ALTMAN
INVESTMENT MANAGEMENT

FIXED INCOME STRATEGY HIGHLIGHTS

JANUARY, 2019

IN BRIEF: The U.S. Fixed Income Markets

We are overweight U.S. corporate credit as we expect the expansion to continue. We believe last year's spread widening was overdone and we consider corporate fundamentals, in aggregate, to be healthy, with volatility potentially serving as a reset button on late-cycle corporate initiatives.

Central banks in Europe and Japan kept policy unchanged. The European Central Bank (ECB) acknowledged weaker growth data and noted that risks around the economic outlook had tilted from "broadly balanced" to the "downside". The central bank remains confident that inflation will rise toward target going forward and reiterated its forward guidance around policy rates remaining at their present levels "at least through the summer of 2019".

We expect gradual monetary policy normalization to continue or commence in several advanced economies this year, with rate hikes in the U.S., UK, Canada, Sweden and the Euro area. In contrast, market-implied pricing barely points to a full rate hike in any of these economies, and since the turn of the year Bloomberg has indicated either no rate hikes in the U.S. or slim possibility of a rate cut.

Rising rates remain at the forefront of investors' minds as the calendar flips to 2019. This year, the U.S. 10-year Treasury yield hit a cycle high, thanks to better economic growth expectations, a recalibration of the Federal Reserve's rate hike path, rising oil prices and increased supply.

Within our taxable fixed income allocation, we prefer U.S. investment-grade credit and are maintaining our short duration bias relative to our benchmark to guard against interest rate risk. For investors in high tax brackets, the municipal bond market continues to offer tax-advantaged income.

Fixed Income Sector Performance – Q4 2018

Fixed Income Sector Performance – 2018 Q4 - Sector	Rating	Maturity	Duration Mod Adj	Yield	Spread	Price	Trailing12 Month Total Return
Treasury	Aaa/AAA	8.0	6.2	2.6%	N/A	$100.9	.8%
Agency	Aaa/AA+	5.3	4.1	2.7%	10	$105.1	1.4%
MBS	Aaa/AAA	4.2	3.7	3.0%	40	$ 99.5	1.1%
Municipal	Aa3/A+	5.0	3.7	2.1%	0	$109.5	1.6%
Corporate (Intermediate)	A2/A-	4.8	4.2	3.9%	130	$ 98.6	(.2%)
High Yield	B1/B	5.8	4.3	7.9%	320	$ 92.3	(2.3%)

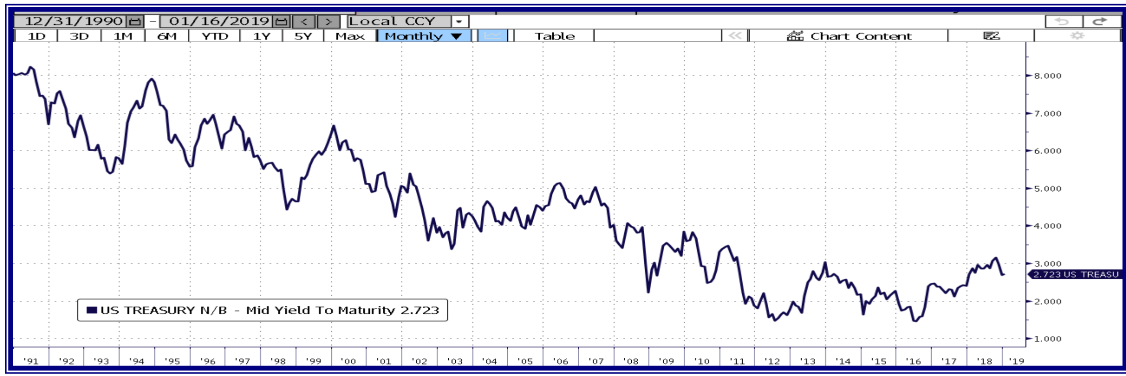
Source: Altman Investment Management Research and Bloomberg

THE FEDERAL RESERVE UPDATE:

Helping to boost sentiment for both stock investors and consumers on January 30th , the FOMC decided to pause rate-hiking. The FOMC statement included the December language that "further gradual increases" in interest rates were warranted. Instead, a more cautious approach was signaled: "In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes."

In a separate release, the FOMC also signaled a more flexible approach to quantitative tightening (QT), i.e., the paring of the Fed's balance sheet: "The Committee is prepared to adjust any of the details for completing balance sheet normalization in light of economic and financial developments."

Ten-Year Generic Treasury Yield



Source: Altman Investment Management Research and Bloomberg

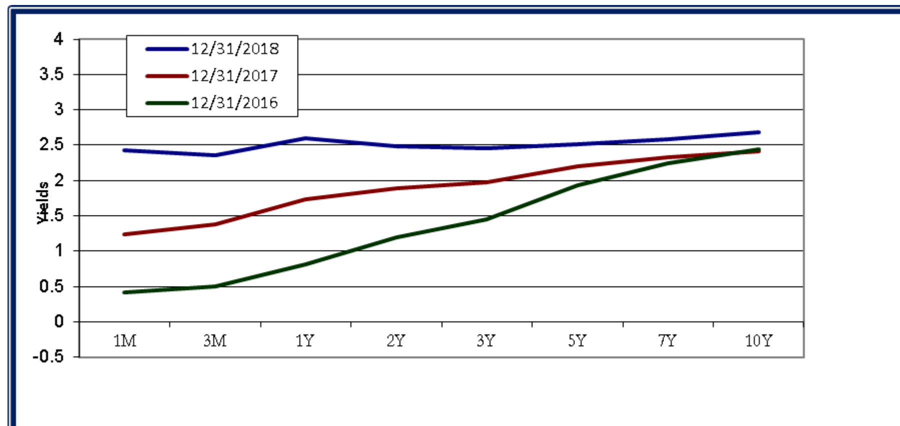
CLOSE-UP:

➢ Government Bonds

U.S. Government Index 7-10 year

Source: Altman Investment Management Research and Bloomberg

Active Government Yield Curves

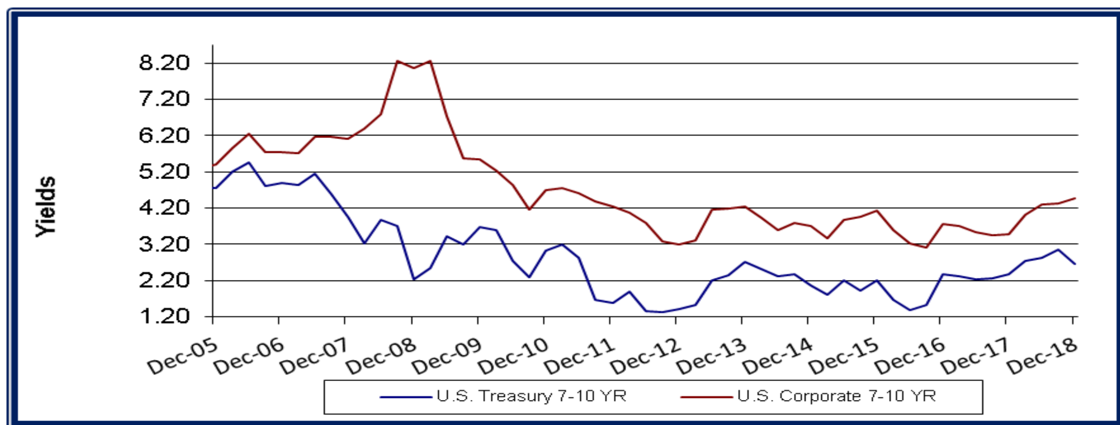


Source: Altman Investment Management Research and Bloomberg

Fixed Income Sector Performance – 2018 Q2 - Sector	Rating	Maturity	Duration Mod Adj	Yield	Spread	Price	Trailing 12 Month Total Return
Treasury	Aaa/AAA	8.0	6.3	2.7%	N/A	$100,2	(.6%)
Agency	Aaa/AA+	5.0	3.9	2.8%	10	$103.9	(.1%)
MBS	Aaa/AAA	4.6	4.1	3.0%	30	$ 99	(.5%)
Municipal	Aa3/A+	4.8	3.7	2.1%	0	$108.8	.4%
Corporate (Intermediate)	A2/A-	4.9	4.3	3.8%	110	$ 98.7	(.4%)
High Yield	B1/B	6.2	4.7	6.5%	380	$ 97.8	2.5%

Investment-Grade Corporate Bonds

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



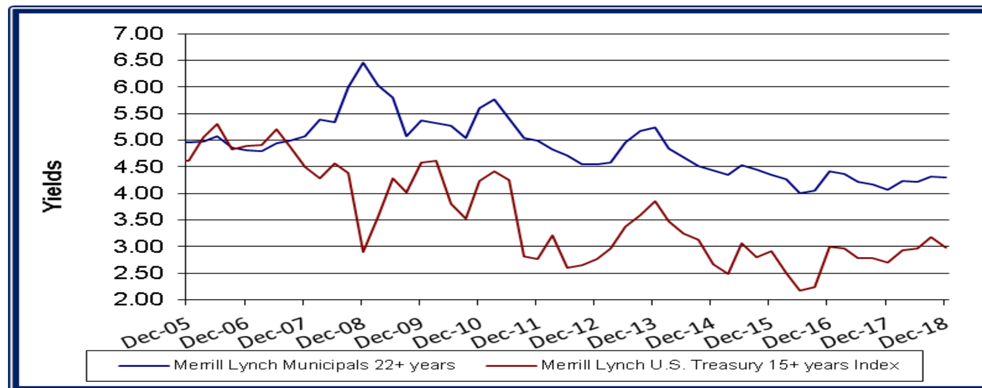
Source: Altman Investment Management Research and Bloomberg

The low interest rate environment has fostered corporate actions such as stock buy-backs and/or debt issuance. As we move through this economic cycle, the ability to deal with these actions going forward will likely affect the market. Yield spreads can be an indicator of real or perceived risks on debt. It is noted, for example, that on February 1st of this year, the BBB corporate versus 10-year Treasury index (Bloomberg U.S. Corporate BBB/Baa – 10 Year Treasury Spread) spread hit its 5 year low of 120 basis points. The spread has risen 38% this year to 166bp, contributing to the general credit attentiveness; however, on a relative basis, the 5-year average spread between the BBB corporate versus 10-year Treasury index is 160bp, meaning today's spread is in line with 5-year averages. Even though the rationalization can be argued, there are strong market indicators demanding due diligence concerning current credit issues. Recent volatility is real for some specific credits. The takeaway demands that analysis includes both market (interest rate) risk and credit risk assessment when contemplating appropriate bond purchases and analyzing currently held positions.

Municipal Bonds

The market expectation is that rates will stay neutral in 2019. The Federal Reserve Open Market Committee left short term interest rates unchanged when they recently announced that the target range for the Fed Funds rate would remain at 2.25% to 2.50%. As the month of February unfolded, according the Bloomberg, the Fed futures market suggest neutral interest rates throughout 2019 with less than a 5% chance of a hike in 2019 and a 0% chance of a cut until December when the probability increases to a low, 8.2%, chance of a cut at the December meeting.

Long Term Municipal to Treasury Yield Spreads



Source: Altman Investment Management Research and Bloomberg

Demand for municipal bonds remains high for many reasons, including the tax advantage with the top tax bracket at 40.8% (37% Federal + 3.8% Medicare surtax on net investment income). Additionally, those clients impacted by the SALT cap in higher tax states such as NY, NJ, CT, and CA, will find state specific municipals to be an attractive investment. State and local debt remains historically safe for investors, as bonds have low default rates and are generally backed by an issuers' taxing power or revenue from an essential service. Collectively, the states enter 2019 on "generally strong footing from a credit standpoint" with half of the states rated AAA or AA+ and 41 states rated AA or higher, according to a January S&P report, and U.S. local government sectors "remain stable and resilient for now". Although new issue supplies this year has been similar to last year and supply in 2019 is expected to be slightly higher than last year, net new supply (excluding debt that is called, refunded, or matures) is expected to be negative in 2019. This negative net supply along with continued strong demand should be good for municipal performance this year. In weeks ahead, an expanded new issuance calendar presents additional opportunity to invest in municipal bonds.

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