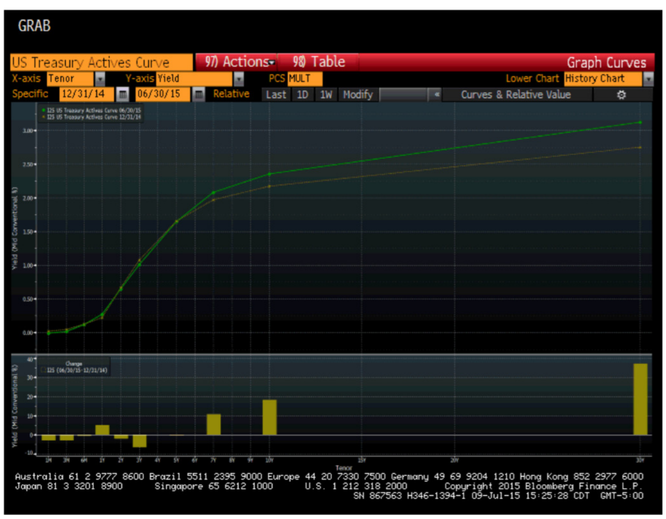
Bond Market Update

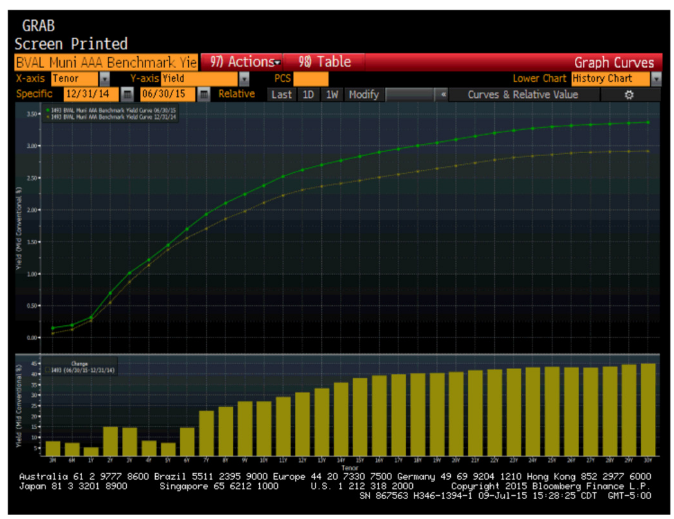
As of June 30, 2015 / Volume 4, Issue 2 / FFTAM.COM

The second quarter of 2015 for the fixed income market was somewhat eventful. Total returns were slightly negative, the economy rebounded from its -0.7% 1st Quarter GDP print, the Federal Reserve continued to entertain the idea of raising cash rates, Europe continued its version of QE (Quantitative Easing), Greece voted for socialism at the expense of its German creditors (and others), and the AAA yield curves, both taxable and tax-exempt, steepened (albeit, different in magnitude).

Total returns for taxable and tax-free investments where slightly negative. For the 2nd quarter, the Barclays Aggregate Bond Index recorded a total return of -1.68% and the Barclays Muni Index recorded a total return of -0.51%. Year-to-date returns are -0.10% and +0.32%, respectively. As mentioned above, the economy rebounded and estimates for second quarter GDP now average a growth rate of 2.8%. ISM Manufacturing and ISM Nonmanufacturing continued their levels above 50 (a reading above 50 indicates expansion). The unemployment rate dropped to 5.3% from 5.5. From the minutes of the June FOMC meeting, members "saw economic conditions as continuing to approach those consistent with warranting a start" of tightening. However, members also "mentioned their uncertainty about whether Greece and its official creditors would reach an agreement and about the likely pace of economic growth abroad, particularly China and other emerging market economies." In short, the members decided, again, to delay increasing the Federal Funds target rate from effectively zero.

Below to the left is the US Treasury Yield curve as of 12/31/14 and 06/30/15. As you will see, the yield curve is little changed to slightly steeper from the beginning of the year. Below to the right is the AAA Municipal Yield as of 12/31/14 and 06/30/15. Its move is a little more pronounced with rates moving up slightly and the curve steepening.





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FIRST FINANCIAL TRUST & ASSET MANAGEMENT COMPANY NA

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The US Treasury curve shows that with all the talk of rates going higher and the Fed coming into play, bond investors believe whenever the Fed actually does come into play that their moves will be small and protracted, hence the slight steepening on the long end of the curve. The AAA Tax Free curve shows the amount of pressure new issuance (supply) has brought with municipalities rushing to refund existing debt before the Fed comes into play. In addition to supply, negative credit headlines have caused risk premiums to expand with the city of Chicago, IL being downgraded to non-investment grade, "junk," by Moody's and Puerto Rico's Governor saying they will not be able to pay their debts dollar for dollar.

Year-to-date, investment grade credit spreads were little changed and high yield (also known as "junk bonds") spreads tightened marginally versus the risk free rate.

Looking forward, we will continue to deploy that same strategy from previous quarters. In short, we remain committed to a very high credit quality portfolio with a slight bias towards flat to slightly higher/lower interest rates (range bound). It is important to note that the levels of interest rates around the world are lower than here in the US. That fact in conjunction with a FED that may come in to play (with the market expectation of a very modest pace of the Fed increasing the funds target rate) is causing us to buy bonds with maturity characteristics that result in our bond portfolios being equal to slightly longer than our representative indices. For tax free bonds, we believe that longer-term yields will remain fairly stable which will allow us to capture a benefit of our active bond management.

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