# 2017 FGFOA Annual Conference

**Economic overview: Will it continue to be the tortoise or is the hare really here to stay?**

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Monday, June 26, 2017

Insight
INVESTMENT

# Agenda

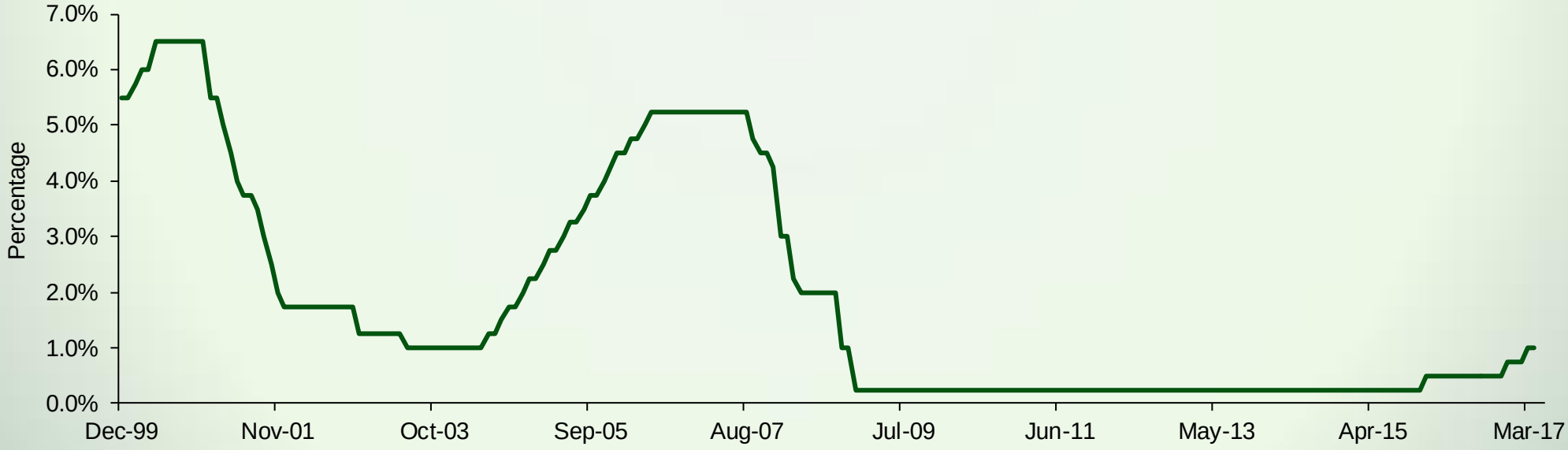
- The global environment: more of the same or paradigm shift
- Our investment views for navigating the landscape
- Higher interest rates: a good thing for short duration portfolios
- Florida: a ‘state’ of consistency moving forward

# The global environment:
# more of the same or paradigm shift

# Enough is enough!

- Since 2009, market returns have been dominated by the direction of central bank policy
- US acted first, aggressively and decisively
  - Interest rate cuts
  - QE (quantitative easing)
  - QE+twist

**Federal Reserve quickly cuts rates to zero**




Source: Bloomberg, as of April 28, 2017.

# What did all that QE mean anyway?

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- First order of business: stabilization
- Next order of business: prevent deflation; preserve price stability

**Personal Consumption Expenditures**


Source: Bloomberg, as of March 28, 2017.

# The US kitchen sink approach

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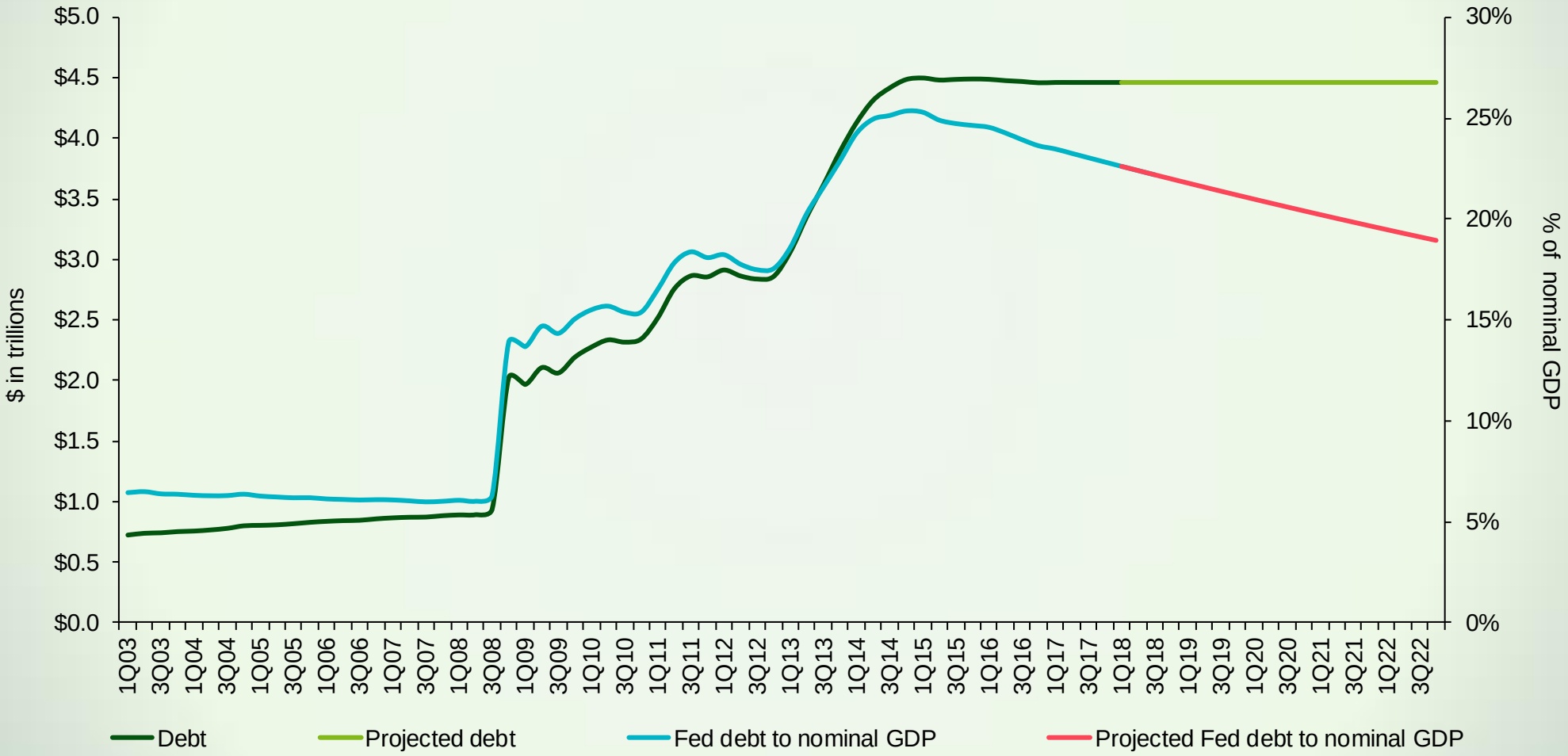
- Quantitative easing
  - Central banks buying financial assets
  - Financial assets are purchased from banks
  - Creates scarcity value in assets being purchased and liquidity at banks for lending
- Twist: targeting specific treasury tenors to influence the shape of the curve
- Unlimited: removed timelines and added US agency MBS (Mortgage-Backed Securities)
- Forward guidance
  - Summary of economic projections
  - Press conferences
  - Global financial conditions

# Fed balance sheet as a percentage of GDP




Source: Bloomberg, as of March 31, 2017. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# Fed statement May 7, 2002

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The Federal Open Market Committee decided today to keep its target for the federal funds rate unchanged at 1 3/4 percent.

The information that has become available since the last meeting of the Committee confirms that economic activity has been receiving considerable upward impetus from a marked swing in inventory investment. Nonetheless, the degree of the strengthening in final demand over coming quarters, an essential element in sustained economic expansion, is still uncertain.

In these circumstances, although the stance of monetary policy is currently accommodative, the Committee believes that, for the foreseeable future, against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the risks are balanced with respect to the prospects for both goals.

Voting for the FOMC monetary policy action were: Alan Greenspan, Chairman; William J. McDonough, Vice Chairman; Susan S. Bies; Roger W. Ferguson, Jr.; Edward M. Gramlich; Jerry L. Jordan; Robert D. McTeer Jr.; Mark W. Olson; Anthony M. Santomero, and Gary H. Stern.

*Voting against the action: none.*

Source: Federal Reserve, as of May 7, 2002.

# Fed statement May 3, 2017

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Information received since the Federal Open Market Committee met in March indicates that the labor market has continued to strengthen even as growth in economic activity slowed. Job gains were solid, on average, in recent months, and the unemployment rate declined. Household spending rose only modestly, but the fundamentals underpinning the continued growth of consumption remained solid. Business fixed investment firmed. Inflation measured on a 12-month basis recently has been running close to the Committee's 2% longer-run objective. Excluding energy and food, consumer prices declined in March and inflation continued to run somewhat below 2%. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee views the slowing in growth during the first quarter as likely to be transitory and continues to expect that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace, labor market conditions will strengthen somewhat further, and inflation will stabilize around 2% over the medium term. Near-term risks to the economic outlook appear roughly balanced. The Committee continues to closely monitor inflation indicators and global economic and financial developments.

In view of realized and expected labor market conditions and inflation, the Committee decided to maintain the target range for the federal funds rate at 3/4 to 1%. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2% inflation.

Source: Bloomberg, Federal Reserve, as of May 3, 2017.

# Fed statement May 3, 2017 *continued…..*

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In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its objectives of maximum employment and 2% inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. The Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.

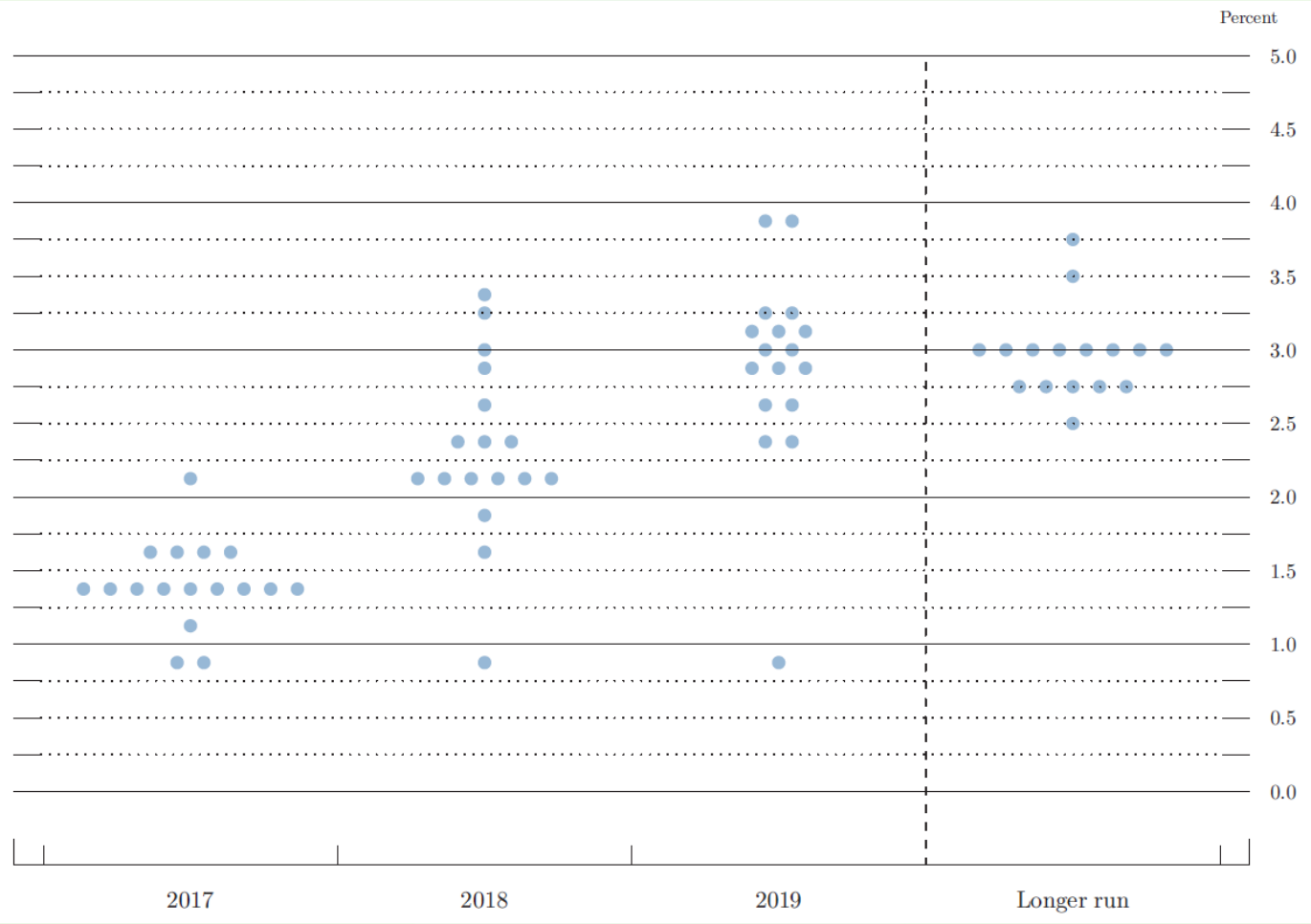
The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction, and it anticipates doing so until normalization of the level of the federal funds rate is well under way. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Charles L. Evans; Stanley Fischer; Patrick Harker; Robert S. Kaplan; Neel Kashkari; and Jerome H. Powell.

*Voting against the action: none.*

Source: Bloomberg, Federal Reserve, as of May 3, 2017.

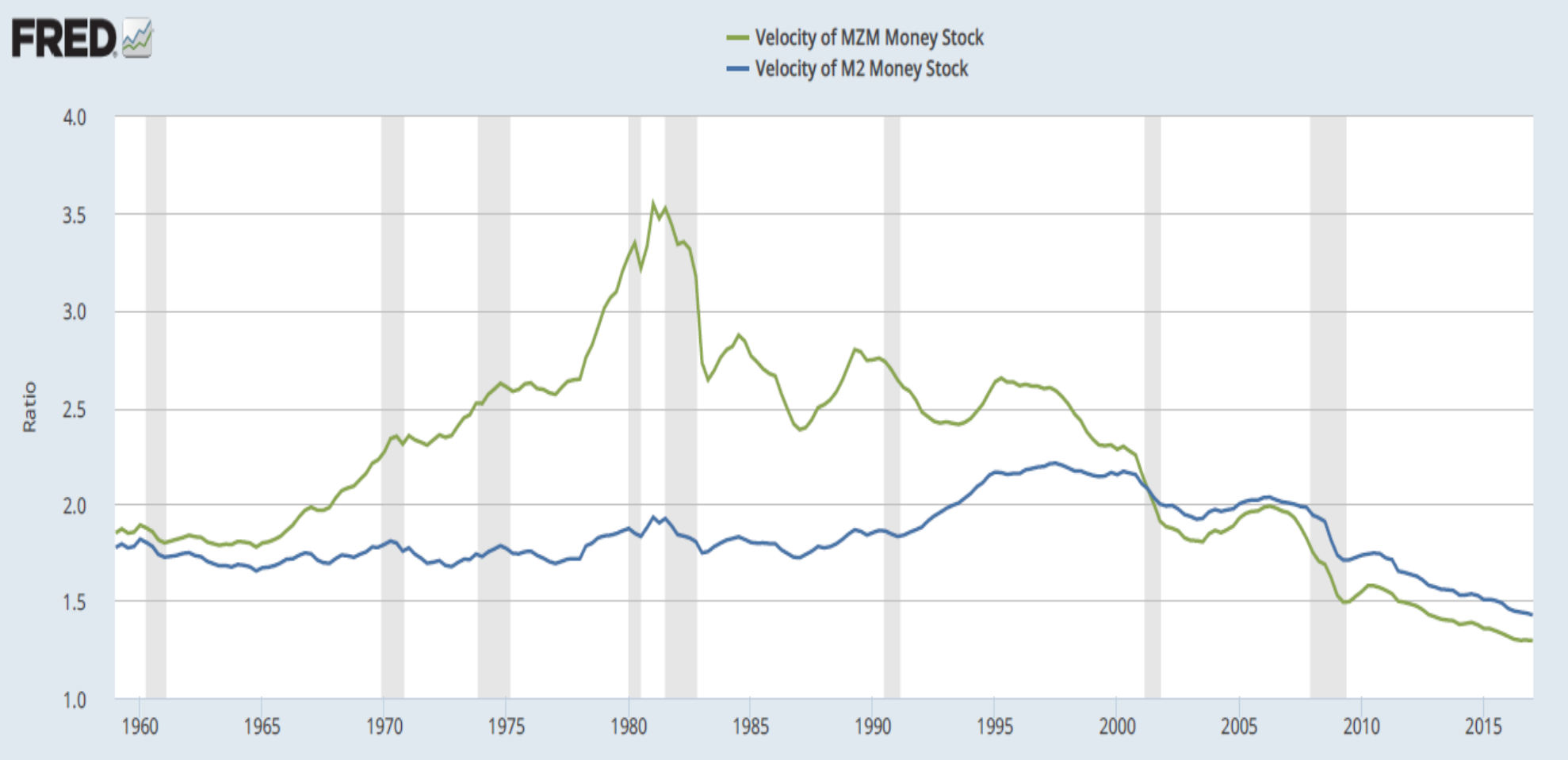
# FOMC ‘assessments’




Note: Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant’s judgment of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. One participant did not submit longer-run projections for the federal funds rate.

Source: Bloomberg, Federal Reserve, as of March 2017.

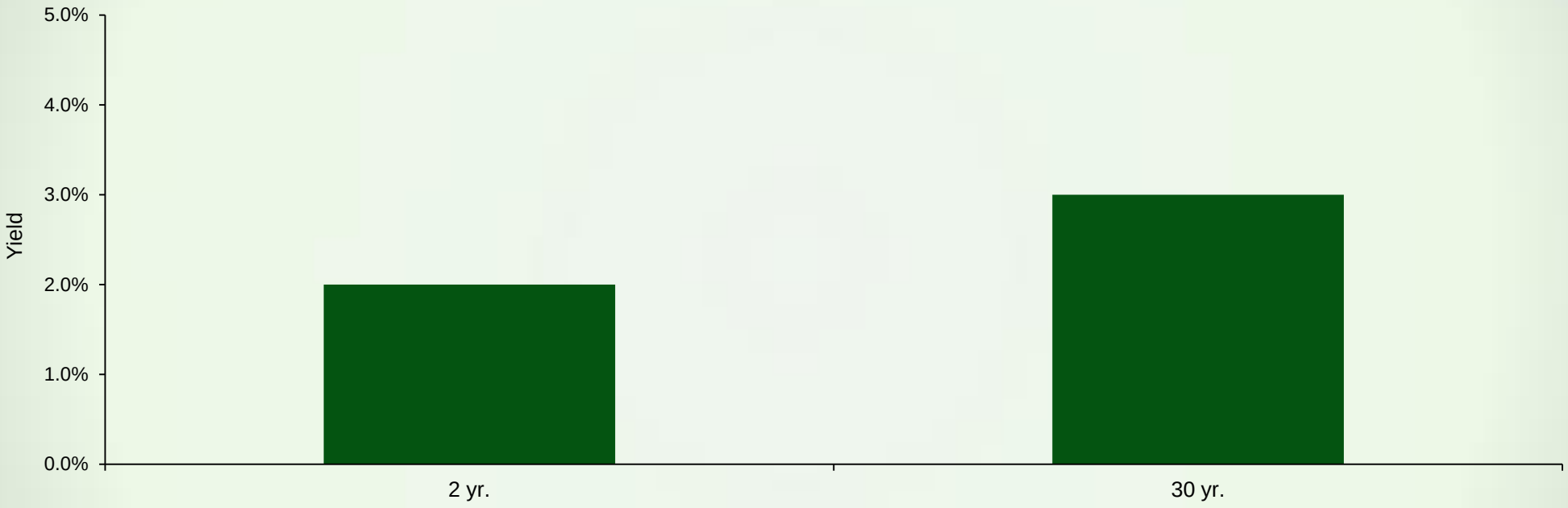
# Unintended consequences aplenty




Source: Federal Reserve, Bank of St. Louis, as of May 2017.

# But did it work? Let's look to bonds

## US Treasuries




- Long maturity Treasuries should yield more than short maturity Treasuries
  - This is called **Term Premium**

For illustrative purposes only

# But did it work? Let's look to bonds (cont'd)

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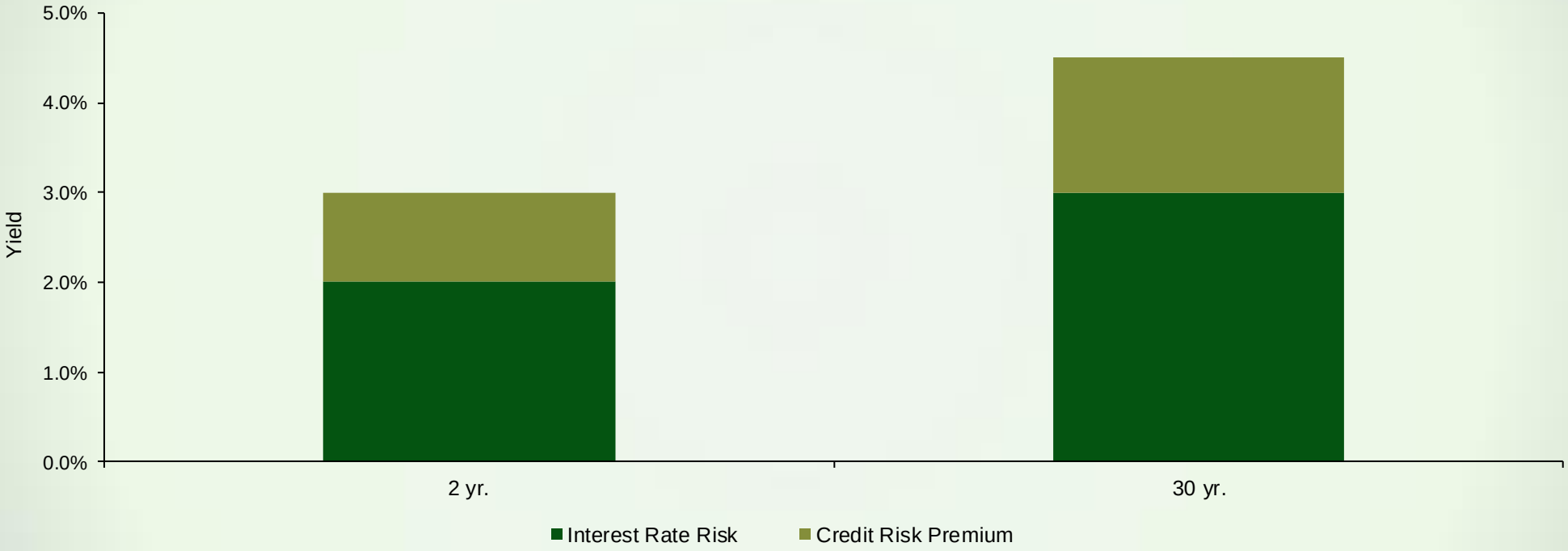
## Corporate Bonds




- Investors should be compensated for default risk and that compensation should increase with longer maturity corporates

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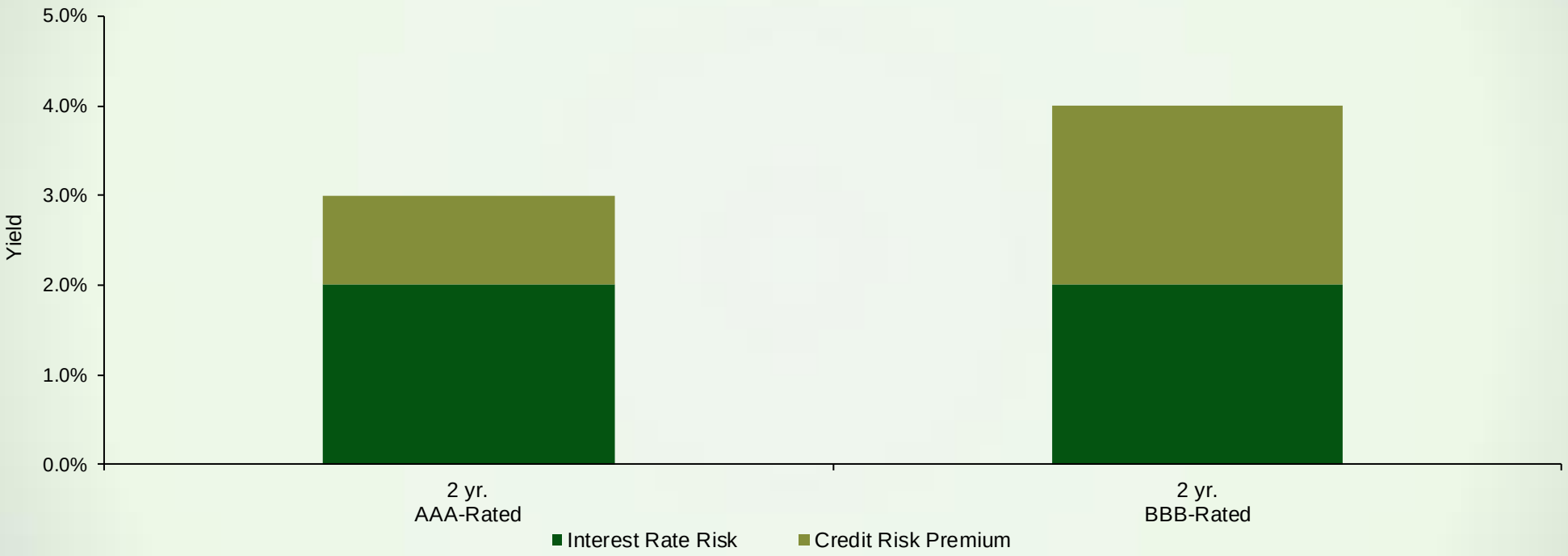
# But did it work? Let's look to bonds (cont'd)

## Corporate Bonds




- Default risk compensation should also increase for riskier credits

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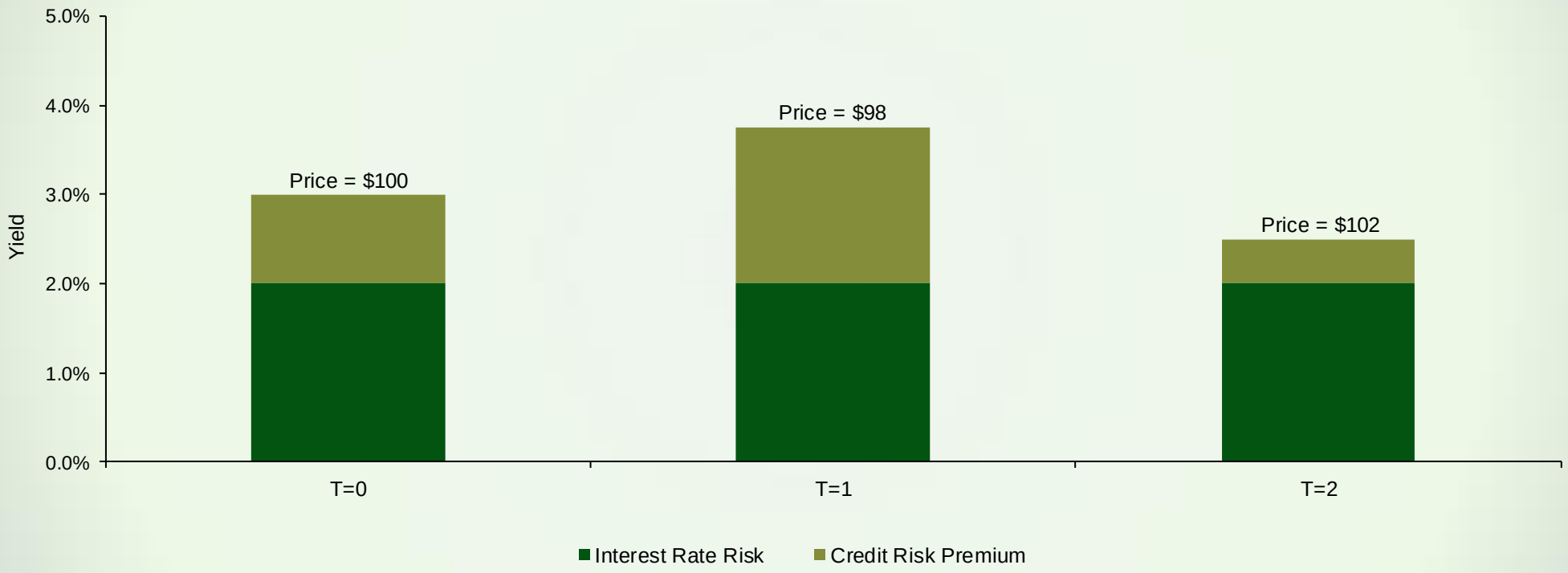
# But did it work? Let's look to bonds (cont'd)

## Changes in risk premiums change prices

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# But did it work? The short answer is, ‘yes.’

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## US Corporate Investment Grade OAS: 2007–2015


Source: Barclays, as of May 2017.

# 2016: Markets push back on QE

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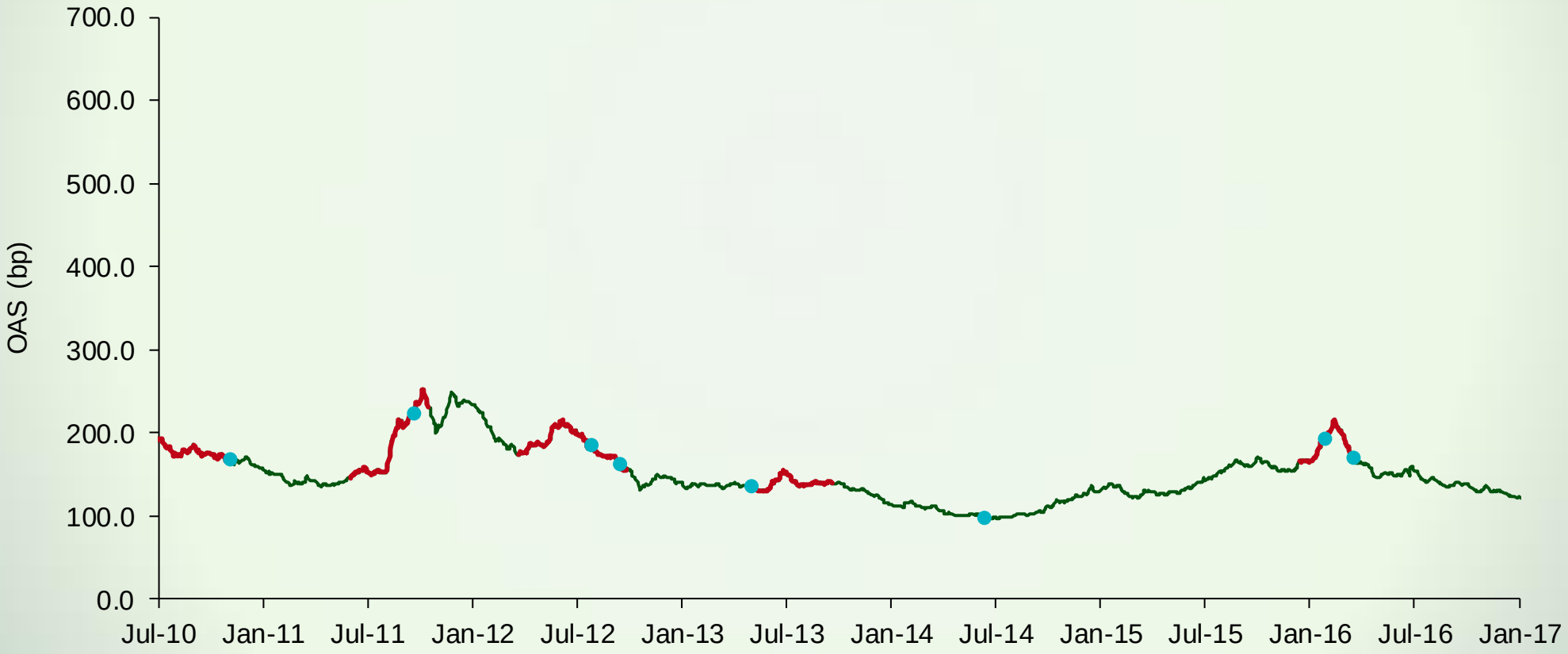
- European Central Bank
  - Negative deposit rates
  - Financial assets are purchased from banks
  - Creates scarcity value in assets being purchased and liquidity at banks for lending
- Bank of Japan
  - Yield curve targeting
- China
  - Capital controls

# A new market response to central bank policy

## US Corporate Investment Grade OAS: 2010–2017




Source: Barclays, as of May 2017.

# Our investment views for navigating the landscape

# Insight's 2017 global outlook

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**United Kingdom:**
**GDP 1.3% CPI 2.9%**

- Weak pound has boosted manufacturing, inflation
- Brexit headlines may pose downside risks
- Monetary policy on hold

**Euro Zone:**
**GDP 1.9% CPI 1.5%**

- Nearing the end of emergency easing
- Variable growth with Spain and Germany leading, but Italy lagging
- Signs of investment are budding

**United States:**
**GDP 2.4% CPI 2.4%**

- Monetary policy normalizing
- Fiscal policy potentially supportive through 2018
- Consumption is underpinning growth

**China:**
**GDP 6.3% CPI 1.5%**

- Fiscal expansion supporting growth
- Capital flows have steadied
- Too much debt

**Japan:**
**GDP 0.6% CPI 0.8%**

- Demographics are problematic
- Lack of inflation
- Easy monetary policy

**Emerging markets:**
**(Russia, India & Brazil)**
**GDP 3.5% CPI 5.1%**

- Helped by commodity stabilization
- Worst may be behind Russia and Brazil
- Constructive on Argentina, Mexico and India

= Improving
= Stable
= Deteriorating

Source: Bloomberg, as of March 31, 2017. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# Duration
## Government bond markets

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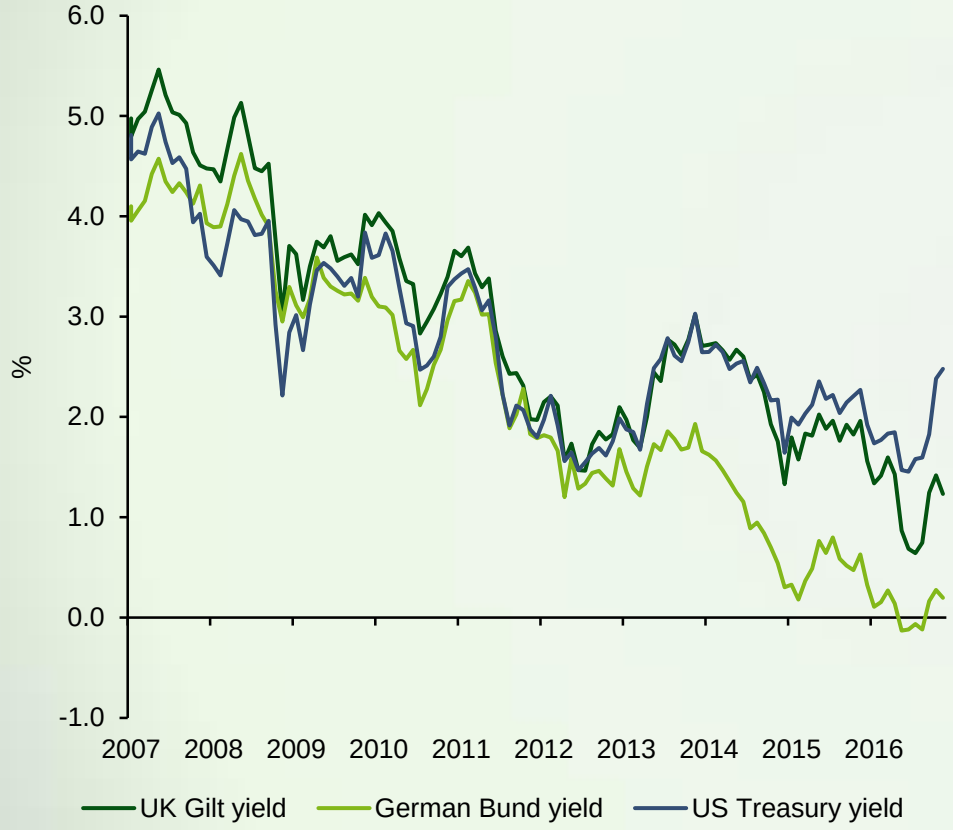
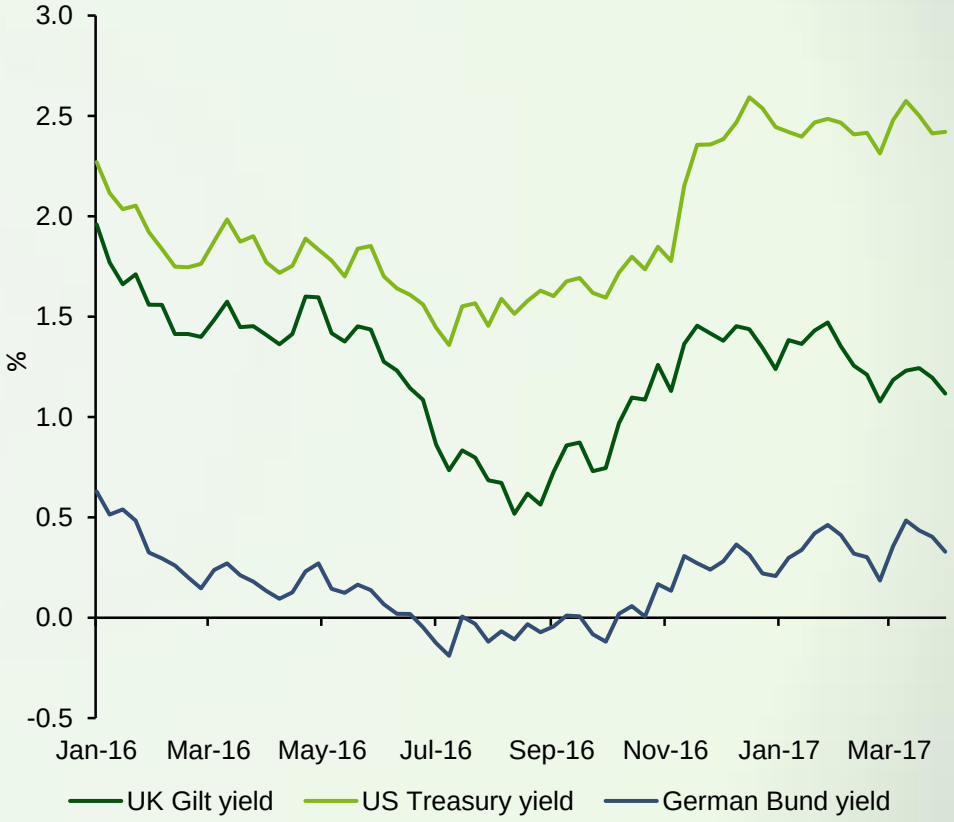
### Government bond yields (10 years, %): long history




### Government bond yields (10 years, %): recent history




**Bond yields traded in a range following Q4 sell off**

Source: Bloomberg, as of March 31, 2017.

# Market allocation
## Inflation

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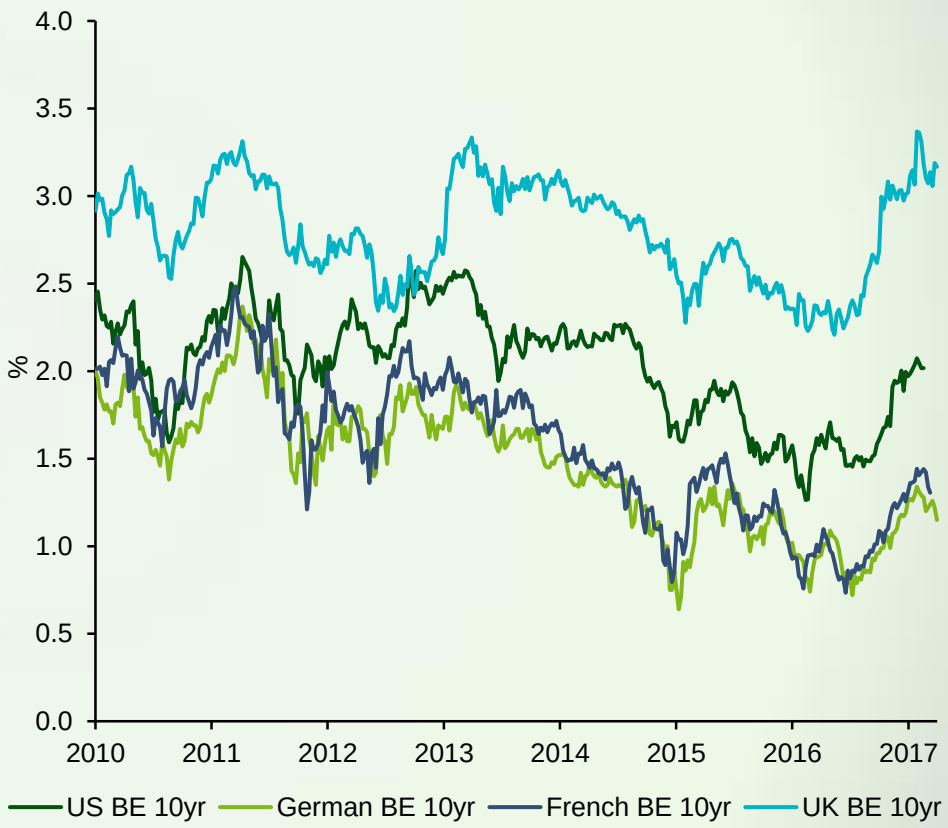
### 10 and 30 year US breakeven inflation (%)


### Global breakeven inflation (%)




**Inflation expectations have normalized, likely to rise further in the US**

Source: Bloomberg, as of March 31, 2017.

# Market allocation
## Political event risk

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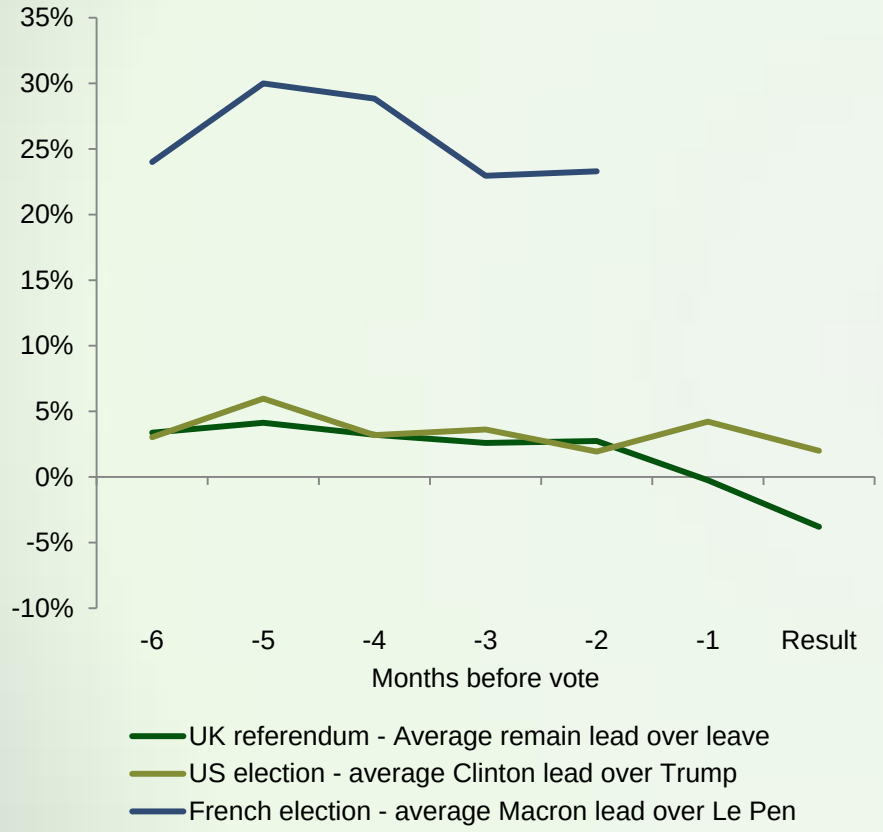
### Opinion polls:
### French and US elections and UK referendum




### French government 'credit' spreads widening


**French market well priced for political risk. We are overweight French risk**

Source: Wikipedia, March 2017.

Source: Bloomberg, as of March 23, 2017.

# US structural themes and implications

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**Post-crisis deleveraging too low**

- Slower long-term potential growth
- Lower neutral interest rates
- May raise refinancing risks down the road

**Easy monetary policy coming to an end**

- Rates should rise in US
- Reins passed to fiscal authorities from central banks, particularly in the US
- ‘Quantitative easing bid:’ underpinning assets like mortgage-backed securities will fade

**Public opinion raises risk of more atypical political leaders**

- Could benefit inflation pricing from protectionist policies
- Tactical opportunities may arise as political headlines cause undue volatility
- Looking through ‘tax reform’ and ‘tweets’ – should benefit corporate credit

As of March 31, 2017.

# The three Ts: *'US tax, trade and tweets'*

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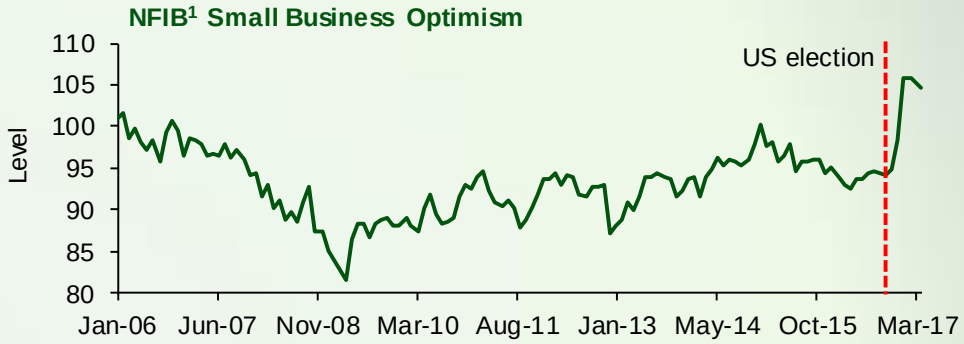
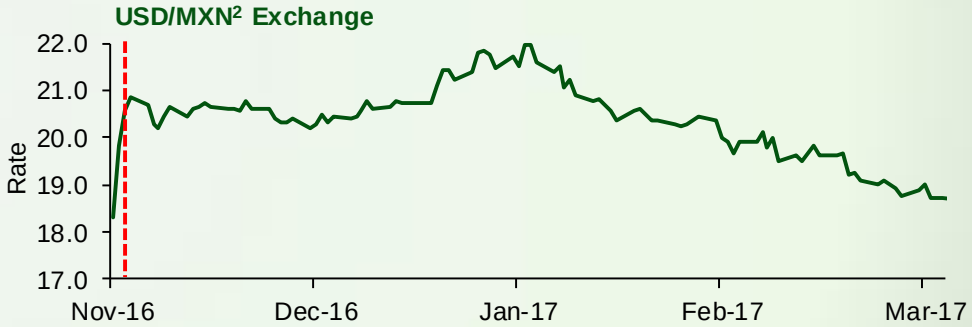
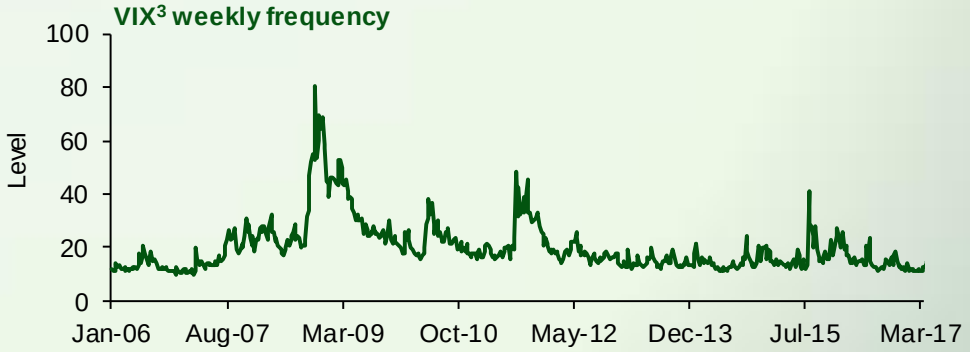
- **The good: taxes**
  - We expect action on taxes this year with the odds seemingly skewed towards a tax cut instead of comprehensive reform
  - This could support consumer spending and corporate profits and underpins optimism around the 'Trump trade'




- **The bad: trade**
  - Campaign rhetoric sparked concerns of a trade war that could be detrimental to growth
  - Thus far, those fears have not been realized, but globalization and free trade face global pressure
  - At the margin, this will be accretive to inflation and negative for growth




- **The ugly (or not): tweets**
  - From North Korea to Syria to non-policy distractions, there are many 'known unknowns,' and the outcome of these events could have a significant impact on growth and confidence
  - Investors should be prepared for volatility, although the low level of the VIX suggests that investors are not worried about these potential tail events




Source: Bloomberg, as of March 31, 2017. [1] National Federation of Independent Business. [2] Mexican Peso. [3] Volatility Index.

# Insight's 2017 US outlook

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- Our economic outlook should support corporate fundamentals and permit moderate outperformance in spread markets
- We believe that 2.3–2.8% GDP[1] growth is the 'sweet spot for credit' as the economy seems strong enough to help companies grow into their capital structure
- We expect the Fed to hike two to three times in 2017 with the 10-year treasury ending the next 12 months in the 3.0%[2] range. While rates may go higher, we are not forecasting an extreme sell-off, due to structural headwinds and demand for duration from insurers, pension funds and international investors
- Market optimism may be susceptible to political headlines as the Trump administration seek to execute on tax reform

Source: Bloomberg, as of March 31, 2017. [1] Gross domestic product. [2] The forecast are based on a 12-month time horizon. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# Market forecasts

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## Major economies: bond yields (%)

| | Central Bank | | 2yr | | | 5yr | | | 10yr | | | 30yr | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Country** | **Forecast** | **Current** | **Forecast** | **Current** | **Mkt fwd** | **Forecast** | **Current** | **Mkt fwd** | **Forecast** | **Current** | **Mkt fwd** | **Forecast** | **Current** | **Mkt fwd** |
| **UK** | 0.25 | 0.25 | 0.40 | 0.12 | 0.29 | 1.10 | 0.59 | 0.77 | 1.80 | 1.18 | 1.40 | 2.50 | 1.75 | 1.82 |
| **US** | 1.63 | 1.00 | 2.35 | 1.25 | 1.79 | 2.65 | 1.93 | 2.34 | 3.00 | 2.39 | 2.66 | 3.50 | 3.01 | 3.13 |
| **Germany** | -0.40 | -0.40 | -0.50 | -0.77 | -0.55 | 0.00 | -0.33 | -0.06 | 0.90 | 0.41 | 0.64 | 1.70 | 1.14 | 1.30 |
| **Japan** | -0.10 | -0.10 | -0.20 | -0.27 | -0.17 | -0.10 | -0.16 | -0.08 | 0.00 | 0.05 | 0.18 | 1.00 | 0.83 | 0.88 |

As of March 22, 2017. Note: The forecasts are based on a time horizon of 12 months. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# Fed forecast versus the futures market

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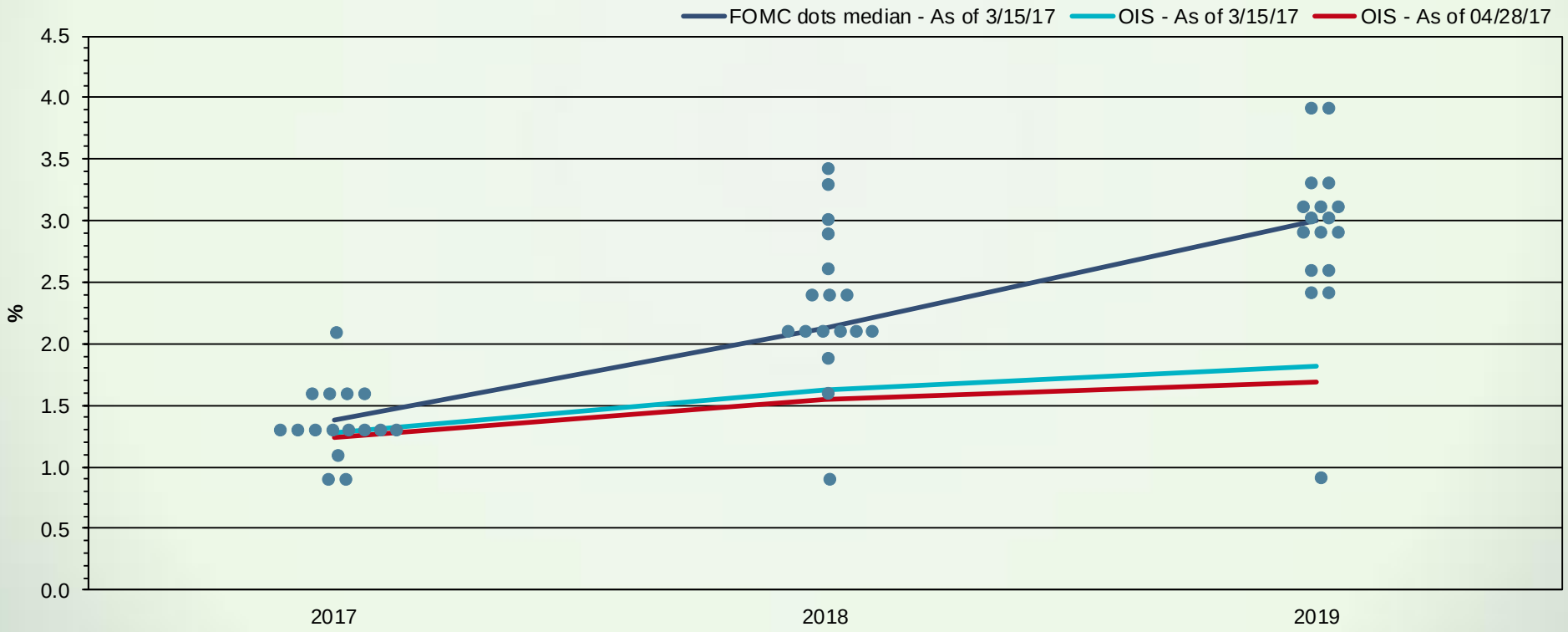
- The market essentially believes the FOMC's (Federal Open Market Committee) 2017 forecast: pricing in nearly two more hikes
- However, the market is skeptical of the Fed's path beyond this year, questioning its ability to continue raising rates
- With a self-sustaining recovery and fiscal support, we believe the market is underappreciating the capacity for future rate hikes, which is reflected in our US interest rate forecast




Source: Bloomberg, as of April 28, 2017. The forecasts are based on a time horizon of 12 months. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# Credit strategy
## Global credit markets

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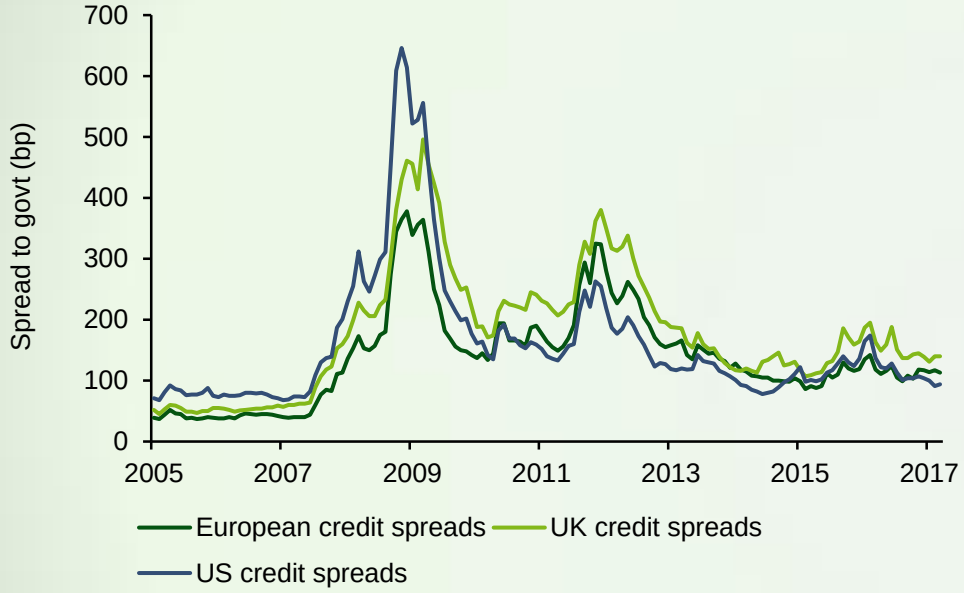
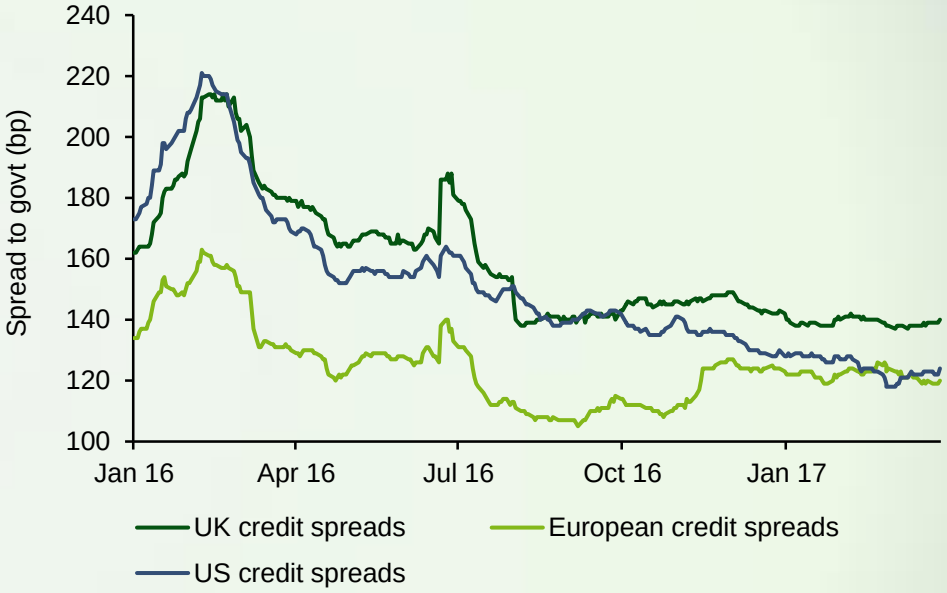
### Investment grade credit spreads: long-term




### Investment grade credit spreads: short-term




**Review:** US credit spreads tightened modestly, while European credit traded sideways during the quarter. We reduced our overweight position as valuations tightened and also introduced downside protection in the UK and France due to political risks associated with the upcoming European elections.

**Outlook**: We are modestly overweight credit given stronger economic growth and the potential for looser fiscal policy, particularly in the US. We favor USD credit and financials versus non-financials.

Heavier supply and the potential for the ECB to taper its corporate-bond purchases may weigh on the European market later this year.

Source: Merrill Lynch, as of March 30, 2017. **Past performance is no assurance of future results.** Information is provided for illustrative purposes only and should not be construed as investment recommendations.

# Credit strategy
## High yield

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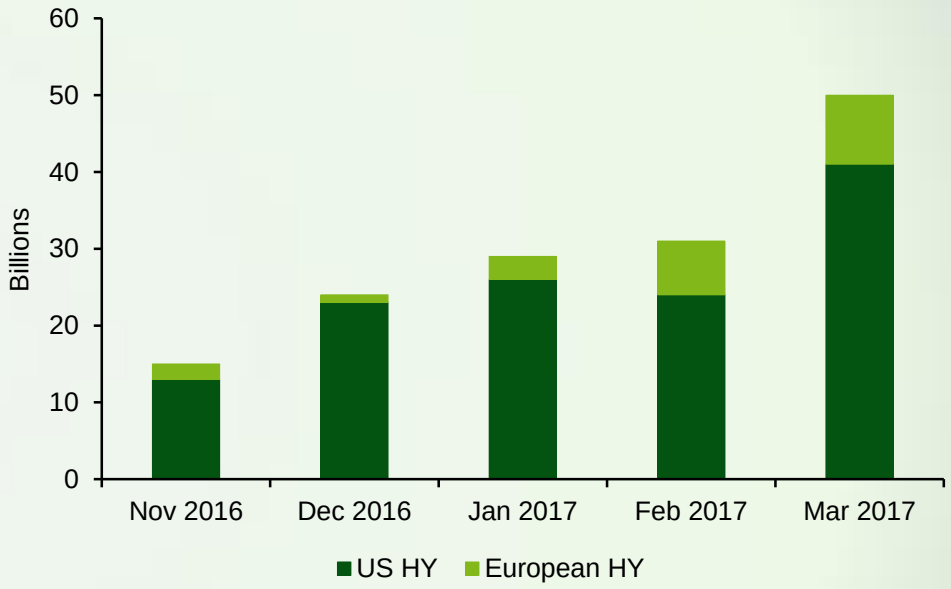
### US and European high yield spreads


### US and European high yield issuance ($ and €)




**Review:** Spreads narrowed in both US and European high yield markets in January and February. The markets were softer in March due to US rate hikes, lower oil prices and high issuance levels.

**Outlook:** Despite the increasing leverage we believe credit fundamentals remain strong. Increased volatility is likely given political risks. Demand for high yield continues to drive IG investors into HY.

Source: Merrill Lynch, as of March 31, 2017.

Source: Barclays, as of March 2017.

Information is provided for illustrative purposes only and should not be construed as investment recommendations.

# Credit and sector strategy
## Asset-Backed Securities (ABS)

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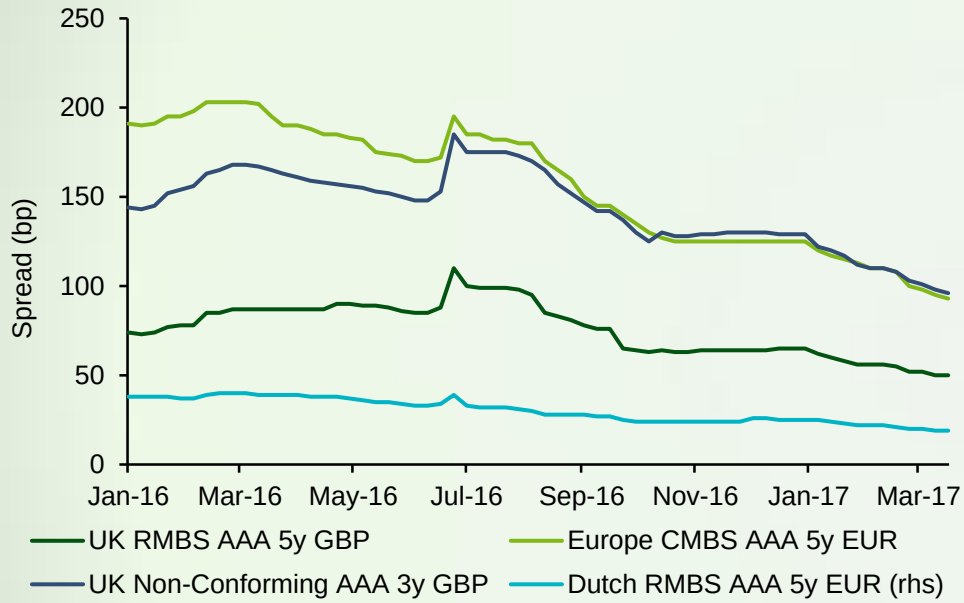
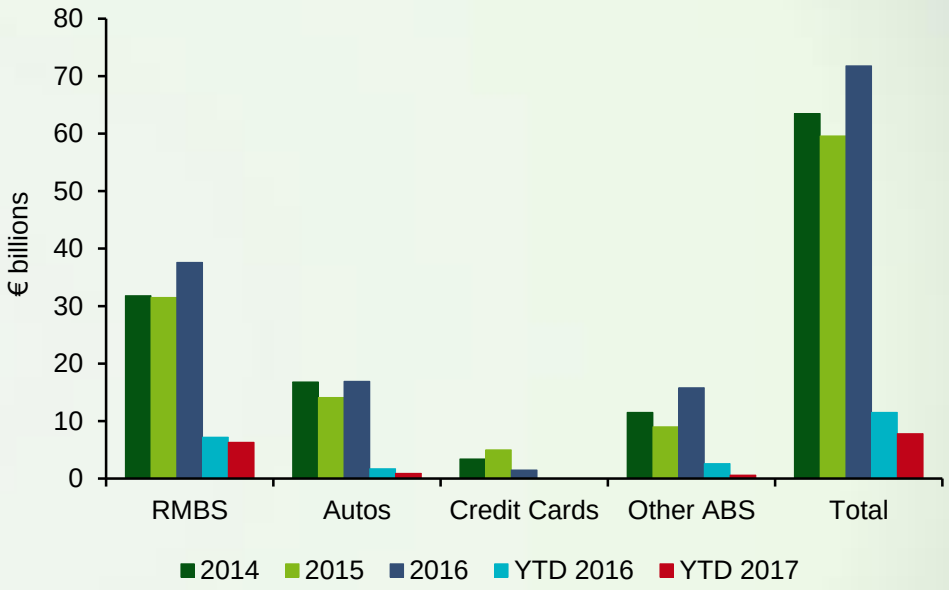
### Spreads for AAA-rated RMBS




### European ABS supply




**Review:** Spreads continued to grind tighter across markets, driven by limited supply and investor cash inflows. This was notable in UK non-conforming markets which outperformed. Given the continued rally in spreads, we reduced our overweight position during the quarter.

**Outlook:** ABS spreads remain supported by reflationary policies and the positive trends in housing and employment. The market should also continue to benefit from positive technical support.

Source: JP Morgan, as of March 31, 2017.

Source: Deutsche Bank, as of March 17, 2017.
YTD numbers reflect issuance up to the March 17 in 2016 and 2017 respectively.

**Past performance is no assurance of future results.** Information is provided for illustrative purposes only and should not be construed as investment recommendations.

# Currency selection
## US dollar weakness and EM improvement

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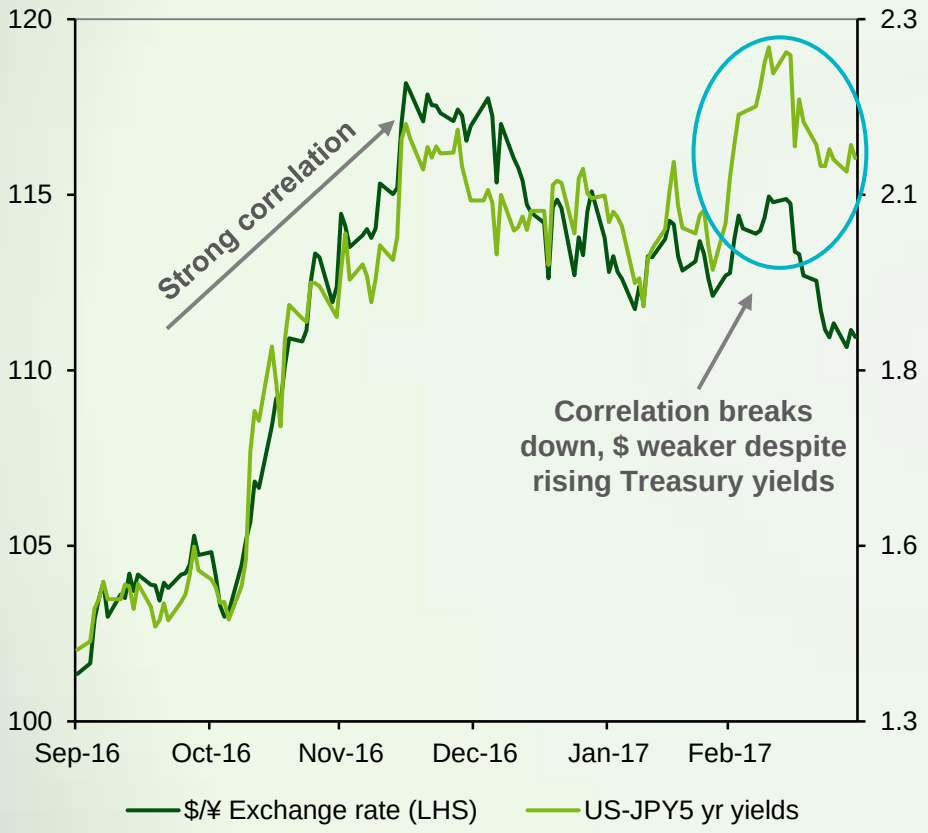
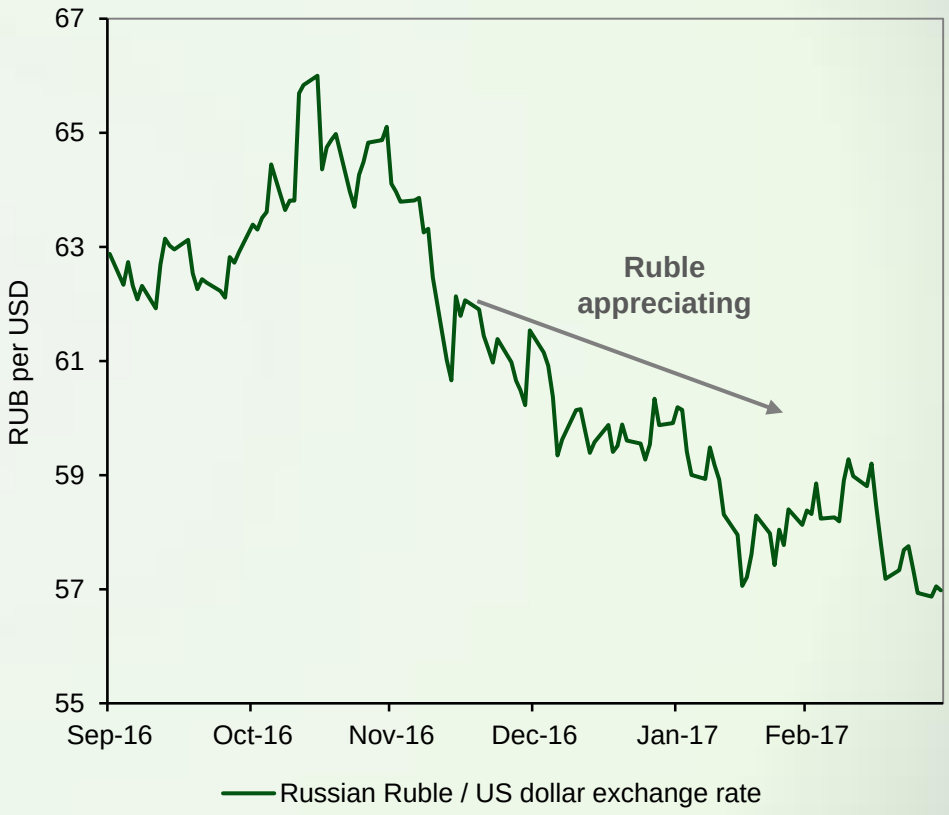
### USD/JPY versus relative 5 year government yields (%)




### US dollar versus Russian Ruble




**Despite improving economic sentiment the USD pulled back as rate support declined. Selective EM currencies traded well**

Source: Bloomberg, as of March 27, 2017. Information is provided for illustrative purposes only and should not be construed as investment recommendations

# Higher interest rates:
# a good thing for short duration portfolios

# Implications of a higher-rate environment

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- Short duration portfolios may benefit from rising rates
- Managing constituents
  - Finance committees and directors
  - Accountants and auditors
  - Public disclosure
- Distinguishing what is ‘priced in’ from surprises

# Forward rates indicate pricing

- **Option A**: Buy a 3-year Treasury at 1.15% and hold for three years
  - (1.015) * (1.015) * (1.015) = 1.047224 = 4.72% holding period return
- **Option B**: Buy a 1-year Treasury at 1.12%, buy a 2-year Treasury in one year
  - Assuming no change in yields or expectations, investor should be indifferent from Option A
  - Forward rates calculate what that 2-year Treasury will yield
    - (1.0122) * (1+X) * (1+X) = 4.72%
    - X = 1.72%

Information is provided for illustrative purposes only and should not be construed as investment recommendations.

# Calculators do the hard work for us

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## US Treasury active curve

| Tenor | Spot | 12mo (projected) |
|---|---|---|
| 3mo | 0.90 | 1.53 |
| 1yr | 1.12 | 1.56 |
| 2yr | 1.34 | 1.77 |
| 3yr | 1.55 | 2.00 |
| 5yr | 1.92 | 2.28 |
| 7yr | 2.20 | 2.46 |
| 10yr | 2.41 | 2.65 |
| 20yr | 2.88 | 3.01 |
| 30yr | 3.02 | 3.13 |
| 50yr | 3.13 | 3.21 |

Source: Bloomberg, as of May 8, 2017.

# Short-term pain for long-term gain

Insight INVESTMENT

## Forward path: May 2017–May 2018

| | Fed adj. | 2yr portfolio | BOP MV[1] | Coupon | Price Change | TRR[2] |
|---|---|---|---|---|---|---|
| 5/8/2017 | | 1.34 | | | | |
| 6/8/2017 | | 1.39 | 1000.000 | 0.11% | -0.10% | 0.01% |
| 7/8/2017 | | 1.43 | 1000.071 | 0.11% | -0.08% | 0.03% |
| 8/8/2017 | | 1.47 | 1000.394 | 0.12% | -0.08% | 0.04% |
| 9/8/2017 | | 1.50 | 1000.824 | 0.12% | -0.07% | 0.05% |
| 10/8/2017 | | 1.54 | 1001.341 | 0.12% | -0.07% | 0.05% |
| 11/8/2017 | | 1.57 | 1001.889 | 0.13% | -0.06% | 0.06% |
| 12/8/2017 | | 1.60 | 1002.530 | 0.13% | -0.06% | 0.07% |
| 1/8/2018 | | 1.63 | 1003.217 | 0.13% | -0.06% | 0.07% |
| 2/8/2018 | | 1.66 | 1003.926 | 0.13% | -0.06% | 0.07% |
| 3/8/2018 | | 1.69 | 1004.639 | 0.14% | -0.06% | 0.08% |
| 4/8/2018 | | 1.72 | 1005.454 | 0.14% | -0.06% | 0.08% |
| 5/8/2018 | | 1.76 | 1006.217 | 0.14% | -0.08% | 0.06% |
| | | | | | | **0.68%** |

## Forward path: June 2018–May 2019

| | Fed adj. | 2yr portfolio | BOP MV[1] | Coupon | Price Change | TRR[2] |
|---|---|---|---|---|---|---|
| | | | | | | |
| 6/8/2018 | | 1.80 | 1006.834 | 0.15% | -0.08% | 0.07% |
| 7/8/2018 | | 1.84 | 1007.502 | 0.15% | -0.08% | 0.07% |
| 8/8/2018 | | 1.88 | 1008.202 | 0.15% | -0.08% | 0.07% |
| 9/8/2018 | | 1.92 | 1008.928 | 0.16% | -0.08% | 0.07% |
| 10/8/2018 | | 1.96 | 1009.676 | 0.16% | -0.07% | 0.08% |
| 11/8/2018 | | 2.00 | 1010.529 | 0.16% | -0.08% | 0.08% |
| 12/8/2018 | | 2.04 | 1011.372 | 0.16% | -0.08% | 0.08% |
| 1/8/2019 | | 2.07 | 1012.224 | 0.17% | -0.07% | 0.09% |
| 2/8/2019 | | 2.11 | 1013.175 | 0.17% | -0.08% | 0.09% |
| 3/8/2019 | | 2.15 | 1014.107 | 0.17% | -0.07% | 0.10% |
| 4/8/2019 | | 2.19 | 1015.148 | 0.18% | -0.08% | 0.10% |
| 5/8/2019 | | 2.22 | 1016.142 | 0.18% | -0.07% | 0.11% |
| | | | | | | **1.04%** |

Source: Insight, Bloomberg, as of May 8, 2017. [1] Beginning of period market value. [2] Total rate of return. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# Managing surprises is key

Insight INVESTMENT

## Forward path: May 2017–May 2018

| | Fed adj. | 2yr portfolio | BOP MV[1] | Coupon | Price Change | TRR[2] |
|---|---|---|---|---|---|---|
| 5/8/2017 | | 1.34 | | | | |
| 6/8/2017 | | 1.39 | 1000.000 | 0.11% | -0.10% | 0.01% |
| 7/8/2017 | | 1.43 | 1000.071 | 0.11% | -0.08% | 0.03% |
| 8/8/2017 | | 1.47 | 1000.394 | 0.12% | -0.08% | 0.04% |
| 9/8/2017 | | 1.50 | 1000.824 | 0.12% | -0.07% | 0.05% |
| 10/8/2017 | | 1.54 | 1001.341 | 0.12% | -0.07% | 0.05% |
| 11/8/2017 | | 1.57 | 1001.889 | 0.13% | -0.06% | 0.06% |
| 12/8/2017 | 0.25 | 1.85 | 1002.530 | 0.13% | -0.56% | -0.43% |
| 1/8/2018 | 0.25 | 1.88 | 998.198 | 0.15% | -0.06% | 0.09% |
| 2/8/2018 | 0.25 | 1.91 | 999.108 | 0.16% | -0.06% | 0.09% |
| 3/8/2018 | 0.50 | 2.19 | 1000.022 | 0.16% | -0.56% | -0.40% |
| 4/8/2018 | 0.50 | 2.22 | 996.031 | 0.18% | -0.06% | 0.12% |
| 5/8/2018 | 0.50 | 2.26 | 997.194 | 0.18% | -0.08% | 0.10% |
| | | | | | | **-0.18%** |

## Forward path: June 2018–May 2019

| | Fed adj. | 2yr portfolio | BOP MV[1] | Coupon | Price Change | TRR[2] |
|---|---|---|---|---|---|---|
| | | | | | | |
| 6/8/2018 | 0.50 | 2.30 | 998.213 | 0.19% | -0.08% | 0.11% |
| 7/8/2018 | 0.50 | 2.34 | 999.284 | 0.19% | -0.08% | 0.11% |
| 8/8/2018 | 0.50 | 2.38 | 1000.386 | 0.19% | -0.08% | 0.11% |
| 9/8/2018 | 0.75 | 2.67 | 1001.515 | 0.20% | -0.58% | -0.39% |
| 10/8/2018 | 0.75 | 2.71 | 997.649 | 0.22% | -0.07% | 0.15% |
| 11/8/2018 | 0.75 | 2.75 | 999.102 | 0.22% | -0.08% | 0.14% |
| 12/8/2018 | 0.75 | 2.79 | 1000.547 | 0.23% | -0.08% | 0.15% |
| 1/8/2019 | 0.75 | 2.82 | 1002.001 | 0.23% | -0.07% | 0.16% |
| 2/8/2019 | 0.75 | 2.86 | 1003.555 | 0.23% | -0.08% | 0.15% |
| 3/8/2019 | 1.00 | 3.15 | 1005.091 | 0.24% | -0.57% | -0.34% |
| 4/8/2019 | 1.00 | 3.19 | 1001.699 | 0.26% | -0.08% | 0.18% |
| 5/8/2019 | 1.00 | 3.22 | 1003.494 | 0.26% | -0.07% | 0.19% |
| | | | | | | **0.72%** |

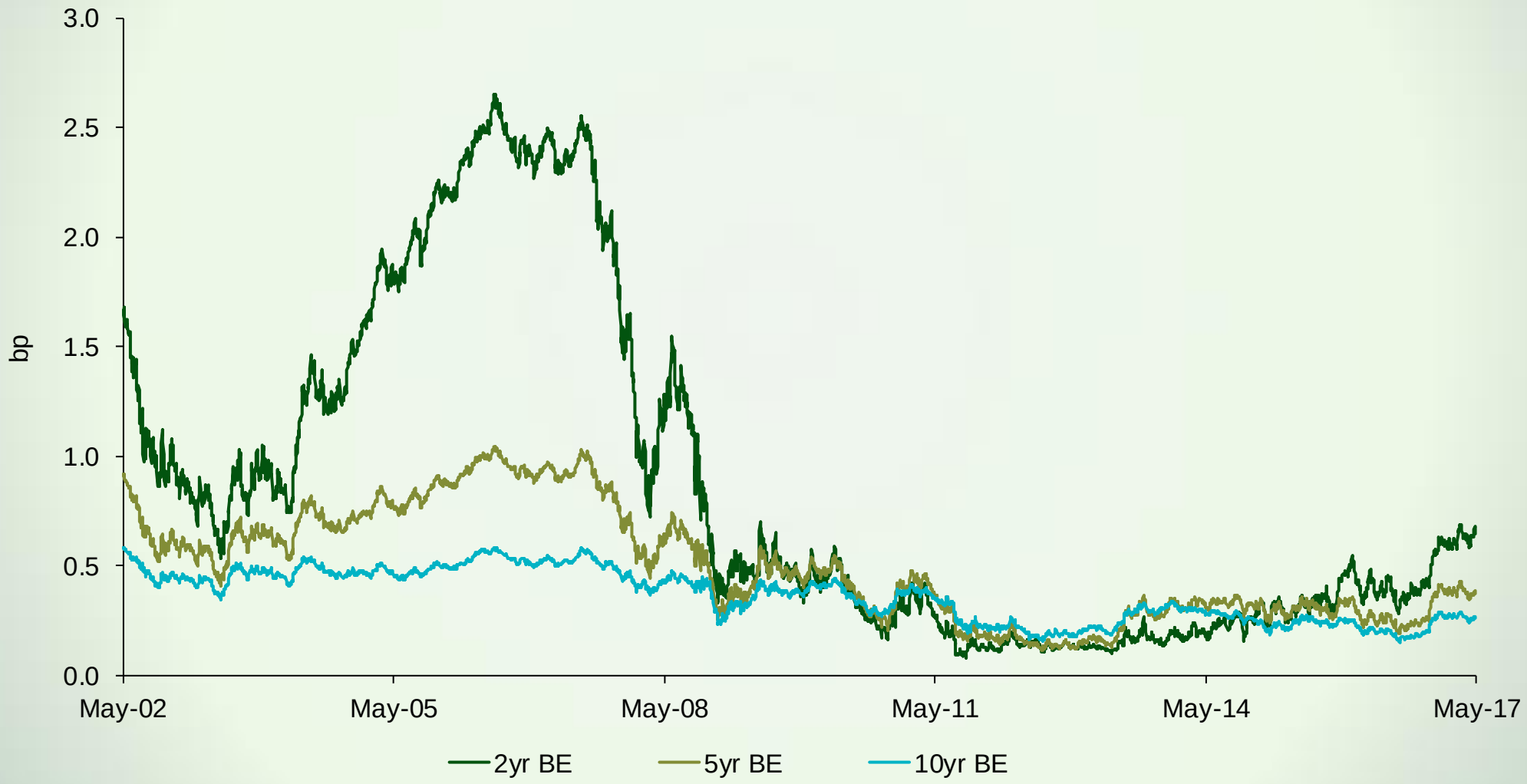
Source: Insight, Bloomberg, as of May 8, 2017. [1] Beginning of period market value. [2] Total rate of return. Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

# A two-year portfolio holds in well with an active Fed


- Portfolios with two-year or five-year durations continue to grow in a benign environment
- But what happens if the Fed moves four more times than what the market is predicting?

Source: Insight, Bloomberg, as of May 2017.

# Breakevens: How many basis points does it take to lose the coupon?




Source: Barclays, as of May 12, 2017.

# Be prepared

Insight INVESTMENT

- Accounting gains and losses are different from portfolio return:
  - Has the market value + accrued interest of the portfolio grown?
  - Was there a credit event or was it rates?
- What is the market narrative?
  - Is the Fed raising rates or lowering rates?
  - Are corporate investments performing or are downgrades picking up?
- Are your assets appropriately positioned?
  - A 5-year portfolio could be appropriate if working with reserve assets
  - Cash matching versus known liabilities helps to reduce liquidity risk
- Maintain flexibility to change the thesis

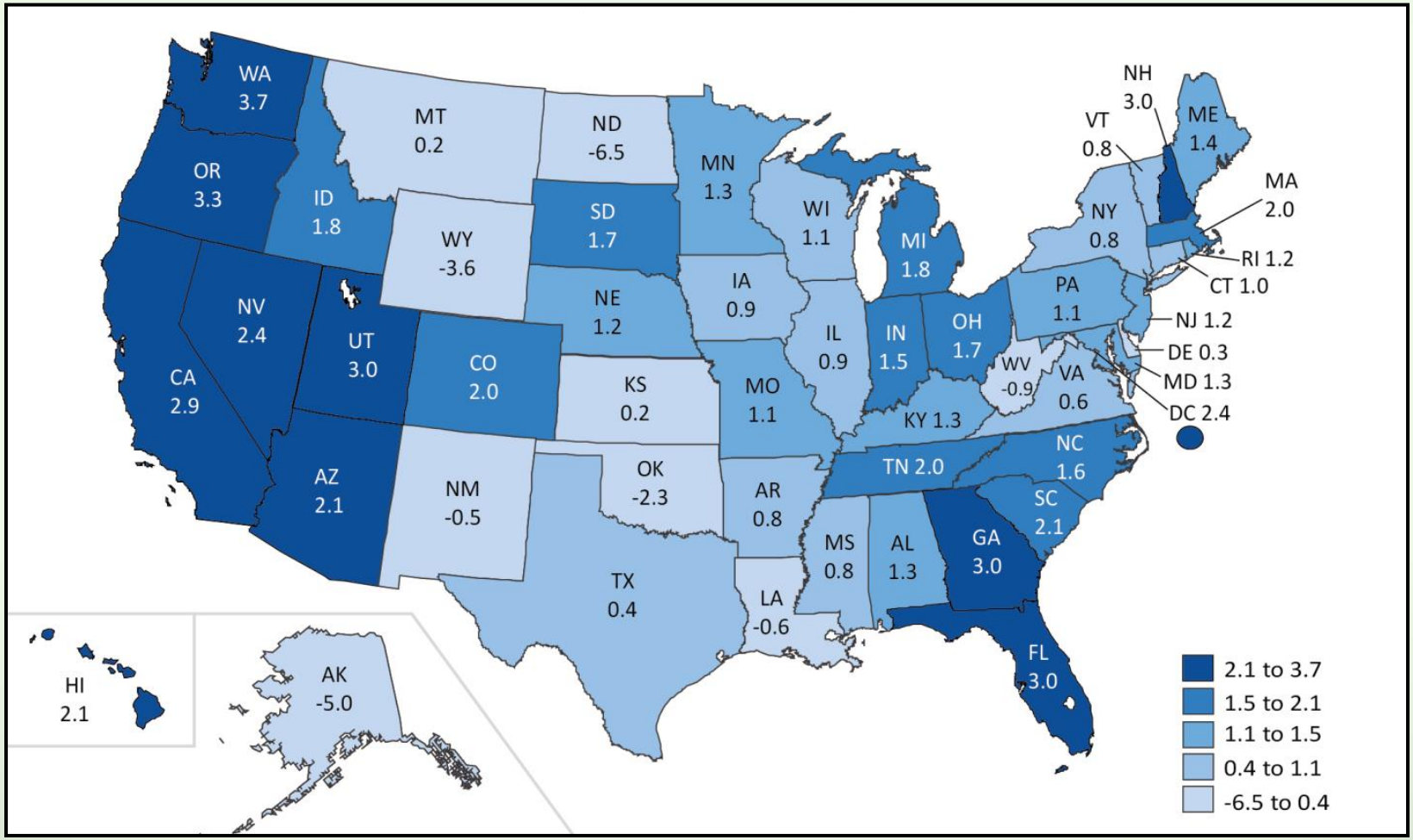
# Florida: a ‘state’ of consistency moving forward

# Our view

## 2016 US state growth: Florida in the top ten for 2016

Insight INVESTMENT

### Percent change in Real GDP by state: 2015–2016



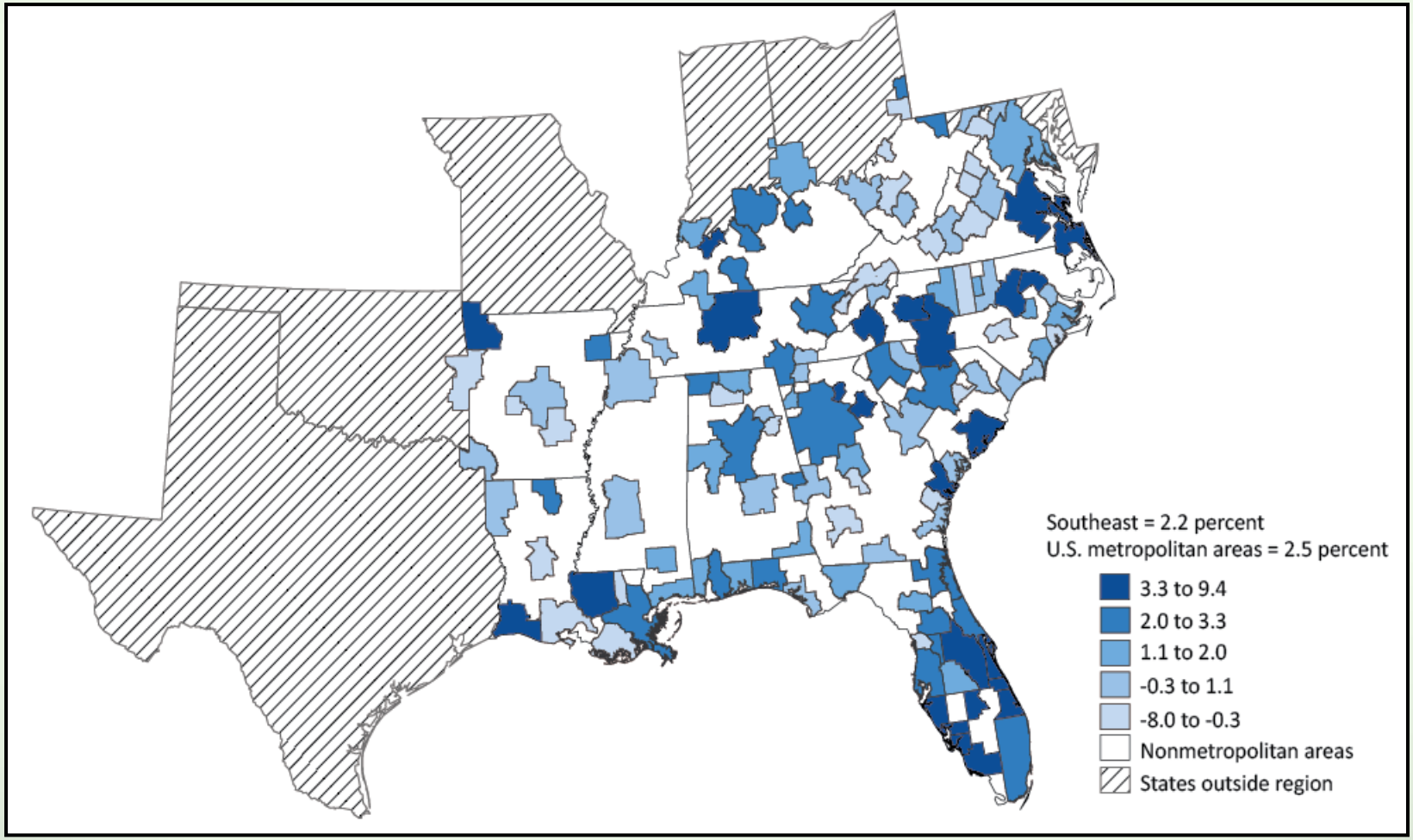

Source: US Bureau of Economic Analysis, as of December 2016.

# Our view

## 2015 Florida intra-state GDP: coastlines in the top quintile

Insight INVESTMENT

### Percent change in Real GDP by metropolitan area in the Southeast Region: 2015



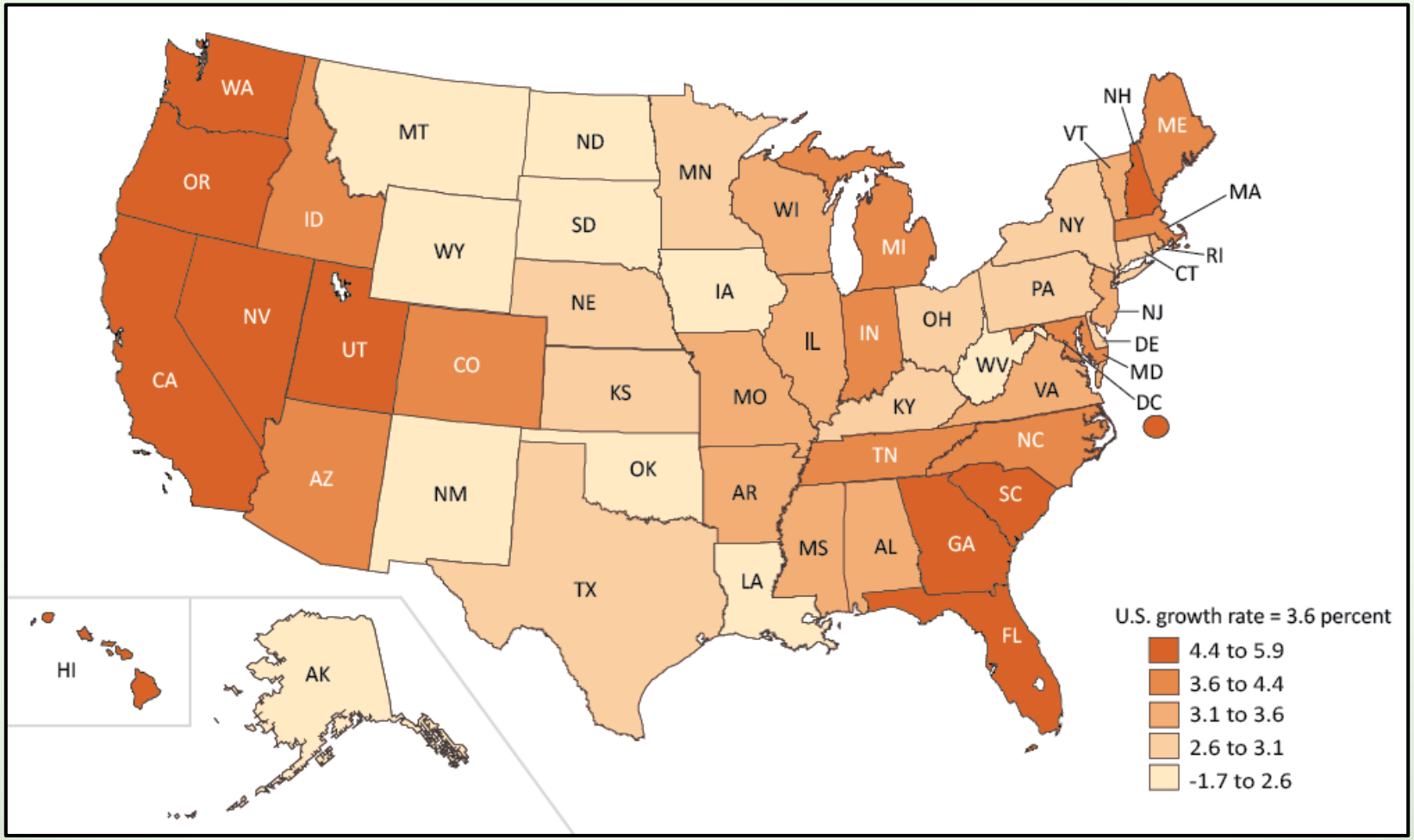

Source: US Bureau of Economic Analysis, as of December 2015.

# Our view

## Personal income: Florida among the strongest states…

Insight INVESTMENT

### Percent growth rate in personal income by state: 2015–2016



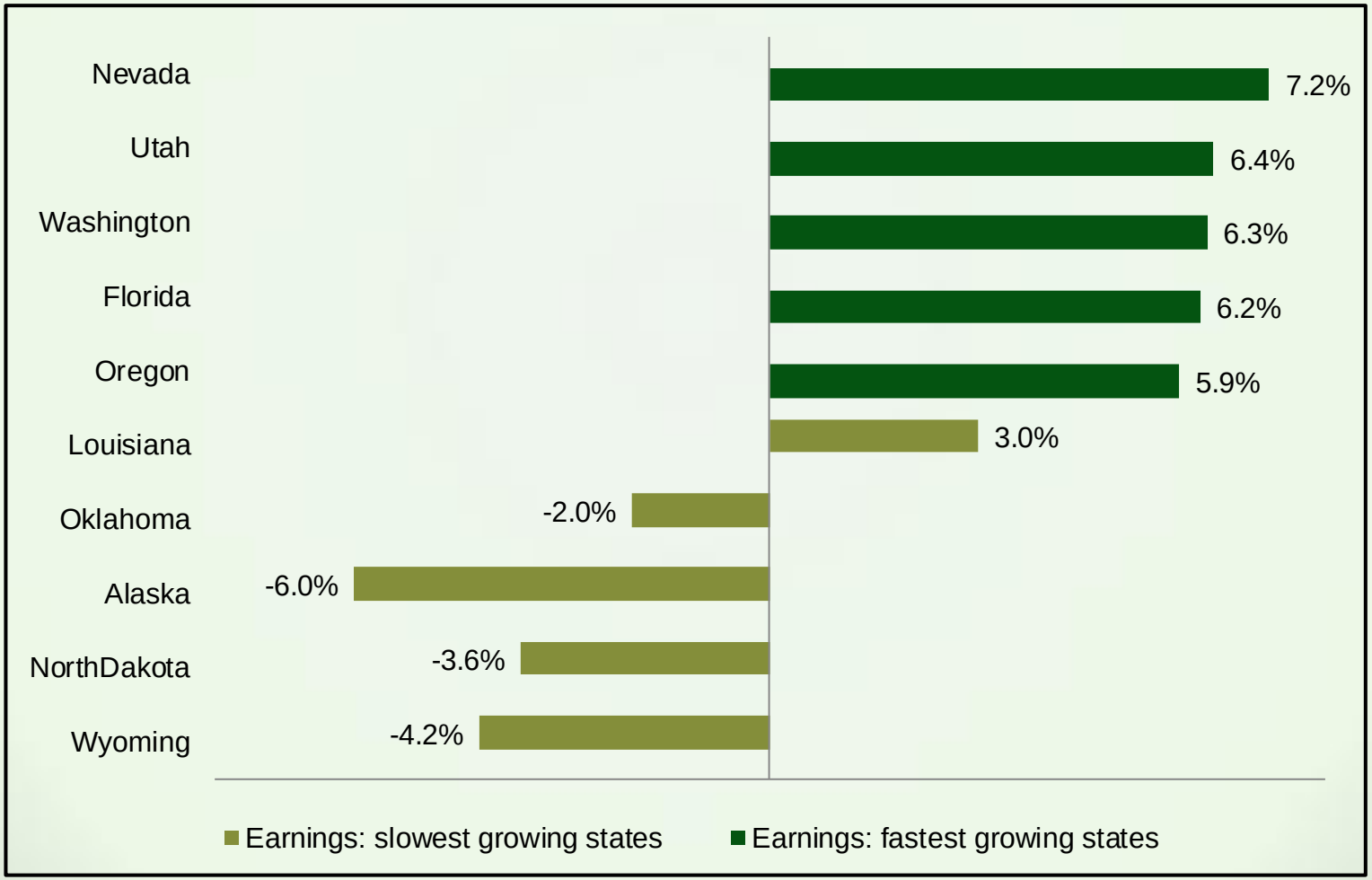

Source: US Bureau of Economic Analysis, as of December 2016.

# Our view

## Personal income: driven by positive earnings

Insight INVESTMENT

### Percent growth rate in earnings by state: 2015–2016



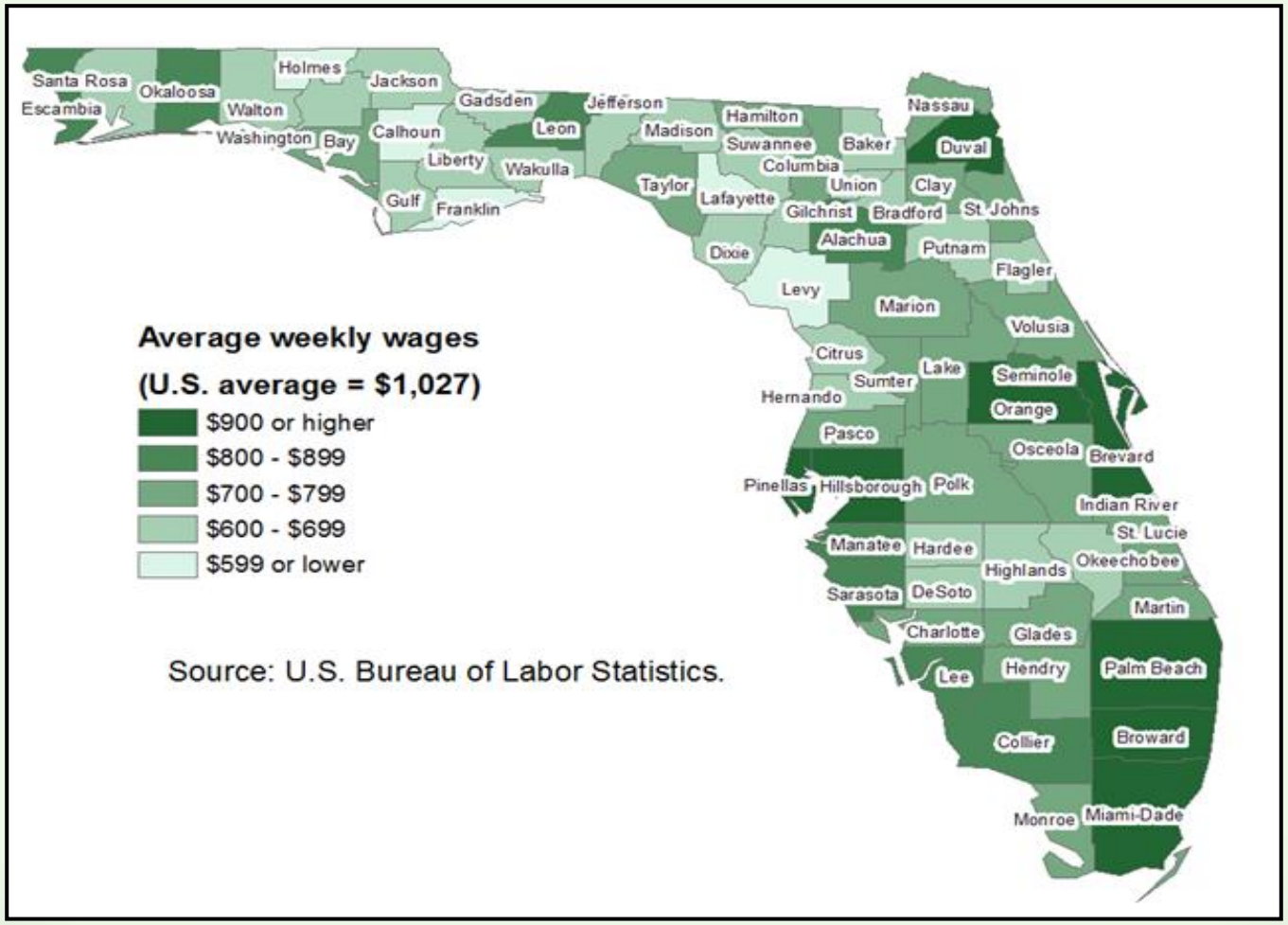

Source: US Bureau of Labor Statistics, as of December 2016.

# Our view

## Florida wages: near the US average and higher on the coast

Insight INVESTMENT

### Average weekly wages by county in Florida: third quarter 2016



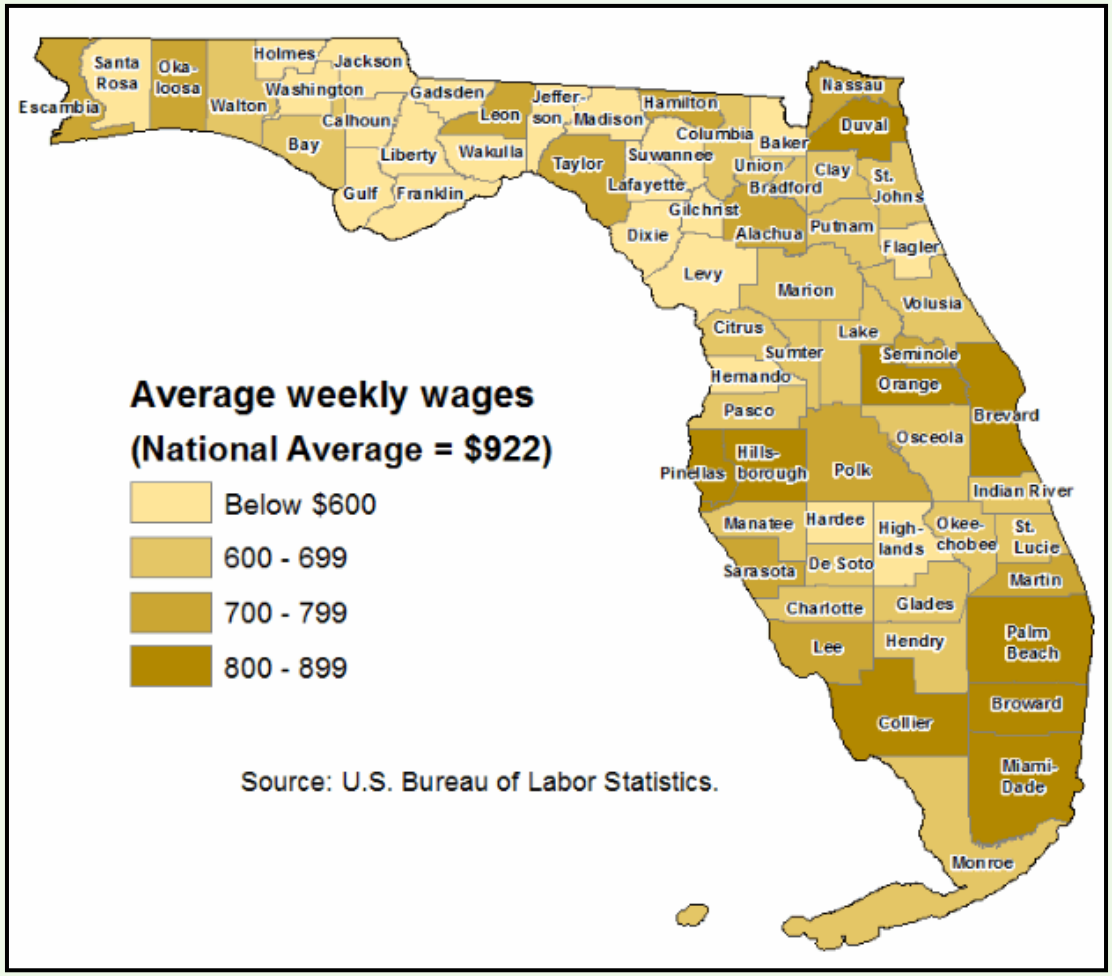

Source: US Bureau of Labor Statistics, as of September 2016.

# Our view

## Florida wages: a look back; the picture remains the same, but at higher levels

Insight INVESTMENT

### Average weekly wages by county in Florida: third quarter 2013



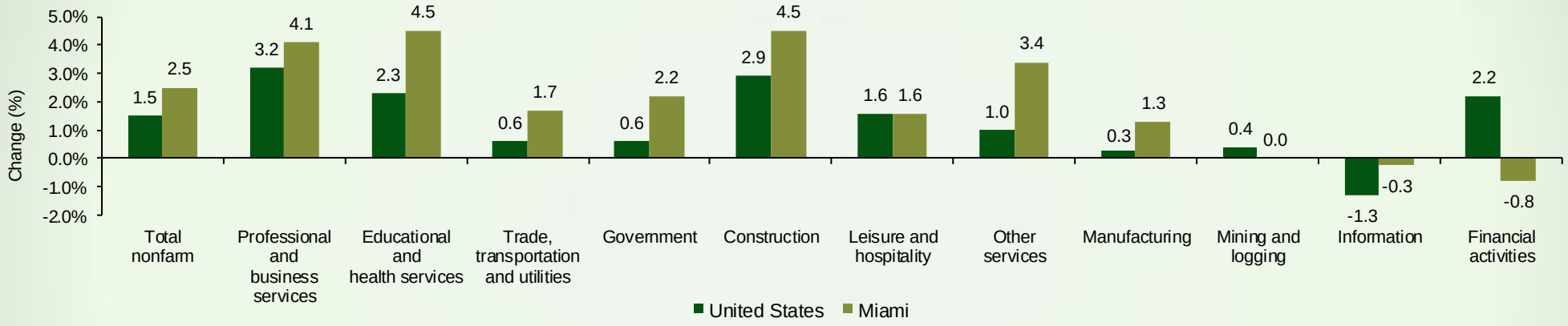

Source: US Bureau of Labor Statistics, as of April 2014.

# Our view

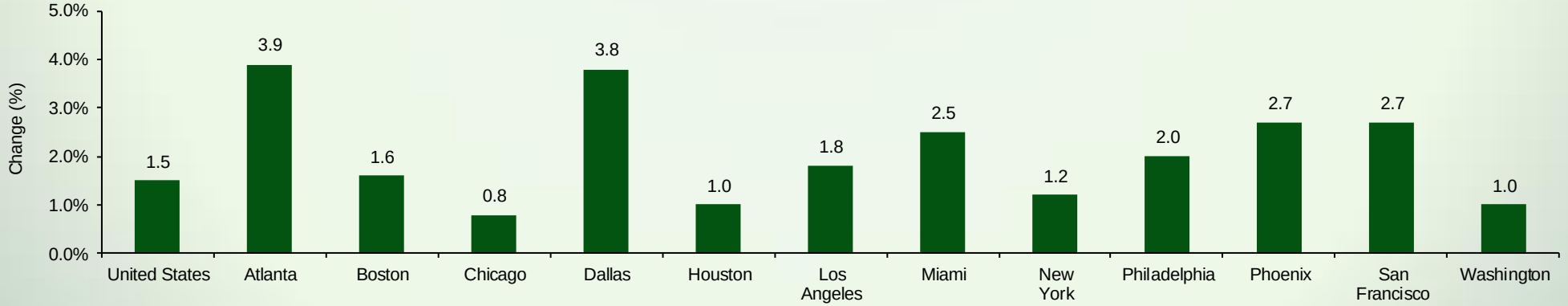
## Sector and large city employment: construction, education, health services and Miami among the leaders

Insight INVESTMENT

**Total nonfarm and selected industry super-sector employment over-the-year percent change in the Miami-Fort Lauderdale-West Palm Beach metropolitan area: March 2017**




**Total nonfarm employment over-the-year percent change in the US and 12 largest metropolitan areas: March 2017**

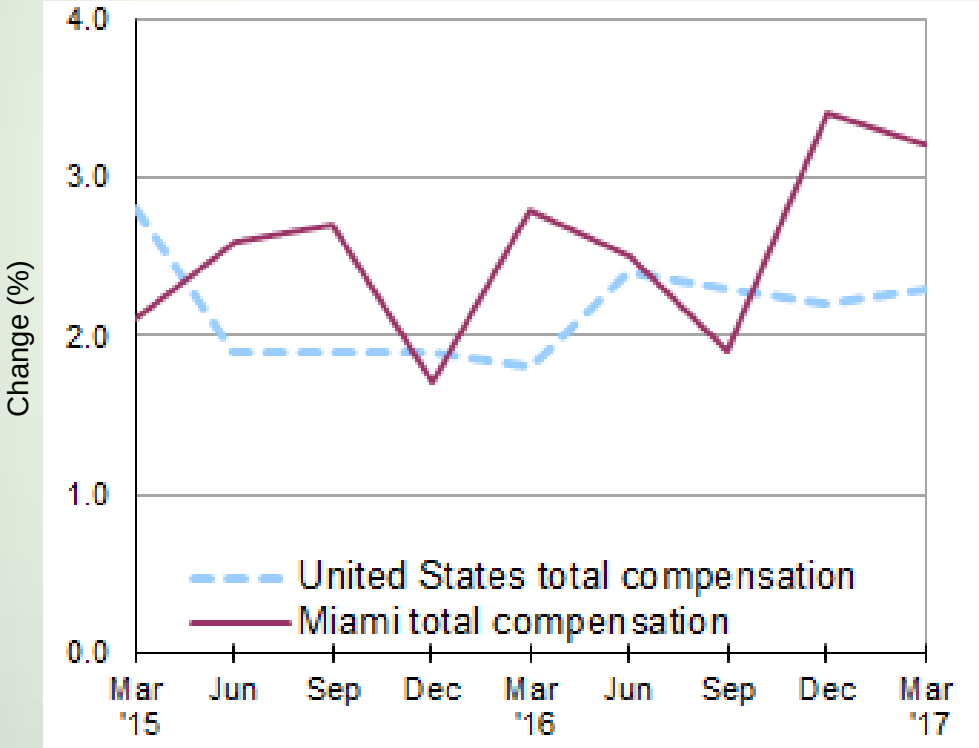


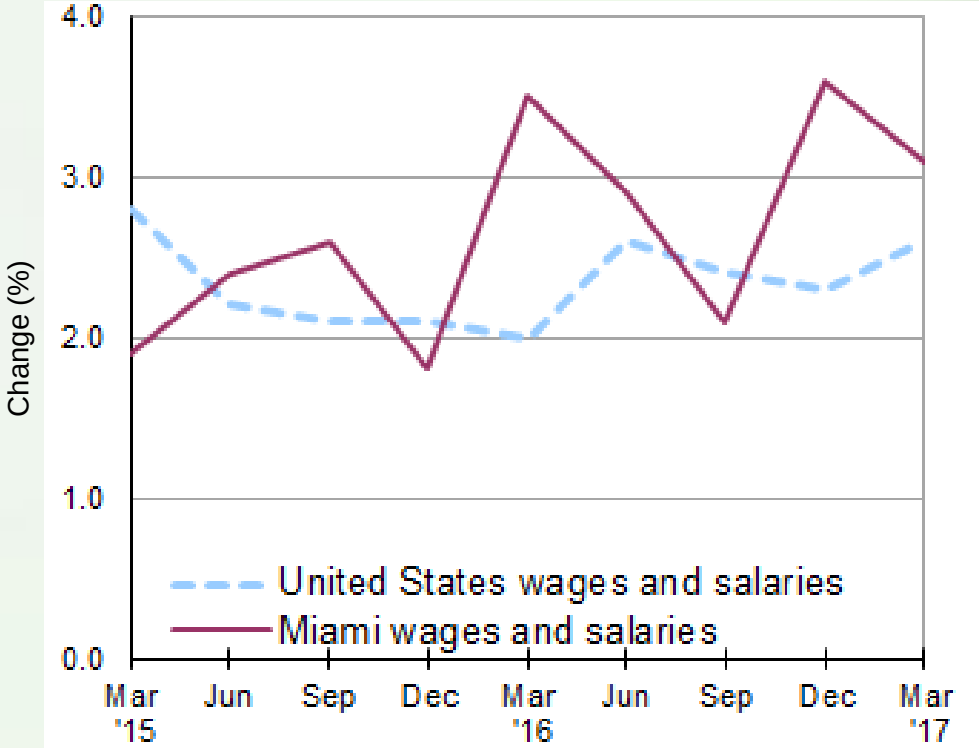

Source: US Bureau of Labor Statistics, as of March 2017.

# Our view

## South Florida employment costs…leveling off after a recent jump?

**12-month percent changes in the Employment Cost Index, private industry workers, in the US and Miami area, not seasonally adjusted: March 2015–March 2017**



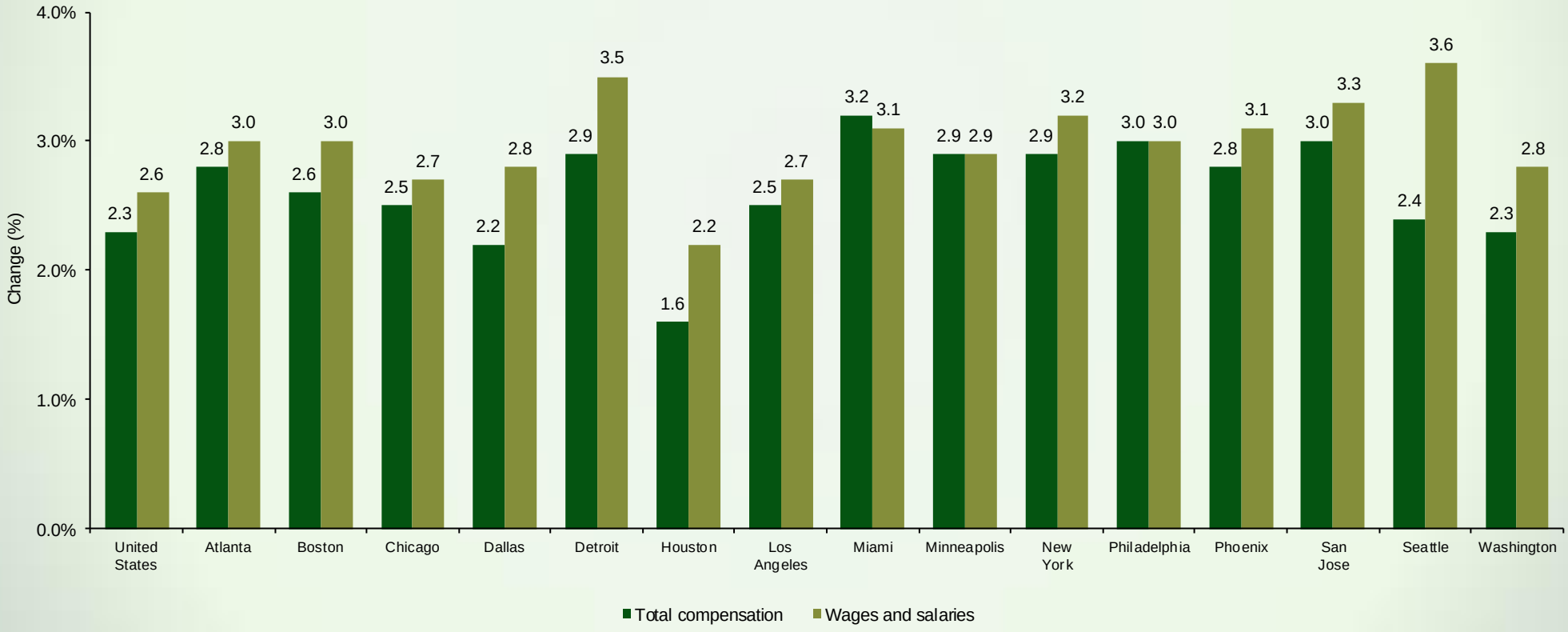

Source: US Bureau of Labor Statistics, as of March 2017.

# Our view

## South Florida among US leaders for wage costs

Insight INVESTMENT

**12-month percent changes in the Employment Cost Index and private industry workers in the US and Miami area, not seasonally adjusted: March 2015–March 2017**




Source: US Bureau of Labor Statistics, as of March 2017.

# Our view

## Florida house prices on a positive upward trajectory


Source: Bloomberg, as of December 2016.

# Our view

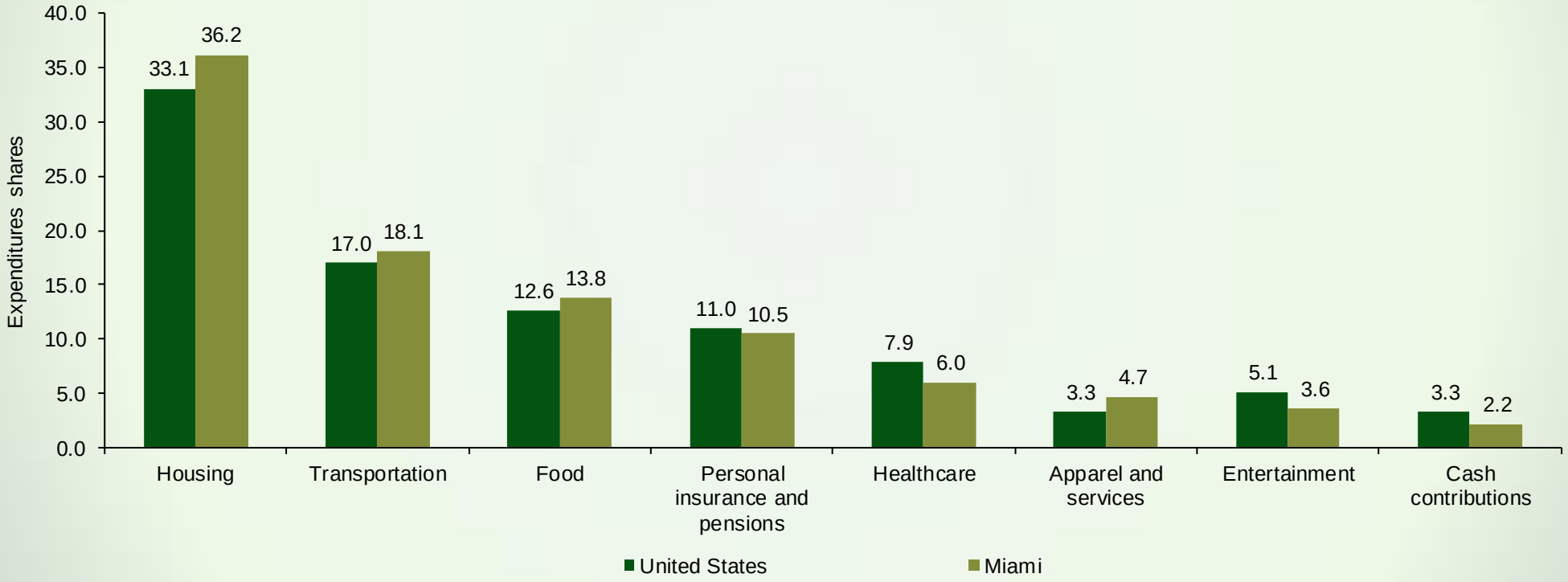
## Florida non-performing loans: back to pre-financial crisis levels


Source: Bloomberg, as of December 2015.

# Our view

## Consumer spending: higher spend for shelter from the elements

**Percent distribution of average annual expenditures for the eight major categories in the US and Miami metropolitan area: 2014–2015**



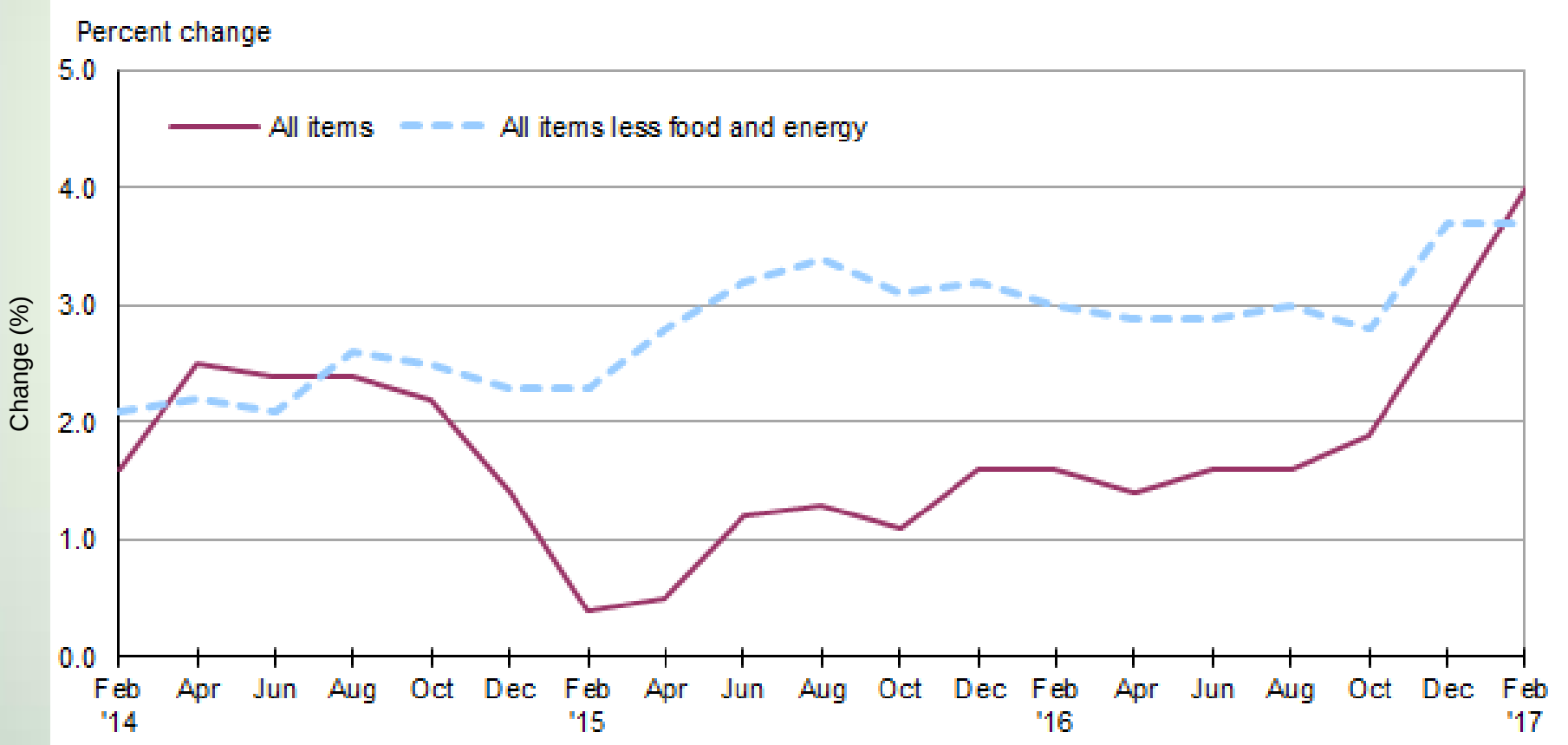

Source: US Bureau of Labor Statistics, as of December 2015.

# Our view

## Consumer prices: the impact of shelter and medical care

Insight INVESTMENT

**Over-the-year percent change in Consumer Price Index For All Urban Consumers, Miami: February 2014–February 2017**




Source: US Bureau of Labor Statistics, as of February 2017.

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