ALTMAN
INVESTMENT MANAGEMENT

FIXED INCOME STRATEGY HIGHLIGHTS

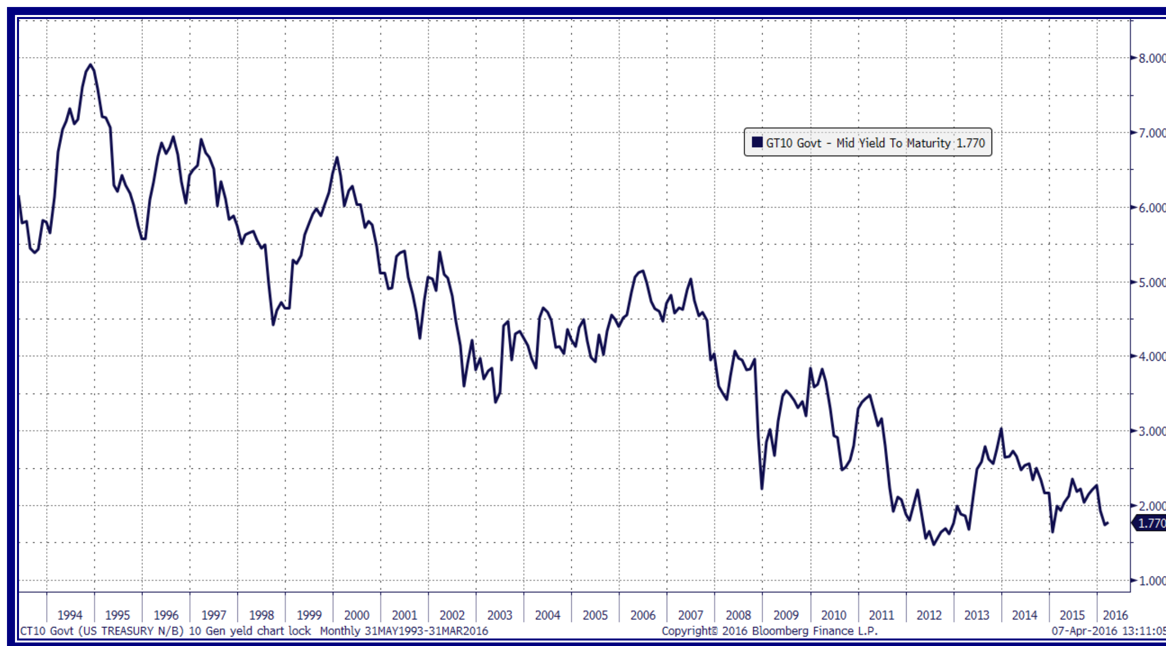
APRIL, 2016

IN BRIEF: The U.S. Fixed Income Markets

As highlighted in all of our commentaries this quarter, at the conclusion of the mid-March Open Market Committee meeting, Fed Chairwoman Yellen indicated that global economic and financial uncertainty pose risks to the U.S. economy and justify a slower pace of interest rate increases. Investor appetite for credit risk exploded during the quarter, pushing nearly every asset class in the fixed income markets skyward. The Fed's dovish response pointed to slowing growth in China, weak oil prices and accommodative global central bank policy. Market forecasters and the futures market are now suggesting that they need to push back their expectations for the Federal Funds Rate during 2016, with perhaps only one tightening move this year. Fed guidance continues to emphasize that future moves will be data-dependent with inflation and employment gains being key factors in their consideration.

EXHIBIT I

Ten-Year Generic Treasury Yield



Source: Altman Investment Management Research and Bloomberg

Our view has not changed over the past quarter. We continue to expect moderate U.S. economic growth, with real GDP advancing at an annual rate of 2.0-2.5% accompanied by additional employment gains and inflation trending slightly higher but remaining moderate. One Fed move this year, perhaps two rate hikes may still be an optimistic expectation for the year.

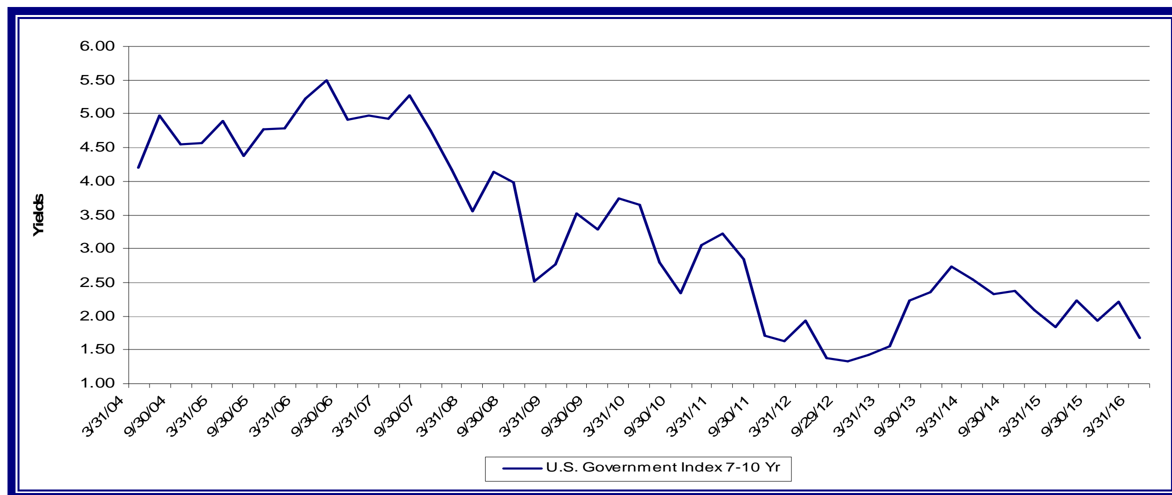
CLOSE-UP:

➢ Government Bonds

As we begin the Second Quarter, investors appear to be waiting for the Fed to raise interest rates for a second time. At this juncture we are somewhat skeptical that this will happen, as we could be waiting for some time given recent commentary provided by various members of the Central Bank. In December was the "Lift Off" in which the policy committee took their first steps to increase interest rates from their multi-year historic lows, with many members hinting that rates would be "data dependent" and they would not hold the future path of interest rates to any prearranged storyline. "Cautious and gradual" is the new topic du jour at the Fed, as both Janet Yellen (Chairwoman) and William Dudley (Federal Bank of New York President) have echoed similar sentiment in the past few weeks. In previous commentaries, we have noted the strong possibility of a low inflation rate hike in which monetary policy would be slow and at the mercy of global economic data.

EXHIBIT II

U.S. Government Index 7-10 year



Source: Altman Investment Management Research and Bloomberg

We are roughly four months from December's "liftoff" and it appears this is exactly what is happening. Many readers are aware of the challenges faced by numerous developed and developing countries overseas including ongoing quantitative easing and negative interest rates in Europe and Japan, as well as slowing growth from China, the world's economic growth engine. Indicating the sentiment in the Eurozone, the European Central Bank (ECB) has hinted that it may launch additional stimulus to offset what it feels are "fresh shocks" to the economy.

On that note, here is an interesting story that helps describe the current state of the world debt markets: a month ago Ireland issued sovereign debt with a maturity of 100 years, aka a "century bond", only a few years after it repaid bailout funds from the European Debt Crisis in 2011. What's fascinating about the bond is not so much the maturity but the yield; Ireland is paying only 2.35%, which is lower than 30-year U.S. Treasuries. Treasury bonds yield ~2.60%, 25 basis points more than Ireland bonds due in 2116, which is unprecedented. Why are European yields so low? Many of the larger, more stable countries in Europe have negative yields out to five years, 10-year yields only barely positive and some 30-year bonds that yield sub 1.00%. Against this backdrop, yields of close to 2.35% don't look so bad. This phenomenon has fostered strong demand for U.S. fixed income. According to Citi Yield Book data, the Broad Investment Grade index returned 3.45% year-to-date, with broad corporate credit also performing well at +4.64%. Longer-dated bonds posted stellar returns

with >10-year Treasuries up 9.50% and similar maturity Corporates up 8.18%. It's worth mentioning that the 30-year "long bond" advanced 10.36% over this timeframe.

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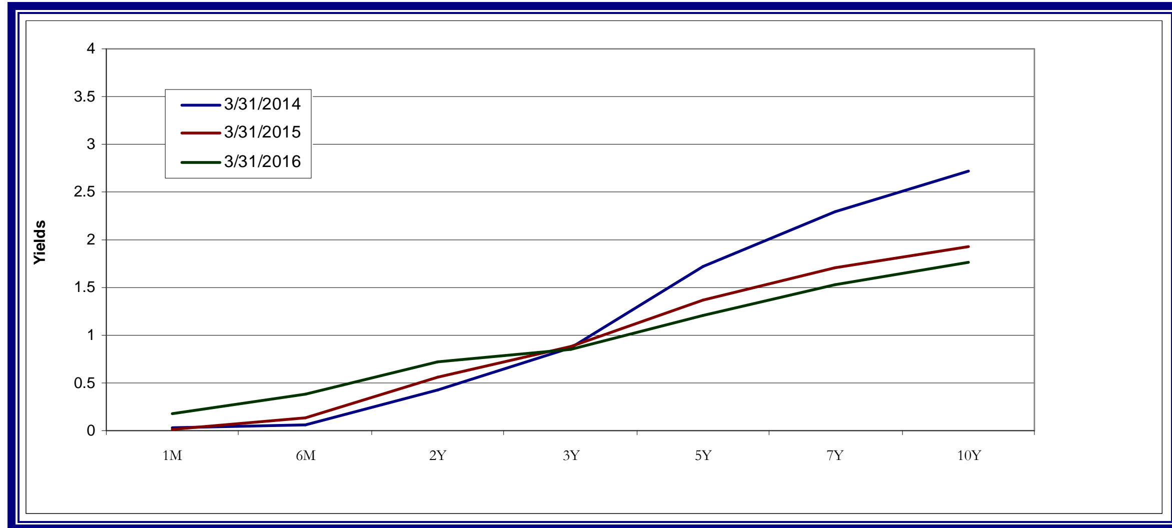
Active Government Yield Curves



Source: Altman Investment Management Research and Bloomberg

EXHIBIT IV

Fixed Income Sector Performance – Q1 2016

Fixed Income Sector Performance – 2016 Q1 - Sector	Rating	Maturity	Duration Mod Adj	Yield	Spread	Price	Trailing1 12 Month Total Return
Treasury *	Aaa/AAA	7.9	6.3	1.3%	N/A	$106.9	2.4 %
Agency	Aaa/AA+	5.1	3.5	1.4%	10	$107.4	1.9%
MBS	Aaa/AAA	4.8	4.3	2.1%	80	$106.0	2.4%
Municipal	Aa3/A+	4.8	4.3	1.3%	0	$112.3	2.6%
Corporate	A2/A-	10.3	6.9	3.2%	190	$105.6	2.2%
High Yield	B1/B	6.3	4.1	8.4%	710	$89.9	(4.0)%

Source: Altman Investment Management Research and Bloomberg

**Intermediate Duration*

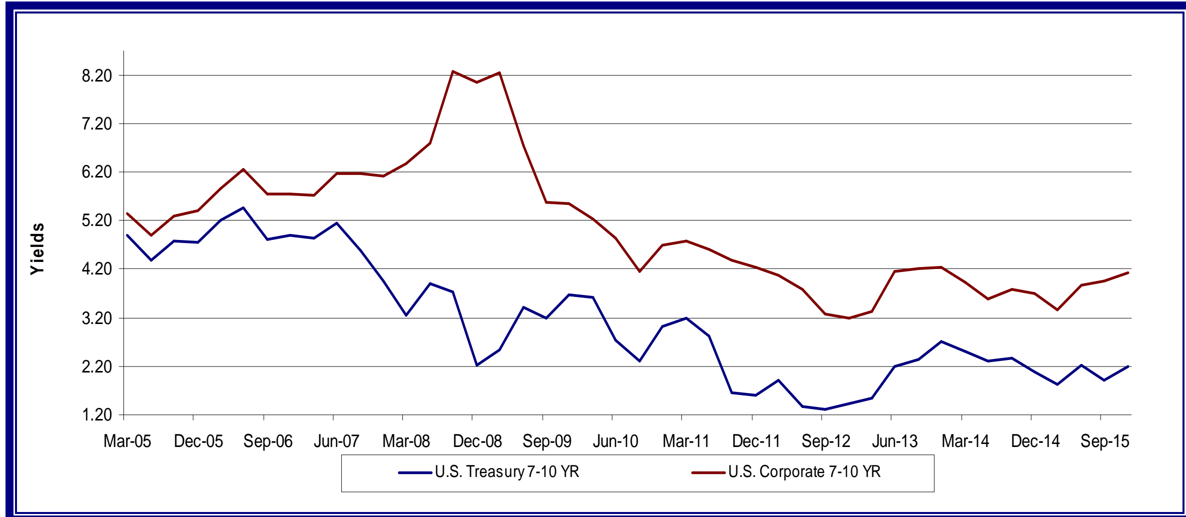
➢ Investment-Grade Corporate Bonds

Since the end of the quarter, investment-grade corporate bond yields have raised by about four bps to 3.15%; the upward movement was of course not as pronounced as seen in the Treasury market. Spread levels fell 10 bps to 147 bps over comparable Treasury yields. The collapse in high yield spreads and yields continued with the yield level falling 17 bps to 7.55%, and the spread level down 29 bps to 587 bps over comparable Treasuries. Investment-grade corporate bonds have a 4.77% total return year-to-date and a 1.68% 12-month trailing total return - while high yield has a 6.59% total return this year and a 12-month total return of negative 1.88%, according to data from Barclay's.

The four-week moving average for Investment grade issuance moved up slightly to $19.3 billion. High yield issuance increased to $9.5 billion moving average, which is the highest since June 2015, according to data from Credit Sights.

EXHIBIT V

U.S. Corporate 7-10 year versus U.S. Treasury 7-10 year



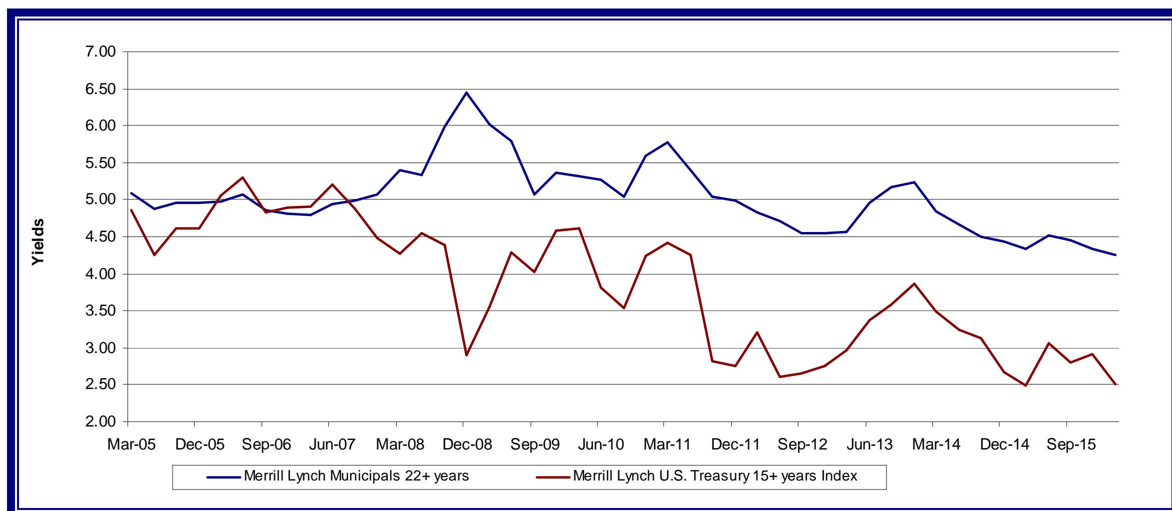
Source: Altman Investment Management Research and Bloomberg

Municipal Bonds

We believe that the tax exempt bonds will continue to provide this year relatively strong positive returns. Good YTD performance has been driven by lower supply, healthy demand and a Fed that appears willing to be patient in raising rates. Now one quarter into 2016, we maintain our outlook for a year not unlike 2015, when municipals returned roughly 3% and outpaced their taxable fixed income counterparts. Our view centers on the idea that investors continue to require and seek: attractive yields in a low-rate world; relatively low volatility and stable returns; and a balance against equity and corporate risk. Investor sentiment should be further buoyed going forward as the recent tax-filing deadline offers a reminder of the value of tax exemption. Muni-to Treasury ratios are compelling across all maturities, making for an attractive income proposition.

EXHIBIT VI

Long Term Municipal to Treasury Yield Spreads



Source: Altman Investment Management Research and Bloomberg

IN SUMMARY:

In the short term, bond sentiment has become too optimistic. Historically, bond prices have pulled back from these levels. In recent years, momentum surges have been followed by consolidations, suggesting limited downside price risk after the extreme optimism is corrected.

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