ALTMAN
INVESTMENT MANAGEMENT

FIXED INCOME STRATEGY HIGHLIGHTS — OCTOBER, 2016

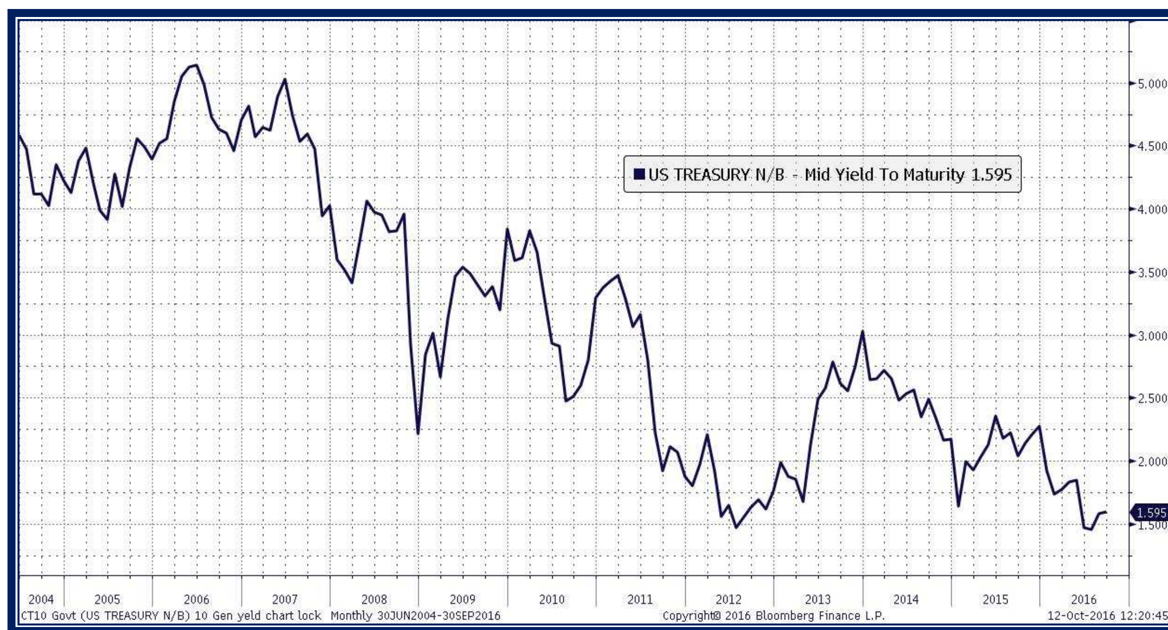
IN BRIEF: The U.S. Fixed Income Markets

Although the Fed was on hold, it was a very different tone this time around as the hawkish sentiment was blatantly obvious with three "nay" votes. It was the first time this has happened since December of 2014, with the first hiking coming in 2015. One of the sticking points for the Fed is that it wants to see inflation closer to 2.00% before a second hike is justified. Interestingly, the committee does not see that level being reached until 2018 and has also decreased its GDP growth estimate to 1.80% from 2.00%. As a reference point, the post-crisis GDP estimate has steadily declined from 2.65% to the current 1.80%. Fed Chair Yellen noted that, "we are generally pleased with how the U.S. economy is doing", despite their estimates consistently being revised downward and/or stretched further out. For now, it appears the "hawkish hold" is one that continues to encourage data dependency and will be patient in both the timing and frequency of any future rate hikes. Of course, with the election slated for November, many are expecting any move from the Fed to be in December at the earliest with approximately a 59% chance of a rate hike according to Bloomberg estimates. September came, September went, and seemingly not a whole lot changed overall.

Meanwhile, although the Treasury market continues to garner strong focus from both investment professionals and the media, it would be apt to remind readers how the credit markets are faring. U.S. domestic corporate credit continues its strong performance with impressive year-to-date gains, more than making up for September's back-and-forth. Spreads are roughly in line month over month and remain significantly lower than their levels from a year ago. Much of the performance in bonds is attributed to the duration effect (longer-dated bonds have outperformed shorter-dated) with the remainder due to the decline in overall credit spreads.

EXHIBIT I

Ten-Year Generic Treasury Yield



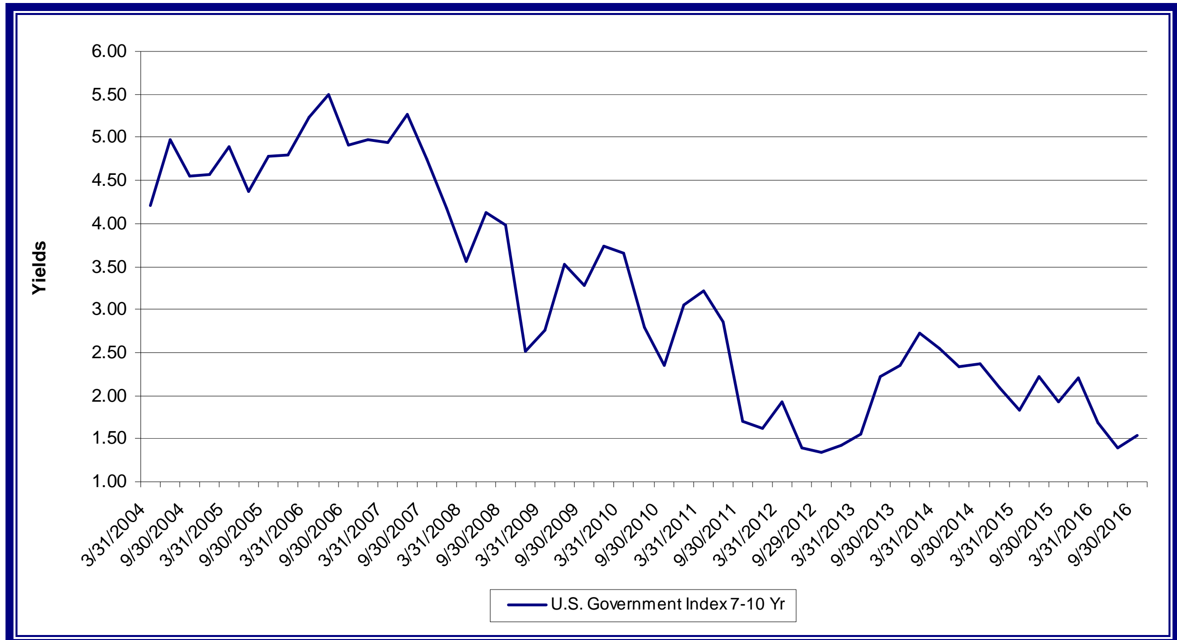
Source: Altman Investment Management Research and Bloomberg

CLOSE-UP:

➢ Government Bonds

EXHIBIT II

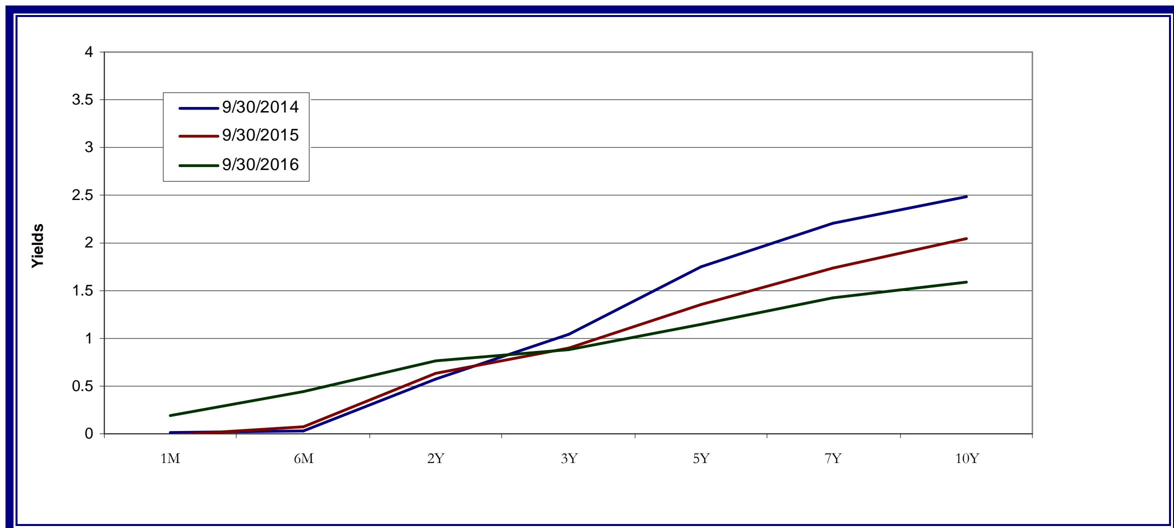
U.S. Government Index 7-10 year



Source: Altman Investment Management Research and Bloomberg

EXHIBIT III

Active Government Yield Curves



Source: Altman Investment Management Research and Bloomberg

EXHIBIT IV

Fixed Income Sector Performance – Q3 2016

Fixed Income Sector Performance – 2016 Q3 - Sector	Rating	Maturity	Duration Mod Adj	Yield	Spread	Price	Trailing1 12 Month Total Return
Treasury	Aaa/AAA	8.0	6.34	1.4%	N/A	$106.0	3.5%
Agency	Aaa/AA+	5.1	3.9	1.4%	5	$107.2	2.7%
MBS	Aaa/AAA	4.9	4.4	2.1%	70	$106.0	3.2%
Municipal	Aa3/A+	5.5	3.9	1.4%	0	$112.3	2.5%
Corporate (Intermediate)	A2/A-	5.0	4.3	2.5%	80	$104.3	5.0%
High Yield	B1/B	6.4	4.0	6.3%	500	$99.1	10.2%

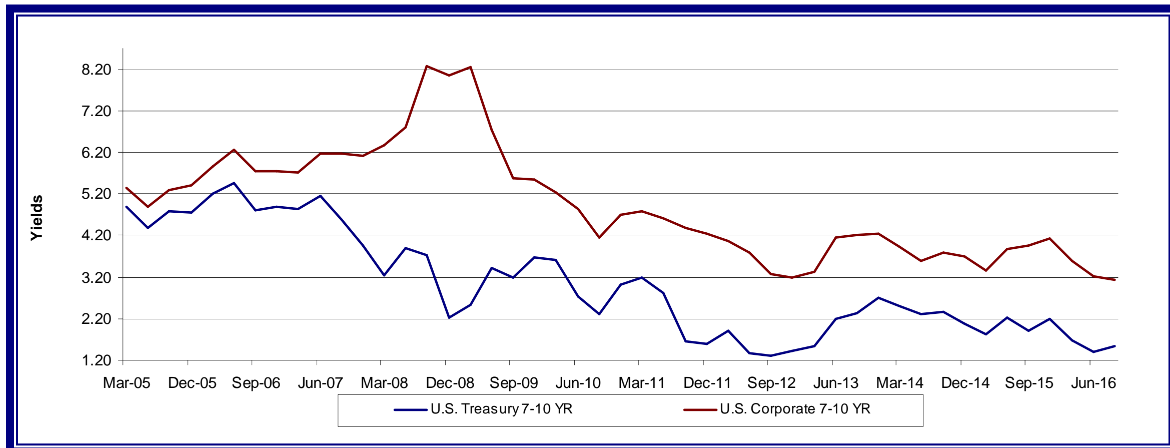
** Intermediate Duration* *Source: Altman Investment Management Research and Bloomberg*

Investment-Grade Corporate Bonds

Investment grade corporate securities were positive for the quarter. The industrial sector, which advanced 1.6%, was the strongest performing corporate credit sector. Financial-related credits followed closely with an increase of 1.2%, while utility-related issuers rose 0.8%. Year-to-date supply of $1.147 trillion is running 5%-6% ahead of the 2015 issuance level and likely to set an annual record. High yield issuance was $188.1 billion, down from $226.1 last year. Spreads on investment grade corporates have narrowed about 35 bps, since the beginning of the year, and average 130 basis points.

EXHIBIT V

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



Source: Altman Investment Management Research and Bloomberg

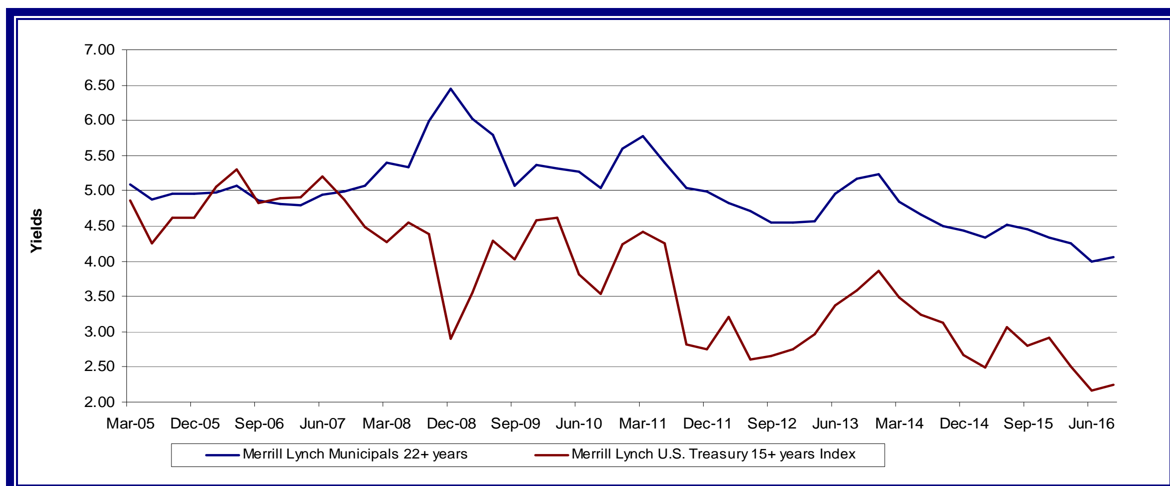
➢ Municipal Bonds

Tax- free municipals trailed Treasuries in September and printed their first negative performance since June 2015, amid a heavy new-issue calendar and the seasonal transition to net-positive supply. Issuance of $35.7 billion represented the largest September supply on record, and followed record-setting August issuance. September supply was up 51% versus 2015; it was also 35% above the five-year average and 28% higher than the 10-year average. The recently elevated supply, in our view, is likely due to issuers pulling deals forward to avoid uncertainty around the U.S. presidential election in November and a potential Fed rate hike in December. As a result, November and December issuance may underwhelm. Meanwhile, demand for the asset class remained largely positive, though softer than the robust levels seen throughout most of the year. Nearly $4 billion entered municipal funds in September, making for inflows of more than $51 billion year-to-date (YTD). The somewhat weaker flows in recent weeks are likely attributed to the turn in performance (as muni demand follows performance) and the ultimately unfounded fears of a September rate hike.

We continue to be positive on the asset class for its ability to provide tax-exempt income, low volatility and diversification away from equity and equity-like risk. We are also cognizant and cautious of weaker technical factors, with issuance likely to remain elevated through the election and demand muted if market performance is lackluster. That said the recent repricing of the market and deluge of issuance may well represent a buying opportunity, as these negative dynamics are likely to fade with the removal of election and Fed uncertainty in November and December. We maintain a shorter duration stance, a position to the steep part of the curve and a preference for A-/A3 or better credit quality.

EXHIBIT VI

Long Term Municipal to Treasury Yield Spreads



Source: Altman Investment Management Research and Bloomberg

IN SUMMARY:

We maintain a cautious stance toward U.S. government bonds. First we believe that inflation expectations are likely to increase over the next several months especially if energy prices stabilize and health care cost continue to rise. Although it may take a few months for the trailing effects of the historical low rates to roll off, the Consumer Price Index (CPI) is likely to move higher and possibly even punch through the 2.0% threshold over the next several months. In addition to rising inflation expectations, both candidates are likely to propose massive infrastructure plans that will likely be financed by long term debt.

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