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TAXABLE FIXED INCOME COMMENTARY

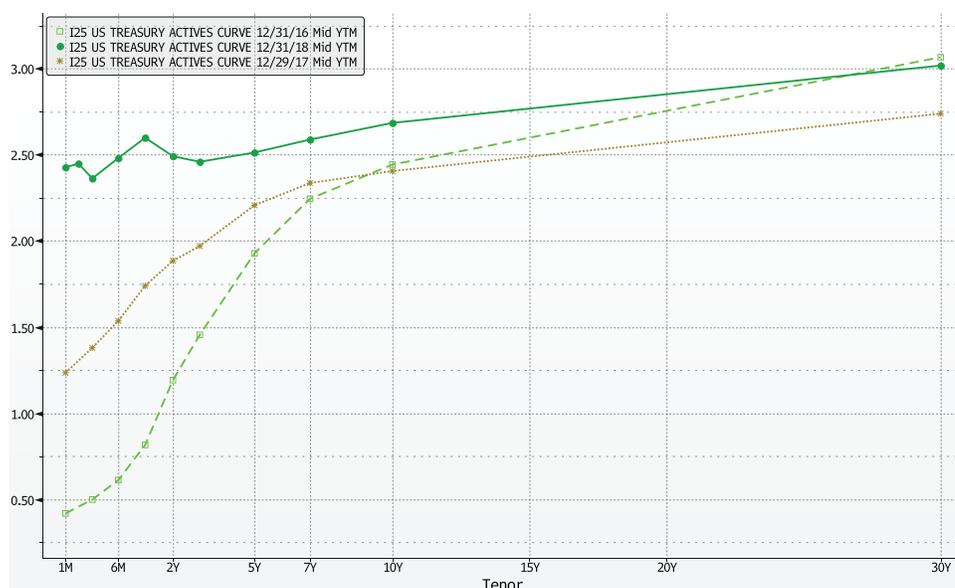
December 31, 2018

CORE FIXED INCOME
INTERMEDIATE FIXED INCOME
CURRENT INCOME PORTFOLIO
INCOME OPPORTUNITIES

Every new year we are faced with the concept of beginning anew. You hear sayings about turning over a new leaf, starting with a clean slate, setting new goals and we even sing about it with the traditional “Auld Lang Syne” which means “times gone by”. But when we look at the markets as we turn the calendar from 2018 to 2019, it doesn’t feel like a new beginning. On the contrary, it appears we have much more of the same – questions on what central banks will do, gridlock in Washington, slowing global growth concerns and continued talk of trade and tariff issues.

As we take a look back on the journey through 2018, we see that the anticipated rise in rates we spoke about a year ago came to fruition as yields moved to their multi-year highs at the beginning of November with the US 2yr Treasury reaching a yield of 2.96% and the 10yr climbing to 3.25%. The more conservative positioning within our fixed income products was advantageous during this time as we reduced our interest rate risk with shorter durations versus the comparable indices and maintained a high level of income that helped drive outperformance relative to the indices.

U.S. Treasury Yield Curve 2018



Source: Bloomberg

- We reduced our interest rate risk with shorter durations versus the comparable indices and maintained a high level of income that helped drive outperformance relative to the indices.
- We do anticipate increased volatility as the path of future Fed Fund rate hikes is determined.
- We are taking opportunities to shift our duration slightly out the yield curve as appropriate although maintaining our reduced interest rate exposure overall.

We also witnessed the yield curve flattening from around 55bps in January down to less than 20bps between the 2yr and 10yr treasury notes as we begin the new year leading many to fear a recession is near. The flattening yield curve combined with the other concerns looming in the market (trade, slower growth, etc.) developed into a fear that the Federal Reserve was too optimistic and the belief that the Federal Open Market Committee would make a policy mistake pushing the economy into recession sooner than originally anticipated. As these concerns grew, we saw the yield curve begin to shift downward and ended the year with the US 2yr Treasury at 2.49% and the 10yr note at 2.68% - a shift of roughly 50bps at the end of the 4th quarter. Although declining yields means market values increase for our fixed income holdings, our shorter duration resulted in a smaller increase as compared to the indices and an underperformance for 4Q18. However, the positive contributions from our duration positioning and income levels allowed the Core Fixed Income, Fixed Income Intermediate and Fixed Income Corporate models to outperform their indices for the year 2018. Although the preferred allocation was stronger the last month of the year, it did serve as a drag on performance in the Current Income Portfolio for the year 2018 with all other sectors providing positive contributions.

As we enter 2019, our 4 step investment process which includes decisions on duration, yield curve positioning, sector and security selection remains steadfast and we continually update our strategy based on this process. Unfortunately, we don't have a crystal ball to see exactly what central banks around the world will do over the coming quarters, but we do anticipate increased volatility as the path of future Fed Fund rate hikes is determined. We are taking opportunities to shift our duration slightly out the yield curve as appropriate although maintaining our reduced interest rate exposure overall.

So even though we may not be starting with a clean slate or new beginnings here in 2019 as it relates to the markets, we are always here to answer your questions and discuss our economic outlook. Although we can't control the markets, we can control our own lives, so I want to leave you with one of my favorite New Year's quotes:

Be at war with your vices, at peace with your neighbors, and let every new year find you a better man. – Benjamin Franklin

Happy New Year!

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