COMMUNITY CAPITAL MANAGEMENT
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4Q 2019 Commentary

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MARKET COMMENTARY

The fourth quarter of 2019 was the grand finale in a stellar year for the capital markets, particularly in the U.S. stock market. Despite evidence that economic growth would fall to the lower levels projected in the prior two quarters, and global trade tensions remaining unchanged, investor exuberance was prevalent throughout the quarter. Investors preferred higher-risk assets like stocks and high yield bonds to investment grade bonds, resulting in higher interest rates along the yield curve and stock valuations and bond spreads reaching levels not seen since the end of 2017. Investors had reason to cheer; in October, the Federal Reserve lowered rates for the third time in 2019 and announced the start of open-market purchases of treasury bills. This was yet another signal of its intent to support capital market liquidity and reduce any potential obstacles to economic growth, a welcome message to investors as they face an election year and potential trade-related uncertainties.

U.S. equity markets moved higher in a relatively steady manner throughout the quarter with the S&P 500 gaining 9 percent. Small cap stocks performed better than large cap stocks with the Russell 2000 gaining 9.94 percent and the Russell Top 200 Index up 9.79 percent. The market has continued to pay a growing premium for growth as growth stocks outperformed value stocks, primarily driven by gains in the technology sector. Within the S&P 500 Index, the technology sector climbed 14.4 percent, contributing to its 2019 return of 50.29 percent and its price-to-earnings ratio at 10-year highs. While the valuation of the S&P 500 is also close to its ten-year high and has exceeded its 20-year high, most of this is attributable to the valuations in the largest growth companies. This means that not all stocks look expensive; small cap value stocks, as measured by the Russell 2000 Value Index, appear the most attractively valued when compared to their 20-year averages. Valuation dispersion among and within the sectors of the equity market means that there is ample opportunity for discerning and talented stock pickers.

Investment grade bonds posted mixed results during the quarter, with the Barclays Aggregate Index returning a mere 0.18 percent. The flight to riskier assets resulted in overall selling in the U.S. Treasury market, particularly in longer-dated maturities. Investors preferred the higher yields of the spread sectors, particularly corporate bonds where the riskier the credit, the better the return. The Barclays U.S. High Yield Index climbed 2.61 percent during the quarter, contributing to its 2019 total return of 14.32 percent. Even within the investment grade segment of the corporate market, investors sought the riskiest of exposures, where the ever-growing bottom-tier BBB segment outperformed the higher quality AA segment by almost 1.48 percent for the quarter and over 5 percent for the entire year. The corporate credit market appears even more richly priced than it was at the end of the quarter where the compensation for taking credit risk is slim and spreads are not far from the pre-crisis lows. This type of risk-seeking behavior may seem consistent with that of the equity market; however, it is not consistent with the stabilizing role that bonds are expected to play in portfolios. With rates at such low levels, income cannot buffer sudden price declines like it can at higher rate levels. And with corporate spreads declining even further, there remains what may be viewed as little margin of safety in a year that is poised to present even greater economic and market uncertainty.

Core Fixed Income Composite

PORTFOLIO COMMENTARY

In the fourth quarter of 2019, the Core Fixed Income composite ("composite") was up 0.30 percent (gross of fees) and 0.24 percent (net of fees). The Intermediate component of the Bloomberg Barclays Aggregate Bond Index ("Benchmark") was up 0.47 percent.

The composite's largest sector, single family agency mortgage-backed securities (MBS), was up 0.88 percent during the quarter and outperformed the Benchmark's MBS sector by 17 basis points. The relative outperformance was mainly due to price return, with the composite having lower exposure to 3 percent coupons, which underperformed 3.5 percent coupons and 4.5 percent coupons. The composite also has no exposure to 15/20-year MBS, which underperformed 30-year MBS. Slower prepayments versus the benchmark positively impacted returns, as did the higher income profile.

The composite's second largest sector, agency commercial mortgage-backed securities (CMBS), was down 0.41 percent during the quarter. The underperformance of Swaps to Treasuries across the curve negatively impacted the sector. Although spreads were relatively unchanged, the price return was down over 100 basis points given the move in rates. Total returns were positively impacted from the income component, which added 69 basis points to the total return in the sector.

The third largest sector in the composite, taxable municipal bonds, was up 0.22 percent. Spreads tightened, helping the price return, while the income component added 89 basis points to total return in the sector.

Lastly, the composite's asset-backed securities (ABS) were up 0.43 percent. The composite's non-agency ABS, which is more than half of the exposure in the ABS sector, generated a total return of 0.56 percent during the quarter, generating an income return of 0.82 percent.

The Benchmark's performance for the quarter was led by its larger position in corporates, generating a 1.10 percent total return and an excess return of 1.21 percent. The second largest sector in the benchmark, MBS, was up 0.71 percent and an excess return of 0.62 percent. The largest sector in the benchmark, Treasuries, generated a total return of 0.01 percent.

As of December 31, 2019, the composite's Yield-to-Worst (YTW) is 2.61 percent, higher than the benchmark's YTW of 2.14 percent, and it exhibited 3 percent longer duration, or interest rate risk, to the benchmark. The portfolio management team does not anticipate any changes to its current asset allocation weightings.

Important Information

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.

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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 12/31/19, 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 6.42%, 2.90%, 3.55% and 4.91%. As of 12/31/19, the average annual net returns for the Core Fixed Income Composite for the same time periods were 6.12%, 2.59%, 3.24% and 4.51%.