

ECONOMIC LANDSCAPE:

As we reflect on the first quarter of 2017, the first two months were predominantly a continuation of the post-election rally, as risk assets continued to climb in anticipation of better than expected earnings reports and an accelerating U.S. economy. Additionally, many economic indicators such as the Purchasing Managers and Business Conditions Indices, along with housing and now capital spending, continue to be on solid footing. Global Industrial Production remains in an uptrend, as well as personal incomes improving against a backdrop of lower unemployment at 4.5%. Although the economic news is generally supportive of a continued upturn, during March the Federal Reserve raised the discount rate coincident with softening loan demand reported by the banks in the quarterly overviews. The failure of the first attempt at the healthcare reform bill was a simple reminder of the challenges facing the Trump economic policies when confronted with the legislative process. As a result, investors stepped to the sidelines fearing that a continuation of the stock market rally was premature. Contrary to our call for the 10-year Treasury yield to begin to rise albeit moderately, its descent was spurred by perhaps a far too optimistic view of economic strength in the U.S.

As oil prices rolled over at the end of the quarter, it had the effect of dampening inflationary expectations and reduced the need for monetary accommodation. Of course, a disappointing GDP release of .7% could have the effect of slowing the pace of normalizing interest rates and delay the process of reducing the size of the U.S. deficit that is approaching \$4.5 trillion.

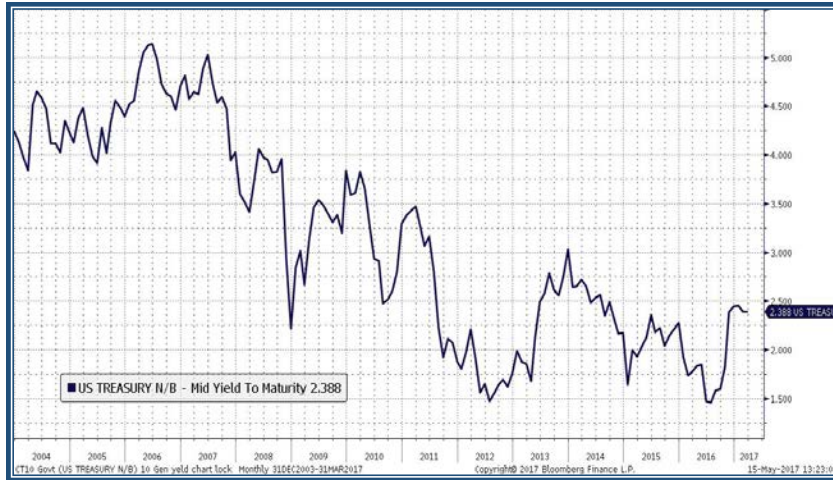
IN BRIEF: The U.S. Fixed Income Markets

As was the case over the prior two quarters, the primary drivers of prices for fixed income securities during the past three months were: the anticipation of (and ultimately the FOMC's decision to move ahead with) a hike in the fed funds rate, an improving economic outlook (especially the employment situation), and record-high stock prices. Another contributing factor has been the perception that the Trump administration will espouse pro-growth economic policies. With the economic backdrop supporting a rate hike, there was little suspense as to whether the FOMC would move to increase rates, especially after members of the Committee, in the days leading up to their meeting, signaled such an outcome was likely. The fixed income markets also evaluated the inauguration of Donald Trump and the heightened activity surrounding his first weeks in office.

In contrast to the prior quarter, the yield curve flattened slightly, as yields on short-term securities rose more than those in the intermediate- to long-term end of the spectrum. The flattening was largely due to the FOMC's rate increase, which is expected to have little impact on longer-dated issues. Yields at the shortest end of the yield curve (up to one year) rose in line with the 25-basis point fed funds rate increase, but maturities of two years and longer experienced little change in yields. By the end of the quarter, the yield on the benchmark 10-year U.S. Treasury note was little changed, ending the quarter at 2.39%, compared to 2.45% at yearend. Inflation expectations crept higher, with the Fed's gauge of five-year forward inflation expectations closing at 1.93% on March 31st, the same level as a year ago.

Fixed income securities generally produced positive total returns in most market segments. The Bloomberg Barclays Treasury 5-7 Yr. Index gained +0.8% for the quarter, but is one of the only fixed income indices with a negative return over the past 12 months. The Bloomberg Barclays U.S. Corporate 5-10 Yr. Index advanced +1.4% during the three months. Municipals performed admirably, as the Bloomberg Barclays Municipal Bond Index rose by +1.6% during the quarter.

Ten-Year Generic Treasury Yield



Source: Altman Investment Management Research and Bloomberg

CLOSE-UP:

➤ *Government Bonds*

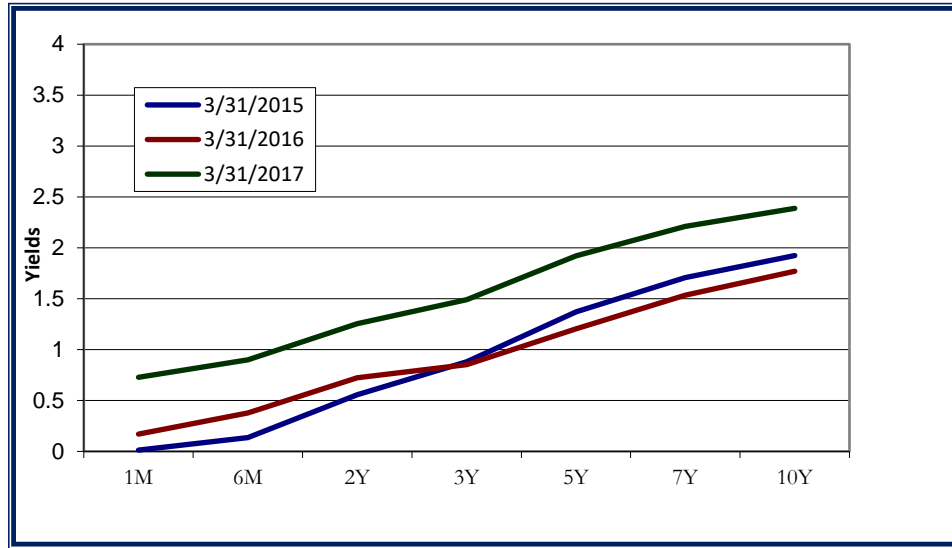
Yields during the first quarter stayed modestly flat around 2.33%, as investors awaited clarity on potential tax reform. Developments into the amount and timing of tax cuts could have substantial impacts on bond markets, not only in terms of the direction of yields but the spread at which treasuries trade. Significant tax cuts could strengthen consumer spending and boost corporate profits pushing treasury yields relatively higher as compared to other fixed income sectors.

U.S. Government Index 7-10 year



Source: Altman Investment Management Research and Bloomberg

Active Government Yield Curves

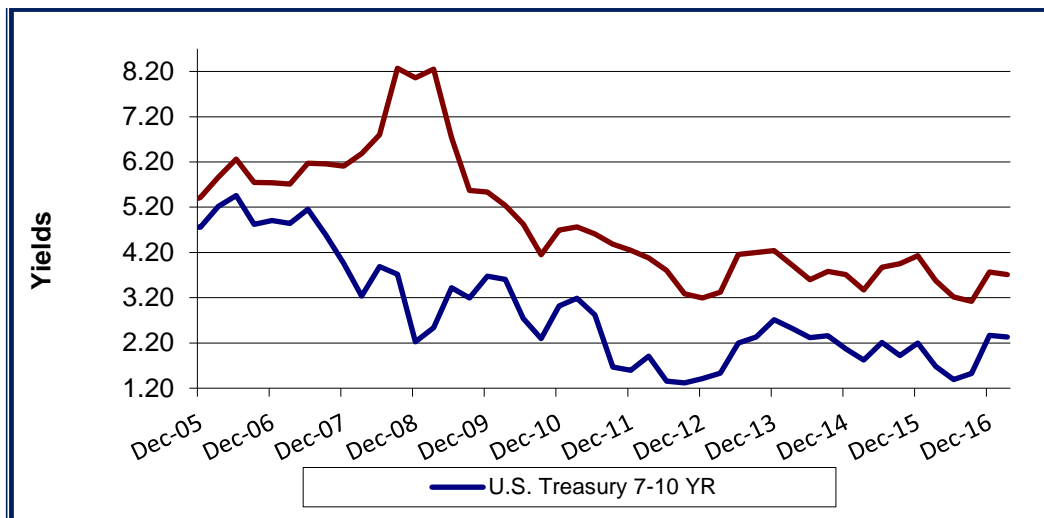


Source: Altman Investment Management Research and Bloomberg

➤ *Investment-Grade Corporate Bonds*

Investment-grade corporate bonds yields ended last month up three bps at 3.24%. The spread level narrowed three bps to 116 bps (over comparable Treasury yields). High yield bonds ended the week down 18 bps at 5.63%, or 371 bps over comparable Treasury yields. Investment-grade corporate bonds have a 3.00% total return on a trailing-12-month basis while high yield bonds have a 13.30% total return for the trailing 12-months, according to data from Bloomberg Barclays Indices. Preferred stock has a 6.56% total return on a trailing-12-month basis while leveraged loans have an 8.28% total return over the same period, according to data from Bank of America Merrill Lynch Indices.

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

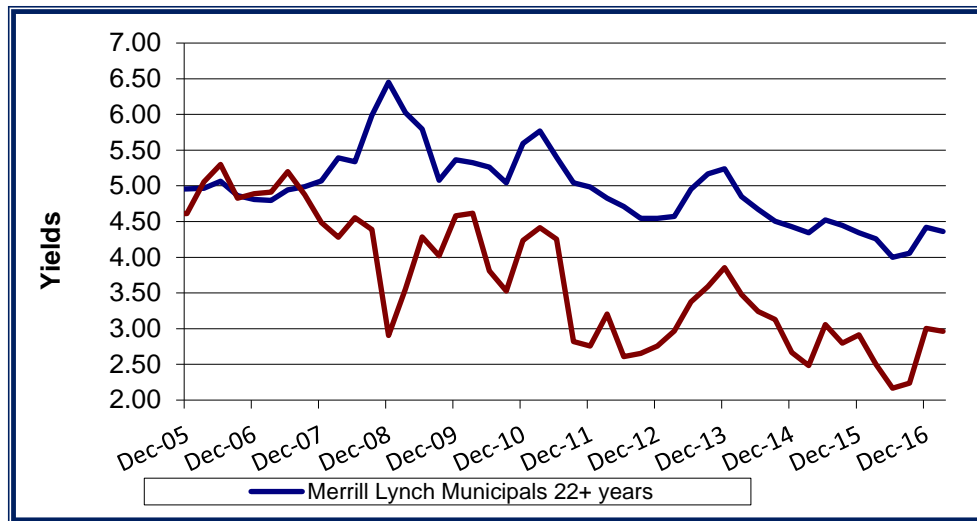


Source: Altman Investment Management Research and Bloomberg

➤ *Municipal Bonds*

March, historically a tough month in the market, surprised to the upside this year. Issuance failed to pick up as expected, which permitted municipals to notch a modestly positive return and outperform Treasuries. This marked the fourth consecutive month of positive performance. New issuance of \$31.2 billion was 14% below the five- and 10-year averages for March. At the same time, demand for the asset class held on. Monthly inflows of \$1.2 billion brought the year-to-date total to \$4.9 billion. Flows remained largely concentrated in high yield. On the credit front, states struggling with pension and budget issues face increased pressure from the rating agencies. New Jersey saw another downgrade (A) due to pension underfunding, and Illinois was warned of the potential for a multi-notch downgrade if it fails to implement a budget during the current legislative session. Such an outcome would make Illinois the first state to be rated non-investment-grade.

Long Term Municipal to Treasury Spreads



Source: Altman Investment Management Research and Bloomberg

IN SUMMARY:

We continue to favor corporate and agency bonds over treasuries. The global outlook for growth appears to be at a rate that would keep inflation in check. The anticipated U.S. fiscal reform, via tax cuts, has the potential to lift consumer spending and corporate profits, leading to the out-performance of corporate bonds. However, should the tax reform process hit obstacles and suffer delays, it could put the outlook for modestly higher rates at risk. The challenges facing the current administration have thus far made it difficult to pass legislation. A smoother and less dramatic process is necessary in order for legislation to stay on target. Municipals also continue to offer value for those investors in higher tax brackets. Fiscal policy could also impact municipals with regards to the level of comparable yields and a proposed cap on the municipal tax exemption. We will continue to monitor the situation as developments unfold.

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