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Fixed Income Market Comments

The Federal Reserve removed the word “patient” from their forward guidance, effectively making the timing of the first Federal Funds rate change in the last 5 years completely data dependent. Yes, the last time the Federal Funds rate has moved at all was in February of 2010. However, Chairwoman Janet Yellen told us “removing the word patient from the statement doesn’t mean we are going to be impatient”. While it’s true the Fed is planning to raise rates this year, the amount of the increases and the pace of the increases is going to be extremely slow and cautious. The course plotted by the Fed indicates rates will only rise by 50 bases points this year max; the first 25 basis points coming in June or September, and the next 25 in December. Unless something changes drastically in the economy, the Fed Funds rate should only move 100 basis points total in the 12 months following the first increase (whether it occurs in June or September). This is a very cautious pace, and while we will see some short term volatility before and after the first increase, things should move more smoothly once the pace of increases has been set.

In respect to international markets, the US is a few years ahead in terms of Quantitative Easing. Japan is still increasing their QE efforts and the European Union finally joined the party and issued their own version of QE. This diverging monetary policy between the Fed and other world central banks hit home in the first quarter. The dollar rallied while oil prices continued to decline, the effects of which are beginning to show in Q1 economic data. Manufacturing has been the hardest hit, as exports, factory orders, and business investment suffer. Dollar strength and lower energy prices create a downward pressure on inflation, but job growth has remained positive and wages are finally beginning to increase, leaving us hopeful that recent headwinds will pass and inflation continue toward the Fed’s target of 2%.

It’s important to remember that it really doesn’t matter to the fully diversified, long term investor when the fed raises rates. If they do it in June, that’s okay. The market will have a period of volatility, but things will level off after a month or two. If they do it in September, that’s okay too. The markets will be more prepared at that point, but there’s still going to be some short term volatility. Bill Dudley, a member of Janet Yellen’s inner circle said recently that hiking rates doesn’t mean the Fed is “tight” and normalizing policy “would be a cause of celebration” and a “positive signal” for the economy. He said the public is paying too much attention to the timing of the first rate hike and not enough to how quickly the Fed will lift rates once it gets going.

While September continues to be the consensus, a rate hike in June is possible, especially if economic numbers come in strong in May. But whether it’s June or September, we still believe there will only be about 100 basis points of rate hikes in the following twelve months, even slower than the gradual series of rate hikes in the 1990s and 2000s.

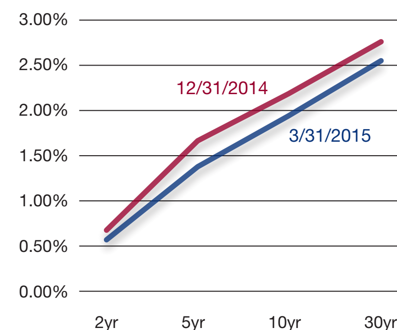
Taxable Fixed Income Performance Composite

The TCVA taxable fixed income composite outperformed its benchmark for the first quarter of 2015. The composite continues to maintain an average weighted maturity and duration shorter than the benchmark, as well as higher credit quality. Maintaining a high yield continues to be a challenge in the current interest rate environment, however we are still finding the most value in the Taxable Municipal bond market and believe that a fixed income portfolio with durations shorter than the respective benchmarks remains the best strategy until rates began to rise.

Portfolio Characteristics:	
Average Maturity	3.6 yrs
Average Duration	3.2 yrs
Average Yield to Maturity	2.45%
Average Coupon	4.40%
Average Quality	AA

Credit Quality:	
AAA	20%
AA	40%
A	33%
BBB	7%

Treasury Yield Curve



Fixed Income Sector Breakdown