CHILTON TRUST

Fixed Income Markets Review

Themes in the Third Quarter 2018

A strong and vibrant U.S. economy requires a vigilant and independent central bank that is prepared to do the job of normalizing interest rates against a backdrop of political and market criticism--- even when the loudest and main policy critic is the President of the United States.

President Donald Trump expressed his frustration at the Federal Reserve on July 19th. stating: "I'm not thrilled…because… (the Fed) wants to raise rates again… I am not happy about it. But at the same time, I'm letting them do what they feel is best…" thereby confirming, at least superficially, his respect for the independence of the Federal Reserve.

With confidence both in full employment and price stability, as well as its independent charter, the Federal Reserve was ready to execute another rate move of 25 basis points- the 8th such move in its normalization policy- at its September meeting.

In anticipation, market participants had already begun to push rates higher following the Federal Reserve's Jackson Hole Symposium where Chair Powell reiterated that "strong growth in income and employment" warranted further gradual increases on the Federal Reserve's policy rate. Chairman Powell followed up the September rate rise with the additional comment that there is "no reason to think" that the risk of recession over the next two years has been elevated. The U.S. Treasury 10-year yield closed the third quarter at a yield of 3.06%- reflecting only a moderate steepening of the yield curve and dispelling the notion that an inverted yield curve and hence an out-right recession was imminent. This is synchronous with Powell's assessments of the current risks to the economy.

Chilton Outlook for Rates

We expect additional rate moves by the Federal Reserve at the December 2018, March 2019 and June 2019 meetings. Additional Federal Funds rate moves in 2019 will be entirely dependent on the continued strength of the U.S. economy in light of the removal of accommodation as well as any growing risks of late cycle inflationary pressures, particularly from wages. In the meantime, the strength of the U.S. dollar has limited import price inflation, and is supported by a growing interest rate differential, all helping to facilitate the Federal Reserve's rate adjustment. U.S. dollar strength versus the major currencies like the Euro and Japanese Yen will likely continue into 2019—so long as the U.S. Federal Reserve remains committed to its rate normalization policy.

Chart of the U.S. Treasury 10-year

While the yield curve still remains historically flat, we look for an upward trend in rates (although the gravitational pull to lower than normal yields remains in place given the state of rate accommodation in the other major developed markets in Europe and Japan).

Chilton Strategies Outlook

- Tax-Advantaged Strategy: Due to ongoing normalization of rates by the Federal Reserve and weaker municipal market technical, we allowed accounts to drift lower in durations relative to the benchmark. On market back-ups, we opportunistically added securities in the A and AA-rated sectors with a concentration on revenue bonds.

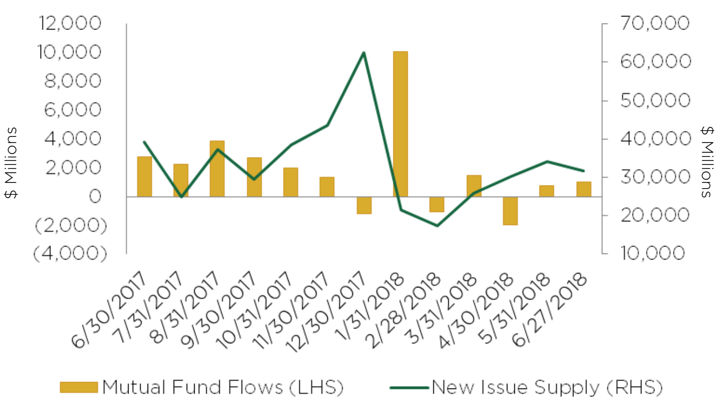
- Crossover Strategy: We continue to maintain an overweight to the Municipal sector as expectations for Mergers and Acquisitions will continue to put pressure on corporate spreads. We tactically added AA and A-rated corporate securities and municipal revenue bonds.
- Corporate Strategy: Interest rates remained range bound for most of the quarter as trade concerns offset positive economic data. At the end of the third quarter, corporate yields resumed their march higher on the potential of a new trade agreement with Canada and Mexico. With corporate yields approaching a multi-year high, we found an opportunity to modestly extend duration. As broker-dealer inventory diminished, we utilized the primary markets to make additional purchases.
- International Strategy: Emerging Market (EM) currency volatility was the story of the third quarter. We continued to decrease our exposure to the high-beta EM currencies to reduce potential portfolio volatility. We extended the maturity of Mexican Peso positions noting that progress would eventually be made on the trade front. We continued to underweight currencies that have negative carry in government bonds due to central bank intervention, such as the Swiss Franc, the Japanese Yen, and the Euro. The combination of lower EM exposure and developed market currency underweights resulted in a strong U.S. dollar overweight.

Municipal Market

The fixed income markets turned volatile with yields sharply rising in the second half of the third quarter. Factors such as strong U.S. economic data and investor demand for riskier assets contributed to negative price returns. In addition, expectations for further interest rate increases and prospects of a more hawkish Federal Reserve weighed on the markets. As expected, at the September FOMC meeting, the Federal Reserve increased the target rate range for federal funds by 25 basis points to 2.00% - 2.25% with expectations for further increases at the December meeting and the first quarter of 2019.

According to the Bond Buyer, municipal long-term bond issuance for the third quarter was $84 billion, or 8.7% less than the same period last year when issuers sold $92 billion. Despite strong technicals in July and early August, the municipal market felt fatigued as it closed the quarter with demand from retail and institutional investors diminishing. New issue deals struggled to garner interest and the secondary market was heavy due to persistent bid-wanted flow forcing dealers to cheapen their inventory. On the demand side, investor's risk aversion is evidenced when analyzing Mutual and ETF fund flows (Chart 1). Although net flows for were positive, an increase in market volatility caused retail investors to pause; moving municipal fund flows into negative territory with September recording $235 million of outflows.

Chart 1 : Municipal Mutual Fund Flows vs. New Issue Supply



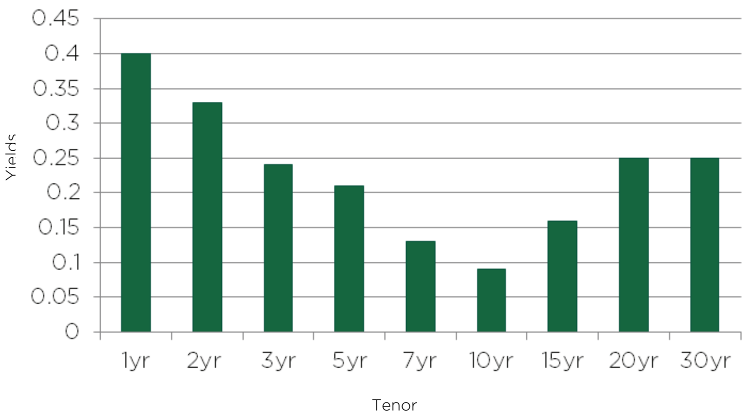
Source: Bond Buyer, Investment Company Institute

Municipal yields remained volatile throughout most of the quarter, forcing investors to be more cautious on term-structure. Thus, investors favored short-duration securities due to moderate market volatility and duration extension risk associated with this structure. As evidenced in Chart 2 on the next page, AAA-rated security yields increased 9 to 40 basis points. The curve did reverse its steepening trend as short-dated yields increased relative to the intermediate and long-end of the curve. The spread between 1 and 30-year securities tightened 15 basis points from 145 in June to 130 basis points, month-end September.

Corporate Market

Corporate securities experienced a modest improvement in the third quarter as signs of strengthening economic

Chart 2: Municipal Yield Changes (June 2018– September 2018)



Source: Bloomberg

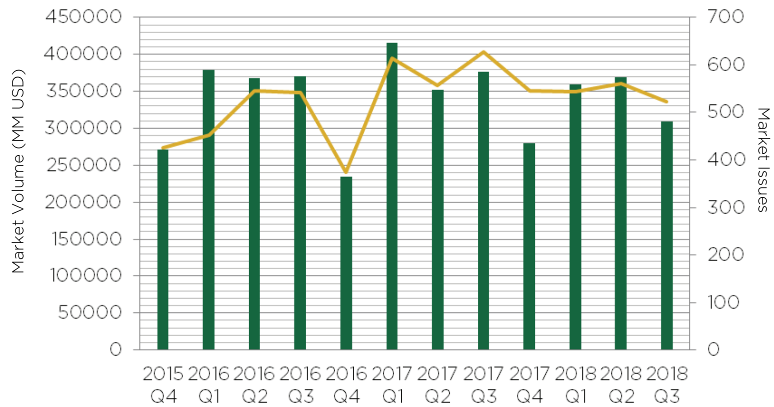
growth raised Treasury yields but corporate spreads tightened, offsetting some of the impact. As can be seen in Chart 3 below, investment grade corporate spreads tightened for the first quarter this year. Total return for the ICE Government Securities Index was negative 0.63%, however with tightening spreads and yield advantage the ICE Investment Grade Corporate Index returned a positive 0.96%. All ratings groups earned positive returns, with lower rated tranches returning more than higher. AAA's returned 0.11% and BBB topped the investment grade universe, earning 1.26%. High yield outperformed investment grade for the third straight quarter.

Chart 3: Investment Grade Corporate Spread

Source: Bloomberg

Supply pressure in the corporate space eased in the third quarter. The number of investment grade issues at 522 was the lowest since the fourth quarter of 2016 and the dollar volume was the lightest in three quarters. However, some large merger financing related deals are expected in the fourth quarter, with Comcast expected to kick off the fourth quarter with a large issuance.

Chart 4: Investment Grade Corporate Supply



Source: Bloomberg