COMMUNITY CAPITAL MANAGEMENT
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PORTFOLIO POSITIONING IN AN EVOLVING INTEREST RATE ENVIRONMENT

Income investors are likely aware of the increased volatility in the bond markets and interest rate sensitive equities lately. We expect that the speed and violence of price moves since the summer, and especially since the presidential election, caught many people off guard. We thought a brief update on recent markets' performance would be helpful to investors deciding what to do next.

We aired our concerns about high prices for yielding assets extensively throughout the summer and early autumn in performance updates and white papers. In short, we believed investors were incurring a lot of capital risk to capture fairly paltry yields from those assets. Given the combination of high valuations and low yields, even a nominal correction in valuations could quickly overwhelm investors' income.

As we feared, that risk was realized. The table to the right shows total returns for treasury bonds and higher-dividend equity sectors since the low point of the 10 year treasury yield (7/8/16 – 11/14/16) and since the eve of the presidential election (11/8/16 – 11/14/16). The data shows that, in many cases, capital losses experienced since July wiped out several years of income investors had received in coupons or dividends. For example, the Dow Jones Utility Average Index has dropped 11.8% since the 10 year treasury yield bottomed out. This equates to over 3 years of dividends at the September 30, 2016 yield. In addition, unlike a bond that matures at par regardless of the prevailing interest rate environment – rate sensitive equities such as utilities do not. There is nothing forcing these losses to be recouped.

Considering that the Dow Jones Utility Average Index's 2016 rally prior to the low point of the treasury yield was almost 25%, it is not difficult to imagine prolonged capital losses far in excess of dividends should the rate normalization period continue. Many other assets exhibit similar asymmetric risk/reward profiles.

	Total Return	
	7/8/16 – 11/14/16	**11/8/16 – 11/14/16**
10 Year Treasury	-7.78%	-3.68%
Bloomberg Barclays Aggregate Index	-2.98%	-1.77%
S&P 500 Index	2.33%	1.18%
S&P 500 Dividend Aristocrat Index	-3.22%	1.22%
Dow Jones Utilities Average Index	-11.78%	-6.37%
Dow Jones Equity All REIT Index	-9.91%	-1.16%

The trillion dollar question is where do we go from here?
For investors holding rate sensitive investments, we think the path ahead for interest rates is hazier than it has been in a long time. We hope that investors realize the interest rate sensitivity of their investments and are earning appropriate yields for the risk of rising rates.

Indices listed are unmanaged and one cannot invest in an index.

10 year treasury yield: The return on investment, expressed as a percentage, on the U.S. government's debt obligations.

Bloomberg Barclays Aggregate Index: a broad bond base index often used to represent investment grade bonds being traded in United States; S&P 500: a market value weighted index of 500 stocks seen as a leading indicator of U.S. equities and a reflection of the performance of the large cap universe; S&P 500 Dividend Aristocrat Index: Companies in the S&P 500 who have increased their dividends for at least 25 consecutive years; Dow Jones Utilities Average Index: price-weighted average of 15 utility stocks traded in the United States; Dow Jones Equity All REIT Index: The index represents all publicly traded real estate investment trusts in the Dow Jones U.S. stock universe classified as Equity REITs according to the S&P Dow Jones Indices REIT Industry Classification Hierarchy.