Chilton Investment Services
Quarterly Commentary
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www.chiltoninvestmentservices.com

Please feel free to reach out to us. We look forward to your phone call.

Timothy W.A. Horan

CIO-Fixed Income

646-443-7748

thoran@chiltontrust.com

Gregg Manjerovic, CFA

Taxable Portfolio Manager

646-443-7768

gmanjerovic@chiltontrust.com

Debra Crovicz

Tax-Advantaged Portfolio Manager

646-443-7756

dcrovicz@chiltontrust.com

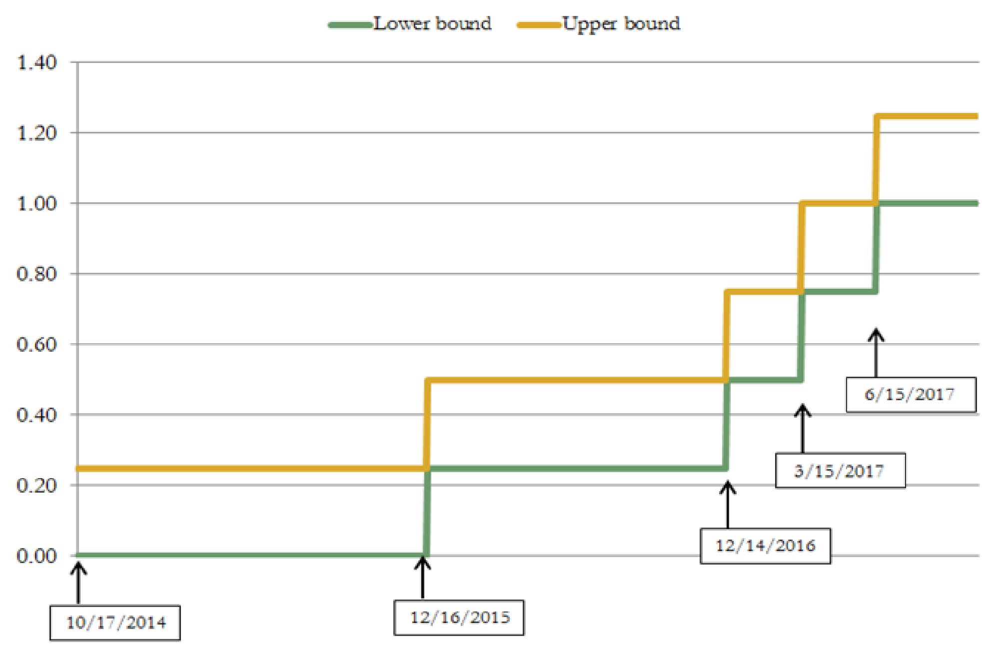
Themes in the Third Quarter 2017

Throughout the Third Quarter 2017, the real economy in the US performed in line with expectations despite the failure of the Republican-led Congress in Washington to pass any of the key pillars of the Trump agenda. The US consumer still led the economy through domestic demand but a weakening USD also helped some US companies sell into an accelerating global growth backdrop with both China and Europe performing better.

Expectation throughout the Third Quarter fluctuated as to the pace of Federal Reserve rate-normalization, with many Fed speakers sharing views about the need to unwind the balance sheet as the baton of policy passes from monetary to fiscal. By Quarter end the odds of a December rate hike increased substantially, keeping pace with the repricing of the front-end of the U.S. Treasury market.

Likewise, throughout the Third Quarter, market participants speculated over who would succeed Janet Yellen as Fed Chair or whether President Trump would actually reappoint Chair Yellen. The impact on the bond market of an actual change in leadership, together with President Trump's likely nominations to fill other vacant seats on the Federal Reserve Board, occupied market attention.

Rate Normalization



Source: Bondedge

OUTLOOK

Our central case for fixed income remains constructive. We expect to continue to reinvest maturities at more attractive yields as the Fed's rate normalization unfolds. While the flatness of the yield curve demonstrates the level of comfort in the market with current moderate trends in inflation, we remain focused on all data points, particularly wage-inflation measures that might suggest that the Fed needs to ramp-up the pace of normalization.

- **Tax-Advantaged Strategy:** Due to primary market valuations, we utilized the secondary market to maintain benchmark neutral duration. We focused on AA-rated revenue bonds in sectors such as transportation and toll-roads where we still found relative value while adding to the pre-funded sector as an alternative to cash.
- **Crossover Strategy**: Continue to increase our weighting to the corporate sector due to stronger international and domestic economic data and tight municipal/treasury valuations. Opportunistically added investment grade corporate bonds in the 2 and 5-year maturity range with the recent back-up in rates.
- **Corporate Strategy:** Modestly extended duration by selling securities with maturities less than one year and purchasing investment grade corporate bonds with durations approximately 2 to 5-years. Concentrated on secondary

issues in the energy/pipeline sector. Strategically swapped issuers in the semiconductor, media, telecom and cable sectors to increase yield.

- **International Strategy**: Due to further strength in non-U.S. growth, we saw opportunity to add additional non-U.S. dollar positions such as Turkey and Philippines.

Municipal Market

The municipal market was mixed in the Third Quarter. July and August witnessed compressed yields, only to rebound in mid- September, resulting in yields having minimal quarterly changes. The table below illustrates the volatility across the municipal yield curve throughout the quarter. According to Bloomberg, AAA-rated securities, with the exception of 5 and 20-year maturities, closed the quarter at only slightly higher yields than month-end June.

AAA General Obligation Yields June 2017-September 2017

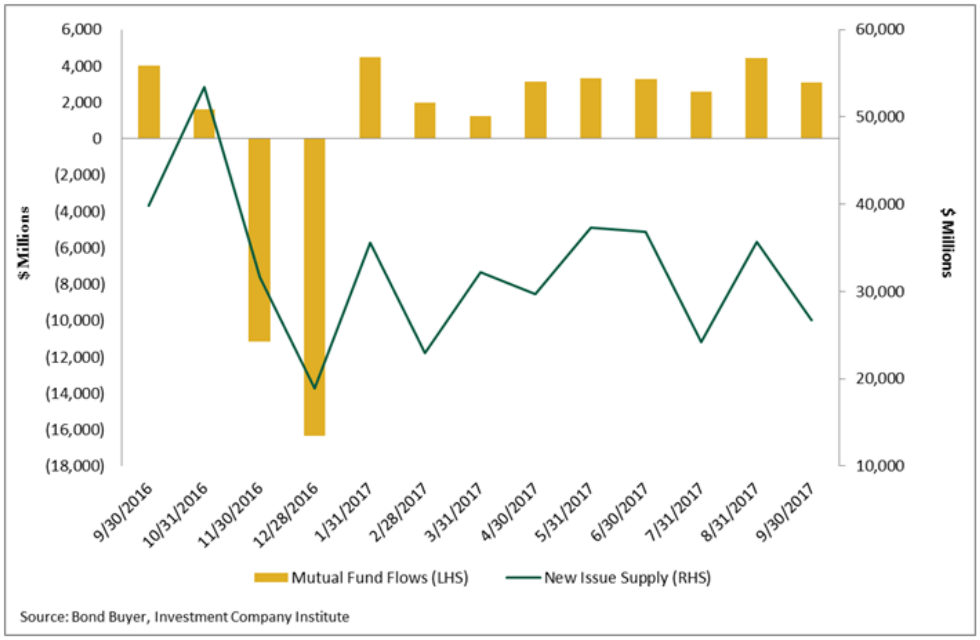
	1 Year	5 Year	10 Year	20 Year	30 Year
June	0.91	1.35	1.99	2.65	2.79
July	0.85	1.21	1.95	2.60	2.76
August	0.77	1.12	1.86	2.51	2.70
September	0.94	1.35	2.00	2.65	2.84
Change	0.03	0	0.01	0	0.05

Source: Bloomberg

The decline in yields in the first two months of the quarter was heavily influenced by a variety of factors, such as a decrease in Treasury yields, geopolitical risk regarding North Korea, and mixed economic data. Political uncertainty regarding the Trump Administration and its ability to cohesively communicate policy also played a role in the direction of municipal yields. Specific to the tax-advantaged market, the Administration's lack of a clear policy and detail on tax reform, healthcare and infrastructure put many issuers on the sidelines, therefore contributing to the dearth of long-term new issue volume and positive market technicals.

On the demand side, heavy bond calls and redemption increased the appetite for municipal securities. As depicted in the chart below, according to the Investment Company Institute (ICI), municipal bond funds recorded $10.1 billion net inflows for the quarter. On the supply side, long-term new issue volume closed the quarter well below last year's level. According to the Bond Buyer, issuance for the quarter was down 26%, with $87 billion of new debt issued compared with $116 billion from the same period last year.

Municipal Mutual Fund Flows vs. New Issue Supply



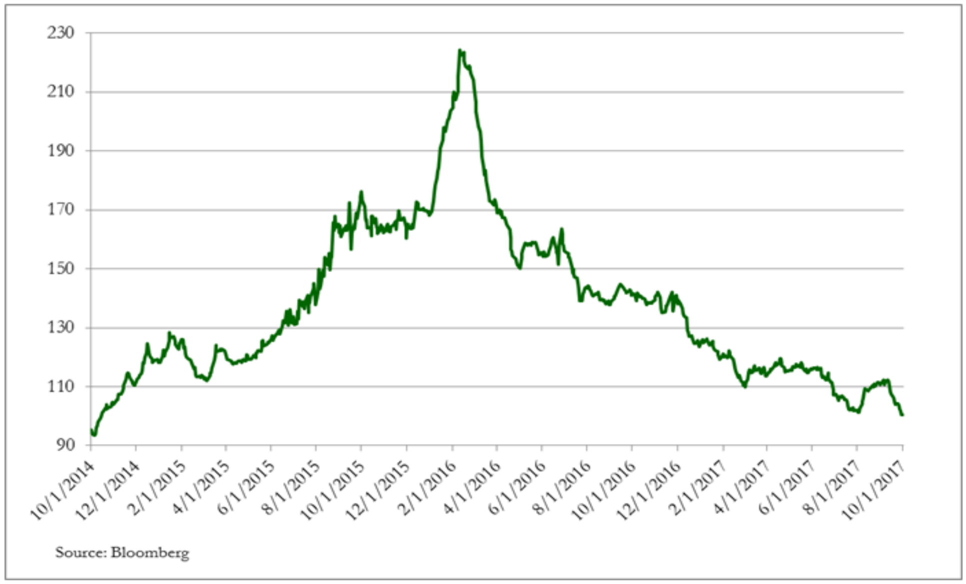
Source: Bond Buyer, Investment Company Institute

We witnessed a turn in overall market sentiment as we ended the quarter. The municipal market was negatively impacted by a variety of factors causing yields to increase 14 to 23 basis points from their August lows. The asset class was influenced by a significant back-up in US Treasury yields after the markets priced in another round of rate hikes at the upcoming December FOMC meeting. During the third quarter, odds of a December rate hike caused the municipal market to touch a low of 22% and closed at 70% by month-end September (source: Bloomberg). Another major contributor to the increase in municipal yields was the rich municipal/treasury valuations or ratios. Ratios, which are AAA-municipal yields divided by comparative US Treasury yields, fell in the 2 and 5-year maturity sectors to approximately 64 to 66 percentage points. As municipal valuations tightened, investors' appetite for municipals waned, pushing investors to seek better alternatives in the taxable markets.

Corporate Market

The run of outperformance in the corporate sector continues; as spreads narrowed for the sixth straight quarter and reached its tightest level in three years. (See Chart below)

Corporate Spreads



Spreads continue to tighten as the US economic and business picture remains benign. Despite a mature business cycle in the US, growth has remained strong, aiding US credit fundamentals. US credit has been further supported by an emerging synchronized global growth story as other regions that had long languished with sub-par growth are picking up. The improvements in overseas markets have boosted US corporate spreads alongside the stock market by providing a direct catalyst for earnings in US-based companies that have global business models, which provided an indirect boost by improving non-US corporate spreads and creating another tail wind for the sector.

Despite steady growth in the context of a mature economic cycle in the US and a surging global recovery, inflation remains low. While inflation remains low, global central banks can move slowly in reducing accommodative monetary stance. This room for global central bank forbearance has also fed into the expectations for continued economic growth.