

1Q 2019 Commentary

ANDY KAUFMAN
CHIEF INVESTMENT OFFICER

KRISTIN FAFARD, CFA
CHIEF INVESTMENT STRATEGIST

ELLIOT GILFARB, CFA
HEAD OF FIXED INCOME

ANDREW COWEN
HEAD OF EQUITIES

JULIE EGAN
PORTFOLIO MANAGER

THOMAS LOTT
PORTFOLIO MANAGER

DAVID SAND
CHIEF IMPACT STRATEGIST

JESSICA BOTELHO
DIRECTOR OF CRA AND IMPACT
RESEARCH

RICKY FERNANDEZ, CFA
JUNIOR PORTFOLIO MANAGER

MARKET COMMENTARY

The first quarter of 2019 proved to be the reemergence of the Federal Reserve's focus on the balance sheet. While Jerome Powell hinted to slowing the pace of run-off of the balance sheet in December, in the first quarter of 2019, he explicitly stated that the Federal Reserve intends to hold the balance sheet steady and stop the increase of fed funds rates unless economic data says otherwise. Powell's confirmation paired with the later stages of a long economic cycle, lower domestic growth projections, and some recent releases of weaker economic data, makes a reversal from lower rates very unlikely in the near future. It helped calm the markets from the increased volatility we saw at the end of 2018 and push both equities and fixed income higher during the first quarter of 2019.

Global stock markets rallied with the S&P 500 Index[®] up 13.7%, and the MSCI EAFE Index and Emerging Markets Indices both up almost 10%. In the U.S., investors shrugged off news that profit margins had declined from their 2018 record-high levels. Price gains were broad-based, yet most pronounced in the stocks of higher-growing companies, which had been the hardest hit at the end of last year when investors became concerned about their continued ability to grow in a slower-growth environment. The impressive 14.6% return in the small-cap-dominated Russell 2000 Index[®] was not enough to erase its now 15-year performance deficit against the largest companies found in the Russell Top 200 Index[®]. With the exception of small cap value stocks, these recent price increases have left the valuations of the broad-based U.S. market indices at or above their 20-year averages.

While stocks grew in the first quarter, the bond market also rallied with the Barclays Aggregate Index moving up almost 3% during the quarter as long-maturity corporates and non-investment grade bonds led the way. Both the Bloomberg Barclays U.S. Aggregate Credit-Long and High Yield Indices were up over 7%, in keeping with their historical pattern of being highly correlated to stocks. Corporate spreads are now back below their median levels of the last 15 years, so similar to stock technicals, there would appear to be very little margin should growth expectations shift even lower. But with more indications that rates may remain lower for longer, cheap access to credit may once again prove to justify lofty valuations in both the credit and stock markets.

Core Fixed Income Composite

PORTFOLIO COMMENTARY

In the first quarter of 2019, the Core Fixed Income Composite (“composite”) was up 2.05% (gross of fees) and up 1.97% (net of fees). The Intermediate component of the Bloomberg Barclays Aggregate Bond Index (“benchmark”) was up 2.28%.

The composite’s largest sector, agency commercial mortgage-backed securities, was up 2.03%. On a stand-alone basis, the sector contributed 29 basis points of income return, while the composite generated a total income return of 81 bps. In addition to the income profile, the price return in the sector was better than the benchmark’s Treasuries given the longer duration exposure.

The composite’s second largest sector, single family agency mortgage-backed securities, was up 2.17% during the month and performance was in-line with the benchmark’s MBS. The composite’s overweight exposure to 30-year MBS vs. the benchmark (the composite currently has no exposure to 15/20-year MBS while the benchmark’s sector exposure is 13%), slower prepayments vs. the benchmark, and a higher income profile all helped negate the underweight allocation of 3% coupons, which were the best performing coupon during the quarter.

The third largest sector in the composite, taxable municipal bonds, was up 2.34%. With spreads tightening during the quarter (albeit not as much as in the corporate sector), plus the move in rates, the overall price return was 1.54%. The rest of the total return in the sector was due to the income component.

Corporates were the best performing major sector in the bond market during the quarter as spreads tightened, generating a 3.82% total return and an excess return of 2.10%. Treasuries were up 1.59% and Mortgages were up 2.17%.

As of March 31, 2019, the composite’s Yield-to-Worst (YTW) is 3.20%, which is higher than the benchmark’s YTW of 2.78%; and exhibited 9% longer duration (interest rate risk) to the benchmark. Overall, the composite’s higher income profile contributed slightly higher relative returns. In addition, the exposure across the longer-end of the curve positively impacted returns given the move in rates.

Going forward, the portfolio management does not anticipate any changes to its asset allocation weightings.

Effective April 1, 2018, the benchmark for the Core Fixed Income Composite changed from Bloomberg Barclays U.S. Aggregate Bond Index to the Bloomberg Barclays Intermediate U.S. Aggregate Index.

Data sources: Barclays Live, Bloomberg PORT, and eVestment Alliance.

CCM is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.

Bonds and bond funds are subject to interest rate risk and will decline in value as interest rates rise. Past performance does not guarantee future results. This performance report should not be construed as a recommendation to purchase or sell any securities held in composite accounts. Market conditions can vary widely over time and can result in loss of portfolio value. The results portrayed included the reinvestment of dividends, interests, and other earnings. The index information presented herein does not reflect the impact of fees; you cannot invest directly in an index.

Gross returns in this presentation do not include the effect of management fees. If included, returns would be lower. Gross returns will be reduced by management fees. For example, a 1% annual fee from an account with a ten-year annualized growth rate of 10% will produce a new result of 8.95%. Actual performance results may vary from this example. Sector attribution is presented on a gross only basis and does not reflect the deduction of management fees. For a more detailed description of fees and expenses, see Form ADV part 2A.

As of 03/31/19, the average annual gross returns for the Core Fixed Income Composite for 1-year, 5-year, 10-year and since inception (8/30/99) were 3.99%, 2.89%, 3.46% and 4.88%. As of 03/31/19, the average annual net returns for the Core Fixed Income Composite for the same time periods were 3.67%, 2.58%, 3.15% and 4.48%.