Quarterly Commentary Q3 2017: Long Roads from Normal

If the past three months have taught us anything it's that while the country has endured tragedy, in the form of both weather and man-made incidents, we understand the path to normalcy will require resolve and time.

Ongoing war mongering between North Korea and the US ratcheted up over the past few months with mixed messages being sent by the Administration in plotting the best path forward. While the impactful hurricane season has left areas in the Gulf and US territories picking up the pieces, an act of domestic violence left the country searching for answers. Another failed attempt at repealing the Affordable Care Act, along with a revolving door in the White House, has created anxiety that the Administration may encounter challenges in pushing forward future agenda items, with the tax plan taking center stage while infrastructure remains idle.

With Janet Yellen's appointment as Fed Chair coming to a possible close, the Trump Administration is actively searching for a replacement. As tax reform debates heat up, the White House would prefer a more "dovish" Chairperson, one who would be more apt to leaving interest rates low for a prolonged period of time. Such an environment would be conducive to continued growth and business investment. A component of the tax plan, allowing companies to immediately expense capital investments, would be a win for businesses while shrinking Federal coffers. That, in combination with higher interest rates, may create an uneasy environment to reign in support from fiscal Conservatives. To offset the decline in revenue the Trump tax plan is seeking a provision to repeal the SALT (State and Local) tax deduction from federal income tax returns, which could save in excess of $1 trillion dollars over a ten year time horizon according to some estimates. The debate surrounding whether the tax plan benefits corporations or individuals has already begun. As the details of the plan come more into focus, we can count on negotiations being long and complex.

Internationally, Catalonia's contentious vote to break away from Spain has caused uncertainty as the validity of the vote continues to be called into question. Additionally, the Spanish government has already issued a decree making it easier for companies to move headquarters away from Catalonia which is aimed at destabilizing Catalonia's efforts toward independence by undermining its economy. In the UK, the pound has been weaker recently as Theresa May, the UK's Prime Minister, continues to deal with gridlock surrounding Brexit negotiations. Confidence in May's ability has been shaken since a snap election saw her lose her Parliamentary majority. A secondary attempt at rallying support, with a recent speech at the Conservative Party's conference, was met with lackluster results. Speculation has grown that May could potentially resign which would result in another snap election providing for additional complications to Brexit talks.

Hurricanes aside, municipals weathered the storm of a somewhat turbulent quarter. Headline risk surrounding Houston and its close neighbors, as well as multiple locations within Florida, seemed somewhat overblown. The long term impacts of flooding in and around Houston is still up for some debate. Puerto Rico, having already defaulted, has had a compounding effect with Hurricanes Maria and Irma delivering additional blows to the US territory. Although President Trump made a vague comment about wiping out Puerto Rico's debt, the likelihood of such a scenario seems remote at best. Outside of federal aid to combat storm damage, the administration has taken a passive approach on dealing with fiscally challenged entities such as Puerto Rico, the Virgin Islands and, more recently, Hartford, CT (RBAM does not hold debt of any of these municipalities). Underlying creditworthiness, in a world heavy laden with debt, remains paramount for investors.

The third quarter brought some trepidation amongst bond investors as the Fed indicated they would begin unwinding their balance sheet, which could place upward pressure on interest rates. Thanks in part to an ambitious tax plan, equity investors were emboldened equating to a bond sell-off resulting in higher rates in both taxable and tax-exempt securities. Municipals did better in the short end as demand in that range remained high. In contrast, taxable securities outperformed in longer dated securities as taxable investors continued to stretch for yield. Credit concerns focused demand on higher rated securities. Ratios in short dated maturities remain compressed while issues maturing ten years or longer continue to maintain relative value.

US Treasury Yields			
	6/30/2017	9/30/2017	Change
1 Year	1.24	1.31	7 bps
3 Year	1.58	1.65	7 bps
5 Year	1.90	1.95	5 bps
10 Year	2.33	2.34	1 bp
20 Year	2.64	2.67	3 bps
AAA Municipal Yields			
	6/30/2017	9/30/2017	Change
1 Year	0.84	0.92	8 bps
3 Year	1.11	1.13	2 bps
5 Year	1.35	1.37	2 bps
10 Year	1.96	2.00	4 bps
20 Year	2.68	2.70	2 bps

During challenging times obtaining a sense of normalcy can be fraught with setbacks as answers can be elusive. While economic indicators show continued, albeit slowing corporate income growth, headwinds remain. Unrest between the White House and Capitol Hill may test the resolve of the decision makers as the tax debate heats up. While level headedness doesn't always prevail in Washington, having a trusted investment advisor helps in navigating the turbulence.

All the best,

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