Roosevelt Current Income Portfolio | First Quarter Commentary

Thoughts from our Domestic Fixed Income Team

Market Overview

US investment grade credit markets settled into tight trading ranges over the first quarter of 2017. Despite the Federal Open Market Committee's (FOMC) official announcement increasing its short-term interest rate target by a quarter of a percent (0.25%) to 1.00%, the 10-year US Treasury note only rose in yield by a scant amount (0.20%) to 2.60% — and then subsequently declined back into the trading range long established for this benchmark. Since November 2016, when Federal Reserve Board officials began to make known their intentions to resume short-term interest rate increases, intermediate credits have barely reacted at all.

It's been a different tale in the shorter-maturity sector, however. ***Two-year US Treasury market yields rose in direct line with the FOMC's actions and guidance. As a result, the US government yield curve has flattened.*** The difference between 10-year and two-year US Treasuries has tightened from 136 basis points on December 22, 2016 to 110 basis points on April 04, 2017. In other words, the yield incentive for investments eight years longer in maturity has declined by nearly 20%. Beyond historically low nominal interest rates, this yield spread contraction presents yet another challenge for income-oriented investors seeking to maximize annual cash flows without assuming a tremendous amount of risk.

In the face of this environment, the continual quest for conservative yield alternatives bolstered the preferred securities market during the start of this year. While the last quarter of 2016 saw preferred securities as a group decline in price rather decidedly, ending with one of the sector's less robust annual total rate of return performances, a great deal of that quarter's price decline was quickly reversed early in 2017. ***As represented by the BofA Merrill Lynch Fixed Rate Preferred Index, US preferred securities posted a robust 5.21% total return over the first three months of 2017 – the best quarter since the beginning of 2014, when the sector wound up the year posting a 15.44% total return.*** While we do not anticipate that level of performance at this time, especially with additional FOMC rate increases on the table for this year and next, the preferred market's enhanced current income characteristics continue to offer opportunities for income-focused portfolios in this anemic interest rate environment.

By comparison, traditional investment grade corporate bonds have held steady during the initial phases of the Fed's tightening of monetary policy, but suffer from a steadily shrinking availability of fixed coupons. ***Years of accommodative interest rates have allowed corporate treasurers to either refinance their company's debt at lower interest rates, issue new bonds at lower interest rates, or both. As a result, the buffer to falling bond prices as interest rates rise, typically provided by higher semi-annual payments, has diminished substantially.*** This aspect of total return exposure, especially in the short-term, was apparent in the first quarter. The BofA Merrill Lynch 1-10 Year US Corporate Bond Index only provided 1.26% total rate of return over a period of relatively little market change, while the BofA Merrill Lynch 1-10 Year US Treasury and Agency Index only provided 0.51% total rate of return.

Outlook

While we continue to remain in a low rate environment, the Fed is very gradually beginning the process of normalization and certain areas of the market are starting to respond. As always, the future remains uncertain.

As such, we believe our risk-conscious approach remains highly relevant. ***At Roosevelt Investments, we do not believe in pursuing high income now at the expense of generating income in the future. Instead, we focus on generating consistent income despite interest rate movements.*** In a rising rate environment, the portfolio is designed to benefit from rising interest rates, while in a low rate environment, the portfolio is designed to provide high income without taking excessive risk.

Our approach to maximizing current income is centered on seeking to avoid as many types of risks as possible in order to preserve the ability of the portfolio to provide income in the future. Through a flexible, benchmark-agnostic approach, we opportunistically combine corporate bonds and preferred securities into a single actively managed portfolio. Diversified across industries, maturities, and issuers, we seek to optimize income while avoiding the typical risks income investors often incur.

We believe our disciplined long-term approach, focused on years rather than months, is key to success. As interest rates begin to “normalize” and credit markets react accordingly, we believe this approach will continue to serve clients well.

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BofA Merrill Lynch Fixed Rate Preferred Securities Index tracks the performance of fixed rate U.S. dollar denominated preferred securities issued in the U.S. domestic market. Securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch) and must have an investment grade rated country of risk (based on an average of Moody's, S&P, and Fitch foreign currency long term sovereign debt ratings).

BofA Merrill Lynch 1-10 Year US Corporate Bond Index is a subset of the BofA Merrill Lynch U.S. Corporate Index including all securities with a remaining term to final maturity less than 10 years.

BofA Merrill Lynch 1-10 Year US Treasury and Agency Index is a subset of the BofA Merrill Lynch U.S. Treasury & Agency Index including all securities with a remaining term to final maturity less than 10 years.

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