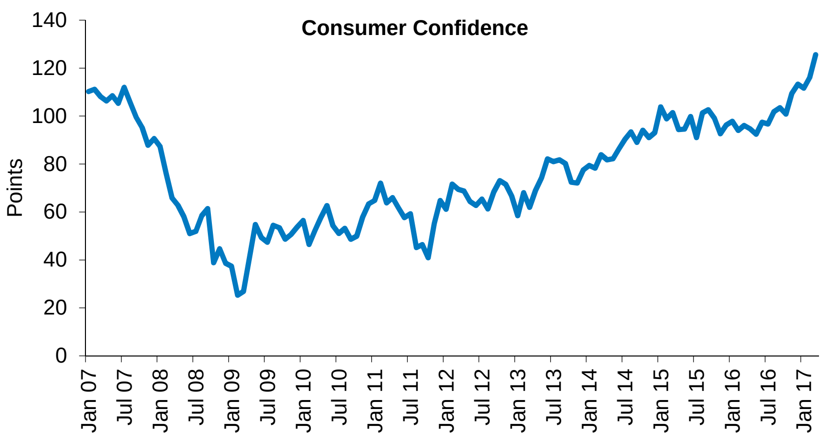
Consumer Price Index (CPI), rose 0.1% in February and 2.7% for the trailing year, the highest level in five years. Core CPI rose 0.2% for February and 2.2% for the trailing twelve months, the sixteenth consecutive month above 2%. The Producer Price Index (PPI) continued its recent uptick, rising 0.3% in February after rising 0.6% in January, which was the largest increase since 2012. PPI rose 2.2% for the trailing year, exceeding the estimate of 1.9%.

Economic update (continued)

Nonfarm payrolls increased by 235,000 in February, ahead of the consensus estimate of 200,000. Construction jobs increased by 58,000, the largest increase for that segment in nearly ten years, while manufacturing jobs rose and retail jobs fell by their largest respective amounts in approximately four years. In line with expectations, the unemployment rate declined 0.1% to 4.7%. Work force participation rose 0.1% to 63.0%. Average hourly earnings rose by 0.2% for February and year over year wage growth increased to 2.8% from 2.6% in January.



Source: Bureau of Labor Statistics



Source: Conference Board

The Conference Board's Consumer Confidence Index level rose to 125.6 in March, the highest level since 2000, up from 116.1 in February. Confidence in the labor market rose as well with nearly 25% of respondents expecting an increase in jobs, while those expecting a decrease fell to approximately 12%. Supporting that sentiment, a Labor Department report for the week ending March 25 showed initial jobless claims remaining below 300,000 for the 108th consecutive week, the longest streak since 1970.

Economic and market perspective

- The bill to repeal and replace Obamacare was pulled from the House floor on March 24th when it became clear it would not pass due to dissent within the Republican party. As the first major legislative initiative for Republicans since their sweeping victory in last year's elections, its failure called into question the ability to pass other significant legislation. While health care reform did not secure sufficient votes, other agenda points such as personal and corporate tax reform are likely to draw greater party-line support and a fiscal stimulus package could potentially appeal to Democrats as well.

- Effective March 29, United Kingdom Prime Minister Theresa May officially triggered Article 50 of the Lisbon Treaty. This action began the formal two year negotiation process for the U.K. to leave the European Union, almost nine months after the "Brexit" vote at the end of June 2016. The U.K. is the first member of the union to depart. The E.U. is balancing the desire for a productive trade agreement with the world's sixth largest economy with the goal of disincentivizing other member nations from departing the union. Part of a recent broader global trend, in February, inflation in the U.K. rose 2.3% for the trailing twelve months. The increase was the highest level since 2013 and core inflation hit 2.0% for the first time since 2014. The Bank of England's target for inflation is 2.0%.

- Dutch elections were closely watched for signs of populism's strength in Europe. Instead of continuing the wave of global populism, incumbent Prime Minister Mark Rutte's Party for Freedom and Democracy defeated Geert Wilders' Freedom Party, winning 33 seats to 20. Wilders was unlikely to be able to form a government even had he won more seats than Rutte, but the defeat was more pronounced than most had expected.

- North Korea test fired multiple missiles into the Sea of Japan in the beginning of March. Three of the missiles landed in Japan's exclusive economic zone, prompting Japan to move to its highest military alert. Prime Minister Shinzo Abe said that the missile launches "demonstrate evidence of a new threat from North Korea."

Outlook and conclusions

- The Fed raised the Federal Funds rate range by 25 basis points at their March 14-15 meeting to a range of 0.75% to 1.00%. The move came as no surprise with Fed Funds Futures pricing in above a 90% likelihood of a rate hike after Chair Yellen delivered a speech to the Executives' Club of Chicago in early March. In that speech she stated that if economic indicators continued to meet expectations a "further adjustment of the federal funds rate would likely be appropriate."
- The Fed released its newest 'dot plot,' summarizing the expectations of Fed Governors for the Fed Funds rate at future dates. There was no change in the projection, which called for two additional hikes this year, three in 2018 and a long-run level of 3.0%. Federal Reserve Vice Chairman Stanley Fischer reinforced the call for two additional rate hikes in a March 28 interview, saying it "seems about right." At the end of the month, Boston Fed President Eric Rosengren and San Francisco Fed President John Williams hinted that a fourth hike in 2017 was a possibility.
- Federal Reserve Bank of Cleveland President Loretta Mester, in a speech on March 23, indicated that "if economic conditions evolve as I anticipate, I would be comfortable changing our reinvestment policy this year." Her views on the reinvestment of maturing principal from the Fed's $4.5 trillion balance sheet follows on the FOMC's statement from this month's meeting when they began discussing the eventual wind-down of the balance sheet, though offering no concrete details.
- In our view, the Fed capitalized on market confidence and excitement surrounding increased growth expectation to deliver a rate hike they wish they could have delivered sooner. After two years of one hike each, the Fed appears to be testing market sentiment on how to further extricate themselves from an exceptionally accommodative policy. Reaction to date suggests fixed income markets were comfortable with the move and may allow the Fed a further window to act, though the Fed's projected terminal point remains unchanged. A high level of positive economic news appears priced into U.S. markets, heightening the possibility of disappointment. The Republican setback on healthcare reform demonstrates the difficulty in treating recent policy proposals as a fait accompli and a reminder that legislative and fiscal policy are unlikely to be a panacea. Nonetheless, U.S. consumer confidence and global inflation have rebounded sharply, maintaining the positive backdrop for non-governmental sectors of U.S. fixed income.

Fixed income returns as of March 31, 2017

Index Returns as of March 31, 2017

	Total Return (%)			Excess Return (%)		
	Month-to-Date	Quarter-to- Date	Year-to- Date	Month-to-Date	Quarter-to- Date	Year-to- Date
U.S. Aggregate	-0.05	0.82	0.82	-0.01	0.11	0.11
U.S. Treasury	-0.05	0.67	0.67	-	-	-
Intermediate	0.05	0.54	0.54	-	-	-
Long	-0.55	1.40	1.40	-	-	-
TIPS	-0.05	1.26	1.26	-	-	-
Agencies	0.08	0.76	0.76	0.09	0.27	0.27
U.S. MBS	0.03	0.47	0.47	0.04	-0.17	-0.17
U.S. Credit	-0.15	1.30	1.30	-0.08	0.47	0.47
Intermediate	0.04	1.14	1.14	0.00	0.54	0.54
Long	-0.59	1.66	1.66	-0.27	0.32	0.32
Industrial	-0.27	1.23	1.23	-0.17	0.34	0.34
Utility	-0.58	0.97	0.97	-0.41	-0.04	-0.04
Financial	-0.08	1.28	1.28	-0.05	0.55	0.55
Non-Corporate	0.23	1.64	1.64	0.27	0.92	0.92
Aaa	0.09	0.74	0.74	0.11	0.15	0.15
Aa	-0.15	1.04	1.04	-0.08	0.26	0.26
A	-0.25	1.02	1.02	-0.17	0.16	0.16
Baa	-0.13	1.71	1.71	-0.05	0.85	0.85
High Yield	-0.22	2.70	2.70	-0.25	2.14	2.14
Floating Rate Notes	0.16	0.66	0.66	0.14	0.54	0.54

Source: Bloomberg Barclays

Disclosures

All investments involve risk, including the possible loss of principal.

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