MAPLE CAPITAL MANAGEMENT

FIXED INCOME COMMENTARY

May 3, 2018

KEY TAKEAWAYS

Interest rate spreads continue to be historically tight as market dynamics push investors into the front and the long end of the curve. In this "bowing" environment, risk to reward return profiles skew to shorter maturities. The Fed will continue to raise rates, but at a gradual pace.

Key Rates (%)	Apr 30 2018	Mar 31 2018	Dec 31 2017
Treasury Yields			
2 Year	2.49	2.26	1.88
5 Year	2.80	2.56	2.21
10 Year	2.95	2.74	2.41
30 Year	3.12	2.97	2.74
Credit Yields			
BBB Industrial 10 Year	4.30	4.11	3.61
Muni Yields			
AAA 10 Year	2.53	2.48	2.01
Mortgage Backed Securities			
30 Year FNMA Current Coupon	3.65	3.46	3.00

APRIL IN REVIEW

- The 10- year Treasury was up 21 bps to finish April at 2.95%.
- High Yield went from the hardest hit sector in March, to the best performing sector in April, up .65%.
- Municipals performed well on a relative basis, -.36% in April.

Over the Rain "Bow"

Interest rates resumed the move higher in April. Bond prices fell across the curve as investors pulled back from the trade war driven "flight to quality" rally we saw in March. The sell-off in April was sparked by continued economic growth and growing evidence of increasing inflationary pressures. The combination of a rising Federal budget deficit and continued reductions of Federal Reserve bond holdings added to the move.

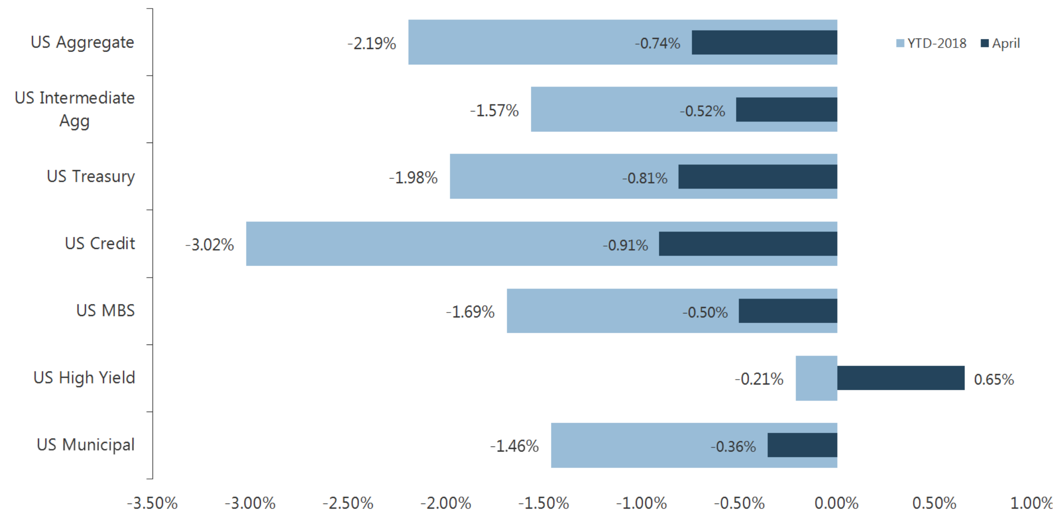
The high-yield market (-0.21%) continued to outpace all other sectors of the bond market. This was primarily due to the performance of defaulted securities rated Ca-D, which posted a +9.64% return for the month and +12.07% return year-to-date (not seen in exhibit). Municipals, mortgage-backed securities, and Treasuries had decent performance on a relative basis, while investment-grade corporate bonds were the worst performing sector for both the month and year. The stellar returns achieved by corporates over the last few years were driven by tightening spreads, which remain near record tights. We expect this strength to become a weakness in coming quarters.

The strong economic data released during April have given the Federal Reserve plenty of cover to pursue policy normalization efforts. The pace of the Fed's balance sheet liquidation efforts rose to $30 billion per month in April and will increase to $40 billion in July. The Fed is also expected to raise base interest rates at least two more times this year - once in June and once in the fourth quarter.

The biggest raincloud threatening the continuation of the bond party is the Federal budget deficit. Deficit estimates are ballooning under the dual pressures of the tax package and increased spending due to the budget signed at the end of the year. After doubling the national debt since 2008, the government is expected to add an additional $1.3 trillion in debt this year, a staggering number by any measure.

This is a potentially toxic combination for bonds. Surging deficits, a normalized Federal Reserve policy, resurgent inflation, and stronger economic growth should lead to higher interest rates in the months ahead.

EXHIBIT 1: FIXED INCOME MARKET TOTAL RETURNS



Source: Bloomberg Financial L.P. and Barclays Securities

While many believe the Fed will seek to prevent sharp moves higher, it is hard to see how rates can remain constant.

The big question when making portfolio decisions is how the rate rise will unfold. We do not expect this to be a linear, across the curve rate shift. Our view now is for the yield curve to move toward an eventual bowed shape. This would happen as short-term rates move closely with changes in Fed policy. Intermediate rates should also be pressured by these Fed moves, and some steepening should occur as buyers seek to minimize duration risks. However, many longer-term market participants have a natural need to buy longer duration assets and there is still a significant shortage of high quality bonds in this segment of the market. Many investors also have uncertainty about the prospects for continued global growth and prefer longer-dated bonds as a hedge against the risks of recession. We see more stability in the long end of the curve than market structure would suggest.

For now, we do not see a significant spike in interest rates. We expect the Fed to keep raising rates on a gradual basis and we see no change to the ever-increasing pace of the Fed balance sheet liquidation process, barring any major hit to the economy or a sharp increase in inflation. We will continue to favor short-duration assets in all fixed-income sectors.

EXHIBIT 2: INTEREST RATE MOVES

US Treasury	April Change	YTD Change	April Closing Yield
2-yr Note	+22 bps	+61 bps	2.49%
5-yr Note	+24 bps	+59 bps	2.80%
10-yr Note	+21 bps	+55 bps	2.95%
30-yr Bond	+15 bps	+38 bps	3.12%

Source: Bloomberg Financial L.P.

Exhibit 2 shows the interest rate movement in April and for the year as reported by Bloomberg.

Per our thesis, the Treasury yield curve is starting to exhibit a bowing trend.

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