Chilton Investment Services

Quarterly Commentary

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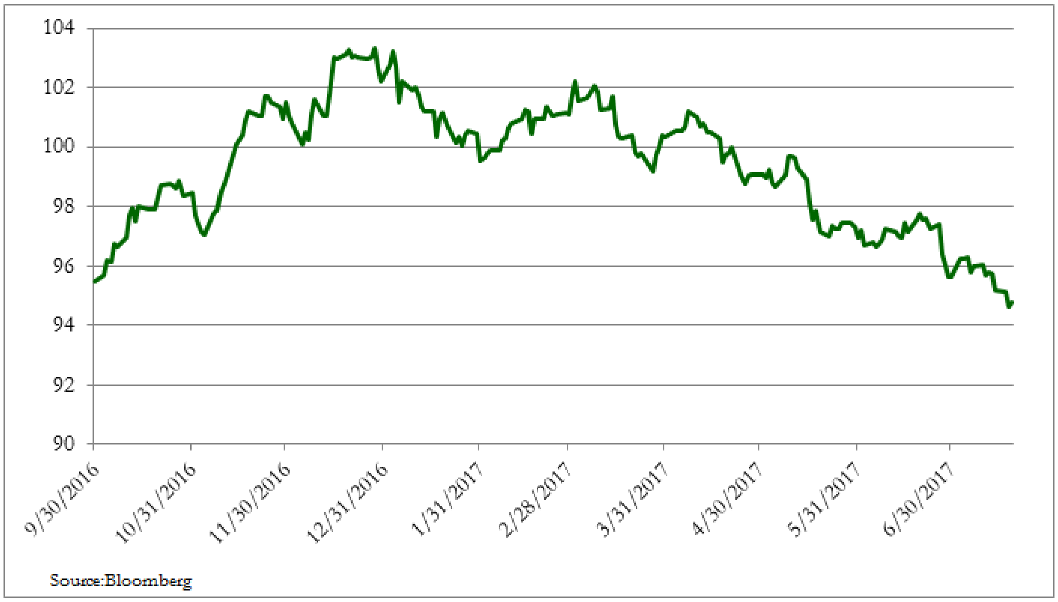
Themes in Second Quarter 2017

- **Tax-Advantaged Strategy**: Maintain a neutral duration relative to the benchmark. Due to tight credit spreads, we focused on AAA and AA--rated revenue bonds in sectors such as transportation, dedicated tax, water and sewer, and regulated utilities.
- **Crossover Strategy**: Increased our weighting to the corporate sector due to tight municipal/treasury ratios. Opportunistically added new issue investment grade corporate bonds in the 3, 5 and 7-year maturity range.
- **Corporate Strategy:** Maintained duration by selling securities with maturities less than one year and purchasing investment grade corporate bonds with durations approximately 3 to 5-years. Concentrated on new issues in sectors such as financials, consumer staples, industrial products, and computer hardware.
- **International Strategy**: Maintained underweights to a number of developed market currencies that had predominantly negative interest rate environments such as Eurodollar, Japanese Yen and Swiss Franc. The yield deficit in these currencies continues to be a headwind for their values. Added an allocation to several emerging market currencies due to a developing theme of balanced global growth, which should benefit these currencies.

With the US economy on track for moderate performance in 2017, the Federal Reserve demonstrated its resolve in continuing to normalize rates at its Quarter-end June Meeting. Despite some softness in wage growth and retail sales, the overall trend in the US growth has supported both full employment and sustainable inflation, close to the Fed's intermediate targets—but not an economy at "escape velocity" that might require a more aggressive monetary restraint.

Early in the Quarter, higher oil prices suggested that an acceleration in global growth might be at hand. Yet, by quarter-end, the reversal to new lows in oil, presented a positive outlook for synchronized growth. For the US economy, lower oil-prices presented the consumer with a net positive for the upcoming Summer driving season. For the global economy, lower oil prices seem to guaranty a better trajectory been generally supportive of growth trends.

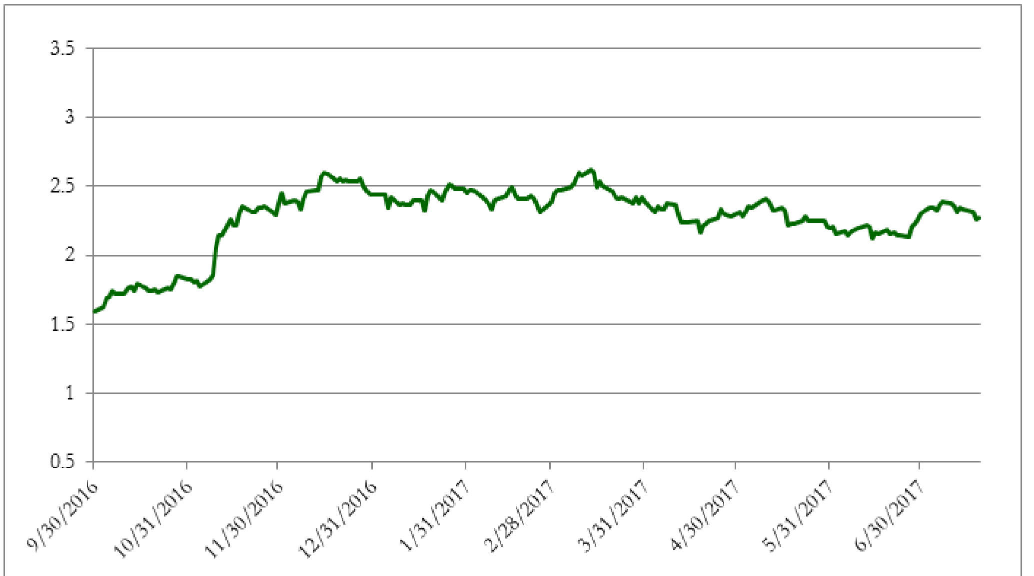
Chart 1: U.S. Dollar Index



Despite the original expectation for upside and an expanding interest rate differential in its favor, the "Trump USD" has proved to be a weaker rather than stronger USD. While in the longer term this weakness may prove beneficial for US manufacturing exporters, at present it seems to reflect the limited success of the Trump agenda. With the failure of the Republican controlled Congress to repeal and replace "Obama-care", all eyes are now on what happens next with Tax-reform, Deregulation, and Infrastructure Spending.

The take-away for fixed income markets is that whatever gets enacted in Washington will pose limited inflationary risks. Hence, the Federal Reserve is likely to move "slowly" both in normalizing interest rates and in unwinding its balance sheet The result should still produce a moderate growth trajectory for the US economy for the intermediate term.

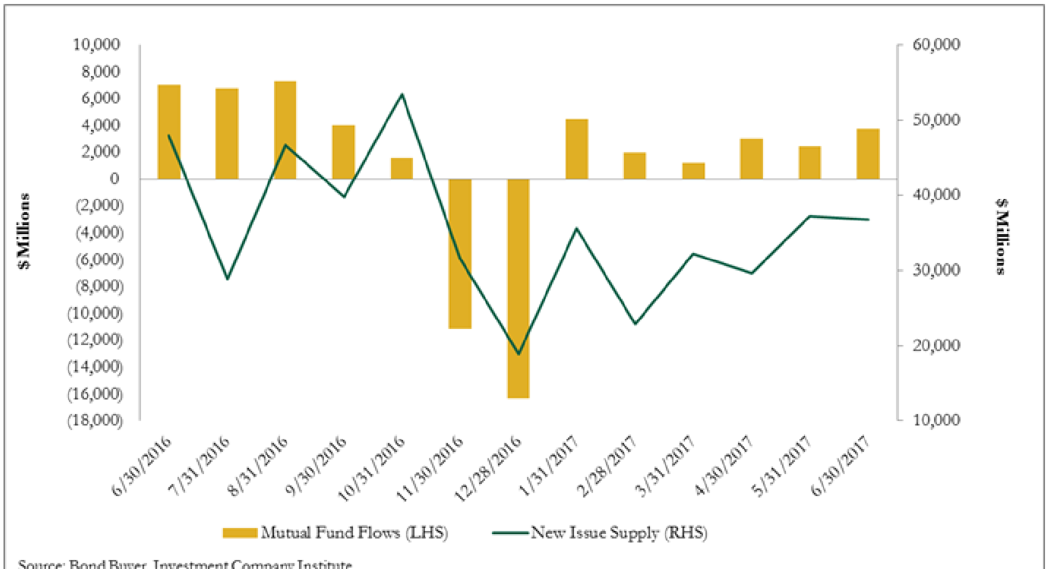
Chart 2: U.S. 10 Year



Source: Bloomberg

The municipal market exhibited strong performance in 2Q17 delivering positive total returns for the second consecutive quarter. Factors such as, declining U.S. Treasury and a continued slow down in new issue volume contributed to a decline in yields. As indicated in Chart 1, long-term issuance remained well below last years levels. According to the Bond Buyer, new issue volume for the quarter was down 18.1%, with $103.7 billion of new debt for the second quarter, compared with $126 billion from the same period last year. In addition, strong technicals due to June's coupon reinvestment and bond maturities, guided yields to post election lows.

Chart 3: Municipal Mutual Fund vs. New Issue Supply



Source: Bond Buyer, Investment Company Institute

According to Municipal Market Data, AAA-rated securities, with the exception of 1-year maturities, closed the quarter at lower yields than month-end March. The outperformance witnessed over the past quarter occurred from 5 to 30-years with yields declining 20 to 26 basis points. The curve continued its flattening trend as investors awaited another increase in short-term rates which occurred at the Federal Reserve's June meeting. The spread between 1 and 30-year securities tightened 31 basis points from 219 in March to 188 basis points, month-end June.

Table 1: AAA General Obligation Yields March 2017- June 2017

	1 Year	5 Year	10 Year	20 Year	30 Year
March	0.86	1.55	2.25	2.93	3.05
June	0.91	1.35	1.99	2.65	2.79
Change	0.05	-0.2	-0.26	-0.28	-0.26

Source: Goldman Sachs, Bloomberg

Positive technicals also translated into impressive performance versus their taxable counterparts. The Municipal/Treasury ratio table below illustrates the relative performance between municipals and U.S. Treasuries over the March to June 2017 period. Municipal significantly outperformed their taxable counterparts during this period. Outperformance was most pronounced in the 5-year sector of the municipal yield curve as AAA-rated municipal yields declined 24 basis points and Treasury yields declined 4 basis points. As a result, ratios tightened 7 percentage points to comparable Treasuries. Ratios in the 2, 10 and 30-year sector tightened 2 to 6 percentage points. Consequently, the muncipal market outperformance has helped push AAA-rated yield ratios toward rich vaulations.

Table 2: Year to Date Ratios (as a percent)

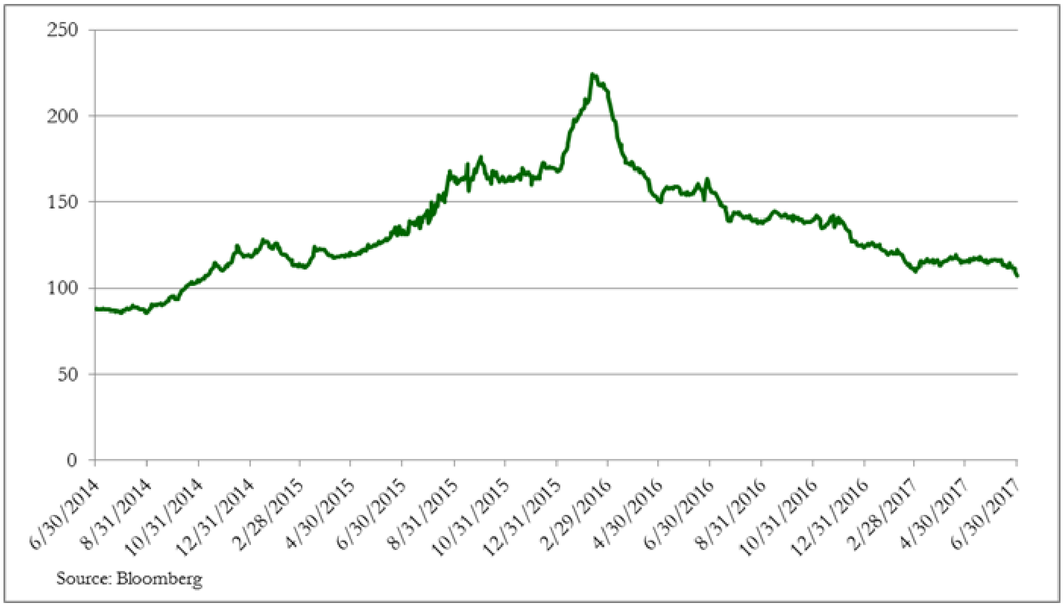
	2 year	5 year	10 year	30 year
March	81	80	94	101
June	77	73	88	99
Change	**-4**	**-7**	**-6**	**-2**

Source: Bloomberg

Corporate Market

Second quarter 2017 was a positive one for the corporate market as spreads narrowed for the fifth straight quarter. The spread of the Bloomberg Investment Grade Index narrowed to a level last seen in November 2014 (See chart 3 Below).

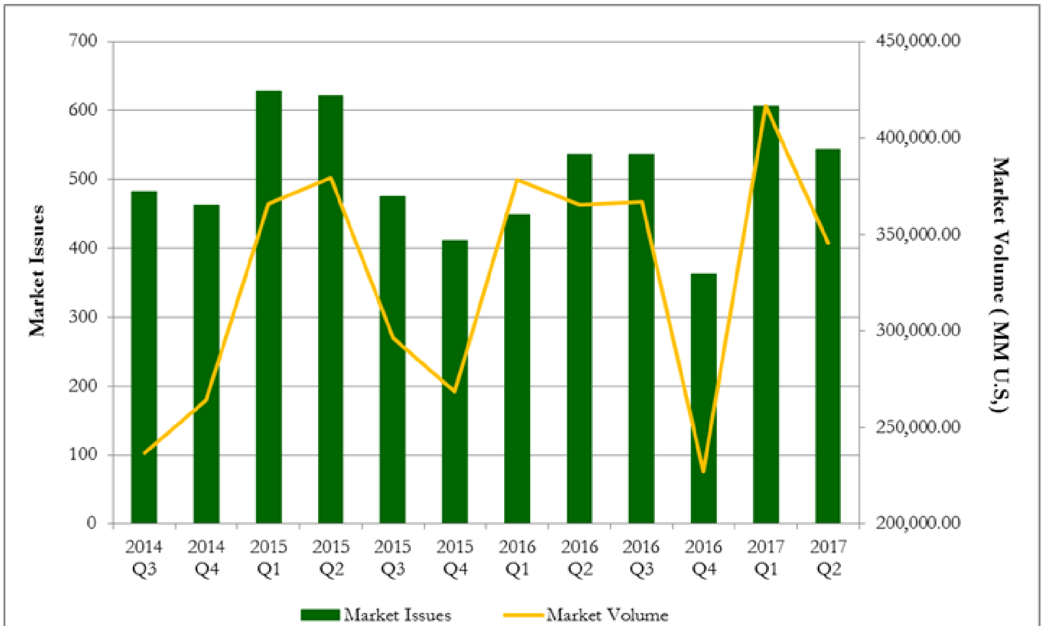
Chart 4: Investment Grade Corporate Spread



Corporate securities continued to perform well despite a number of headwinds. Political uncertainty increased as the ACA repeal debate languished in congress delaying what should be corporate friendly initiatives such as regulatory and tax reform and infrastructure spending. The Federal Reserve fast forwarded a second rate hike for the year in June. Extensive rhetoric from the Fed that stated that a hike wasn't so much a tightening of conditions but natural adjustment to the economy's continued recovery from the financial crisis prevented the hiking from impacting the market. A fall in oil prices during the quarter of just over 10% triggered a widening in high yield energy spreads of 92 Basis Points (0.92%) during the quarter. However, investment grade energy bonds weathered even that commodity price driven turbulence and ended the quarter unchanged in spread.

New issuance, while remaining high, fell from the torrid pace of the first quarter (See chart 4 below). The pace was reduced as merger activity slowed and issuers front-loaded their issuance for the year into the first quarter in an effort to get funding out of the way ahead of anticipated Fed hikes. The slowdown in supply lent technical support for the market.

Chart 5: Investment Grade Corporate Supply



Source: Bloomberg