Quarterly Commentary: No News Is, Well, No News

Heavily debated topics like global warming, campaign finance reform and the like often provide water cooler talk and occasional verbal sparring at the dinner table. The Fed has stoked discussion fires in recent months by choosing its words wisely regarding the appropriate time to raise interest rates as they decided to leave rates unchanged. Surveys of market participants gauging the likelihood of the Fed's actions for their October meeting waffle daily dependent, undoubtedly, on world events.

Continued speculation regarding the Fed's decision making will be plentiful leading up to the October 28th meeting where the markets will, once again, wait with baited breath. The Fed has had to contend with several different factors; pace of economic growth, inflation, job and wage growth, unemployment and the labor force participation rate. The conundrum facing the Fed is which growth measures, if any, are the ones that should trump the others, and ultimately, cause them to take action. Growth, while modest, has been on a continued upswing while unemployment continues its downward trend. Wage growth remains stagnant, barely outpacing inflation, while the labor force participation rate remains at thirty year lows. In combination with falling commodity prices and recent global and economic turmoil, the Fed is staying the course.

As the Fed contemplates dipping its toe into the waters of an interest rate hike this has bode well for investors as they have, in essence, been paid to wait. Investors, anticipating an eventual move by the Fed, have shown some reluctance to buy longer maturities. The net supply of municipal bonds is basically flat for the calendar year due to maturing obligations even though year over year issuance is up. This muted supply has provided support for municipal investors to date. Going forward we anticipate an uptick in issuance as calls for austerity have faded. In the event that rates do rise in the near term, investors could stand to capture higher yields.

Where the Fed has provided a lack of news, the global landscape has provided more than an ample supply of noteworthy items. The current currency wars got another shot of adrenaline as the Bank of China attempted to spur their markets with a surprised rate cut and currency devaluation during the quarter. Japan is once again flirting with another recession and the Eurozone has fallen back into a deflationary period for this first time since March, which was also the last time the ECB took an easing posture to encourage economic activity. Commodity prices were targeted as the culprit for the recent weak reading, with limited relief seen in the short term. With both the Asian and Eurozone economies forecasting slowing growth trends, emerging market economies have slowed in response. Increasing tensions in Syria, the West Bank and Gaza Strip has only fed into market uncertainties and caused some investors to seek protection in US Treasury backed obligations.

US Treasuries slightly outperformed municipals in the third quarter. Both assets classes saw yields retrench as global uncertainty and the Fed's inaction caused investors to seek safety. The risk trade yielded some benefits as single A rated municipal securities outperformed their AAA rated counterparts on maturities five years or shorter. The reverse, however, was true for intermediate and longer municipals as higher rated credits outperformed. Investors continue to benefit from the relative value trade as municipals yields, as a percentage of US Treasuries, are maintaining their trend through historical norms.

US Treasury Yields			
	6/30/2015	9/30/2015	Change
1 Year	0.28	0.34	6 bps
3 Year	1.08	0.96	-12 bps
5 Year	1.67	1.42	-25 bps
10 Year	2.42	2.10	-32 bps
20 Year	2.94	2.62	-32 bps
AAA Municipal Yields			
	6/30/2015	9/30/2015	Change
1 Year	0.32	0.36	4 bps
3 Year	1.01	0.85	-16 bps
5 Year	1.45	1.30	-15 bps
10 Year	2.37	2.09	-28 bps
20 Year	3.10	2.89	-21 bps

The Fed has left us to ponder and guess what, and more importantly, when their next move might be. The slow worldwide economic environment has supplied sufficient news providing the catalyst to encourage investors to review their fixed income allocations. What may be lost in the mix has been the resiliency of the municipal market. In spite of recent volatile interest rates, headline risk associated with the challenges facing Puerto Rico and Chicago, the municipal bond market has benefited from a flat net supply resulting in positive returns for the year. Instead of waiting for news to break and then being forced to react, having an allocation to an efficient asset class makes reading the news a little easier to fathom.