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Second Quarter Fixed Income Letter to Clients

US Treasury bonds continued to rally with great strength in the second quarter. The 10-year US Treasury yield fell sharply, ending the quarter at 2.00%. The market is expecting the Fed to cut rates. Inflation data has been near expectations, running slightly below the Fed target of 2%, leaving their policy stance unchanged. In addition to the economic data that has been fueling the bond market fire, tensions with Iran and speculation about trade developments at the G-20 meeting are also contributing to the market's strength.

The US economy added 224,000 jobs in June, a sharp rebound from the prior month, tempering market expectations of a 50 basis point rate cut by the Fed in July. Yet lackluster wage growth alongside sluggish inflation data could still encourage a 25 basis point cut.

The Tax-Free Municipal Bond benchmark index ended the quarter with a positive return year to date of 5.18%. Most market analysts look for the market to remain strong for the remainder of the year. Supply and demand factors remain favorable, characterized by an anticipated decline in new issuance, positive fund flows and investors ongoing search for tax-free income.

Our current strategy for municipal-bond investors continues to be to own a diversified portfolio of high-quality, investment grade bonds maturing in one to ten years. For clients who reside in high income tax states, we focus on buying a diversified portfolio of bonds issued in their state (when possible) in order to benefit from the state tax exemption. We also buy out-of-state bonds for the purpose of credit diversification.

Our client's portfolios are designed to earn optimal after-tax return while maintaining a relatively defensive portfolio structure given today's interest rate environment. Of course each client has a unique set of circumstances that we focus on in order to customize the portfolio towards meeting their goals and investment objectives. Tax-free income, preservation of principal and targeted duration management is what makes a municipal bond portfolio an attractive investment for clients in a high tax bracket.

Evan Slater
Fixed Income Portfolio Manager