Fixed Income Market Comments

In the second quarter of 2015, the possibility of a June rate increase by the Federal Reserve came and went quietly, with markets unsurprised when rates remained the same. Speculation continues for the date of "liftoff" and there are plenty of arguments for and against rate increases. In the short term, it appears the Fed will raise rates 0.25% in September or December of this year. The initial rate increase will cause some short term market volatility and the next increase will again be "data dependent" (employment, wage and economic growth), allowing the Fed time to observe the repercussions of the first increase before making another. However, looking forward, the FOMC's long-term target for the Fed Fund Rate has fallen from 4.25% in 2012 to 3.5-3.75% according to the June dot plot, and it may continue to fall. The long run fed funds estimate is more important in determining long-term rates than the path of tightening over the next two years, because it affects both the math and the psychology of the yield curve. A lower estimate implies lower long term rates.

The strengthening US dollar will continue to weigh on growth and inflation, two targets of the Fed. Monetary policy indirectly influences the value of the dollar; and when the Fed tightens while the global economy is weak, the dollar will strengthen. Additionally, inflation has been absent so far, and is unlikely to rebound to 2% anytime soon. Not to mention international central banks are still moving in the opposite direction of the Fed, continuing or increasing their quantitative easing, which continues to exert downward pressure on interest rates. Persistent volatility and uncertainty over Greece, Puerto Rico, and Chinese markets has not helped. However, keep in mind Greece's GDP only makes up 2.2% of the entire Eurozone GDP, making it less important than the endless barrage of media may insinuate.

All this implies that we are in a consistently low rate environment for the foreseeable future. The three-year average return of the Barclays Aggregate Bond Index, a broad measure of high-quality bond performance, stood at a modest 1.8% at the end of June 2015. This is an average return, but it provides an approximation of what investors may expect over a longer time frame. The trailing five-year annualized total return is 3.1%, and the trailing 10-year return is nearly 4%, down from 6% near the end of 2010.

We continue to recommend high quality, short to intermediate term bonds. While fixed income mutual funds may seem like a comparable substitute for individual bonds, this is not always the case. It can be difficult to differentiate the investment strategy from one fund to the next, difficult to know exactly what a fund manager is doing, and even harder to know what bonds they hold on any given day. When you hold individual bonds, you know exactly where your money is and when you're going to get it back.

Taxable Fixed Income Performance Composite

The TCVA taxable fixed income composite outperformed its benchmark again in the second quarter. 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 short to intermediate durations remains the best strategy in this interest rate environment.

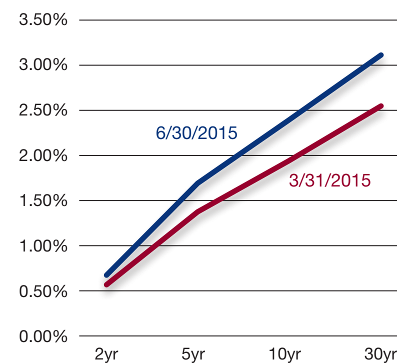
Portfolio Characteristics:

Average Maturity	3.7 yrs
Average Duration	3.3 yrs
Average Yield to Maturity	2.52%
Average Coupon	4.35%
Average Quality	AA

Credit Quality:

AAA	12%
AA	44%
A	35%
BBB	9%

Treasury Yield Curve



Fixed Income Sector Breakdown