MAPLE CAPITAL MANAGEMENT

FIXED INCOME COMMENTARY

April 5, 2016

KEY TAKEAWAYS

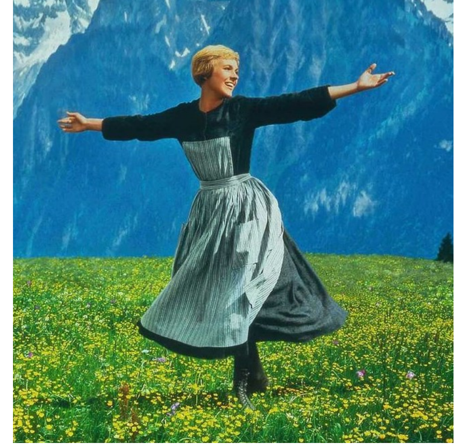
Despite somewhat stronger economic conditions in the U.S., Fed Chairwoman Janet Yellen has decided to maintain a policy of caution towards raising rates. Worries about continued expansion and the persistence of low inflation are the drivers for the cautionary tone. "Lower for longer" is the logical conclusion when interpreting Yellen's public comments.

Key Rates	Mar 31 2016	Feb 29 2016	Dec 31 2015
Treasury Yields			
2 Year	0.72	0.77	1.05
5 Year	1.20	1.21	1.76
10 Year	1.77	1.73	2.27
30 Year	2.61	2.62	3.02
Credit Yields			
BBB Industrial 10 Year	3.41	3.66	3.99
Muni Yields			
AAA 10 Year	1.75	1.75	2.00
Mortgage Backed Securities			
30 Year FNMA Current Coupon	2.57	2.55	3.02

FEBRUARY IN REVIEW

- Strong rally in equities and fixed income spread product, with the S&P up 6.6% and the Barclays U.S. Credit Index up 2.5% in March
- Fourth-quarter real GDP was revised higher to 1.4% from the original report of 0.6%, but still below original expectations
- Probability of the next rate increase moved out to December of 2016, as measured by the implied Federal Funds Futures

The Sound of Music



Federal Reserve Chairwoman Janet Yellen's speech on March 29th was music to the market's ears. Speaking at the Economics Club of New York, she said "Given the risks to the outlook, I consider it appropriate for the Committee to proceed cautiously in adjusting policy. This caution is especially warranted because, with the federal funds rate so low, the FOMC's ability to use conventional monetary policy to respond to economic disturbances is asymmetric. If economic conditions were to strengthen considerably more than currently [sic], the FOMC could readily raise its target range for the federal funds rate to stabilize the economy. By contrast, if the expansion was to falter or if inflation was to remain stubbornly low, the FOMC would be able to provide only a modest degree of additional stimulus by cutting the federal funds rate back to near zero."

These "lyrics" clearly imply the Fed will be very slow to increase rates in 2016 and will err on the side of caution, even as economic data continue to improve. Markets are happily humming this tune and Fed funds futures now imply the earliest rate increase will be in December 2016, down from year-end levels that reflected the Fed's desired four rate increases during the year. Both stocks and bonds rallied in March on the growing prospect of sustained low rates. The U.S. dollar fell on the same view, helping lift commodity prices off their earlier lows.

March economic data did not allay concerns about weaker economic growth. In the U.S., the final report on fourth-quarter 2015 real-GDP came at 1.4%, up from an original report of 0.6%, but still well below initial forecasts of last year. Personal consumption was a solid 2.4%, while the price index rose just 0.9%. The U.S. employment report continued on track, averaging 209,000 new jobs for the first three months of 2016 and 234,000 jobs on average for the past 12-months, but manufacturing jobs plunged and hiring of temporary workers – often a leading indicator of future payroll growth - slowed. The U.S. Unemployment rate rose slightly to 5%, up slightly from the previous report's 4.9%, as more people joined

EXHIBIT 1: MOVEMENT OF RATES ACROSS US TREASURY YIELD CURVE IN Q1 2016

Issue	12/31/15	3/31/16	Change (bp)	Range	Total Return
2-yr Note	1.05	0.72	-33	0.65-to-1.05	0.89
5-yr Note	1.76	1.21	-55	1.12-to-1.76	3.19
10-yr Note	2.27	1.77	-50	1.66-to-2.27	5.16
30-yr Bond	3.02	2.61	-41	2.49-to-3.02	9.25

Source: Bloomberg Financial L.P. and Barclays Securities. All figures are in percent terms (%) except as noted.

the labor force. The Labor Force participation rate climbed to 63% and has been steadily rising from the 62.4% low in September of 2015.

For the quarter, interest rates fell due to the increased volatility in global equities and somewhat softer economic data throughout the quarter. **Exhibit 1** on the previous page highlights the movement of interest rate across the U.S. Treasury yield curve for the first quarter of 2016.

One has to remember that year-end levels reflect a month in which the Fed increased interest rates for the first time since 2008. As the first quarter progressed, softer-than-expected economic data, coupled with Fed inaction on further rate moves, helped the bond market stage a strong rally. In terms of sector returns, credit led the way in March, finally surpassing U.S. Treasuries on a year-to-date basis. **Exhibit 2** highlights the sector performance according to the Barclays Indices.

EXHIBIT 2: FIXED INCOME MARKET PERFORMANCE

Index	February (%)	Year-To-Date (%)
US Aggregate	0.92	3.03
US Intermediate Agg	0.58	2.31
US Credit	2.52	3.92
US Treasury	0.16	3.20
US MBS	0.30	1.98
US Municipal	0.32	1.67
US High Yield	4.44	3.35

Source: Bloomberg Financial L.P. and Barclays Securities

As can be seen from the table above, corporate bonds had a banner month, with investment-grade spreads contracting roughly 30 basis points and high yield issues narrowing by approximately 56 basis points, according to Barclays. U.S. Treasury rates barely budged in March, while mortgage-backed security spreads narrowed slightly. Municipal bond spreads were pretty much unchanged in March.

Going forward, we are sticking with the themes that we've held for a while:

Interest Rates. Lower for longer, with a flatter than expected yield curve (although this is increasingly data dependent).

The Fed. They will move like a herd of turtles; we expect just one rate increase this year.

Duration. We maintain a bias toward shorter rather than longer exposures.

Corporate bonds. Spreads remain vulnerable given the huge debt overhang in the market and the prospect of slowing growth.

Mortgage-Backed Securities. We see price stability as prepayments remain stable, but spreads will widen slightly if US Treasuries rally and vice versa.

Municipal bonds. Will continue to narrow to a more normal historical relationship relative to U.S. Treasuries.

High Yield. The high yield market will continue to be a mine field given the vast supply of energy-related and mining issues in the market and generally weakening fundamentals.

We expect this "slow but steady" back drop to remain in place at least through the end of summer. This should provide a floor for both stock and bond prices, although prevailing conditions suggest volatility may still be a significant risk. We continue to reduce risk in client portfolios.

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