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# 3Q 2019 Commentary

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## MARKET COMMENTARY

Similar to the previous two quarters, the U.S. economic growth rate continued to slow in the third quarter. However, it remained strong compared to the rest of the world. As expected, the Federal Reserve reduced the Federal Funds rate by 0.25 percent in July. With August economic data reinforcing the slower growth outlook, the Fed acted again in September with another 0.25 percent rate cut. Investors' newfound "lower for longer" economic growth and interest rate outlook, combined with the healthy year-to-date gains in stocks, helped to push capital away from the higher growth areas of the stock market and toward what may be perceived as the safety and yield of bonds and income-oriented stocks.

Equity markets bumped around during the third quarter with leadership shifting alongside the release of economic and corporate profit data. Overall, large cap stocks held up better than small cap stocks with the S&P 500 Index up 1.7 percent, and the Russell 2000 Index down 2.4 percent. Within the U.S. stock market, declining interest rates proved beneficial for high yield stocks and bank stocks whose net interest margins generally expand as short-term rates decline. This contributed to gains in the S&P U.S. REIT Index, which was up 7.46 percent, and the S&P Value Index, which was up 2.47 percent. In contrast to the second quarter, the S&P 500 Growth Index trailed the S&P U.S. REIT Index and the S&P Value Index, gaining only 0.72 percent as the lower outlook for growth could no longer justify lofty valuations and almost 20 percent year-to-date gains. With the exception of small cap stocks, valuations remained high relative to their 20-year averages. Additionally, corporate profit growth has moderated, creating little margin of safety if economic conditions worsen. In this environment, we believe that attention to both fundamentals and price becomes even more important when building a stock portfolio.

With the outlook for growth slowing, investment-grade bonds continued their prior three quarters' rally, particularly in the longer maturity segment of the market where investor demand was the greatest. The Bloomberg Barclays Aggregate Index rose 2.27 percent with long-dated U.S. Treasuries posting the best results of all investment-grade sectors, rising 7.92 percent, and long-dated corporates up 5.61 percent. Similar to the second quarter, the MBS sector, which comprises approximately 27 percent of the Bloomberg Barclays Aggregate Index, delivered a 1.37 percent return, lagging most other sectors as mortgage refinancing increased amidst declining interest rates. The corporate credit market appears richly priced as spreads are less than 25 percent of their late-2008 levels. More importantly, over half of the outstanding value of investment-grade corporate bonds now carries the lowest credit rating (BBB/Baa) within the investment-grade rating scale. This combination (high prices and declining fundamentals) can create more risk – so decisions around credit selection and overall allocation to corporate credit can become even more important.

# Core Fixed Income Composite

## PORTFOLIO COMMENTARY

In the third quarter of 2019, the Core Fixed Income composite ("composite") was up 1.61 percent (gross of fees) and 1.52 percent (net of fees). The Intermediate component of the Bloomberg Barclays Aggregate Bond Index ("Benchmark") was up 1.38 percent.

The composite's largest sector, agency mortgage-backed securities (MBS), was up 1.37 percent during the quarter which matched the benchmark's MBS sector return. 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 percent), a higher income profile, and a superior paydown return all positively contributed to relative returns for the quarter. The composite had an underweight allocation to 3 percent coupons, which were the best performing mortgages during the quarter.

The agency commercial mortgage-backed securities (CMBS) sector was the best performing sector of the composite, generating a 2.07 percent total return. Spread tightening across the project loan REMIC space, which accounts for over 50 percent of the sector's exposure, was the primary reason for the excess return. Income was also a key driver, accounting for over one-third of total return. Additionally, the longer duration profile of Agency CMBS positively impacted returns.

The third largest sector in the composite, taxable municipal bonds, was up 1.42 percent with a price return of 0.62 percent, while the income return was 0.81 percent. The sector's return was negatively impacted as spreads widened during the quarter.

The Benchmark's performance for the quarter was helped by its larger position in corporates, which was the best performing sector in the bond market during the quarter, generating a 1.74 percent total return and an excess return of 0.62 percent. Treasuries and mortgages also contributed to the benchmark's performance, up 1.18 percent and 1.37 percent, respectively.

As of September 30, 2019, the composite's Yield-to-Worst (YTW) is 2.59 percent, higher than the benchmark's YTW of 2.11 percent, and it exhibited 4 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.*

*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 09/30/19, 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 8.06%, 3.18%, 3.50% and 4.95%. As of 09/30/19, the average annual net returns for the Core Fixed Income Composite for the same time periods were 7.72%, 2.86%, 3.18% and 4.56%.*