Jamie Mullen
Senior Portfolio Manager

As a Senior Portfolio Manager, Jamie manages the Taxable and Tax Free Fixed Income Strategies. He is a member of the Clark Capital Investment Committee. Jamie has over 30 years of experience with fixed income securities. He began in municipal credit research and worked in public finance before moving to a position in trading, where his experience included trading municipal bonds and employing fixed income futures and futures options. He has extensive experience in dealing with mutual funds, trust departments and money managers. He received his degree from St. Joseph's University. He joined Clark Capital in 1999.

THE RATES MARKET WAS KUNG FU FIGHTING

If the shape of the yield curve is any indication, the Federal Reserve and investors are locked in a battle of divergent expectations. In a normal market, the yield curve should be upwardly sloping and reflect both inflation expectations and economic growth anticipation. However, the flatness of the yield curve is currently reflective of a Fed committed to a path of quantitative tightening combined with a continued demand for long-dated U.S. Treasuries, which has helped keep longer end rates largely in check.

Fed fund futures appear to be anticipating the Fed will hit the brakes on rate hikes in 2019, while the Fed dot plot is suggestive of continued hikes through 2020, providing further evidence of divergent opinions from segments of the market.

Those rates were fast as lightning

U.S. Treasury rates are finally catching their breath after a roller coaster of a quarter. The 10-year U.S. Treasury rates hit the highest levels since 2011 while the 2-year U.S. Treasury rate topped 2.6%, the highest since 2008. Over the past three months, the 10-year U.S. Treasury rate increased from 2.73 to 3.11%, prior to rallying back to 2.86% at the end of June. Unlike their longer counterparts, short term rates have held onto the new higher levels as the Fed continues on their path of tightening monetary policy. Higher rates, in general, are a bit of a conundrum for the market, since on one hand, rising borrowing costs could threaten an equity bull market that has been largely fueled by lower rates, but on the other hand, rising rates would certainly give support to the belief that the economy is firing on all cylinders. But is everything as it seems?

While many market pundits were eagerly anticipating 10-year rates heading above the key 3% level, the inability of rates to hold above this psychological mark is pretty telling. The confidence of investors to bid bond yields up beyond 3% is paper thin, and the general flatness of the yield curve seems to be telling a story contrary to that of the Federal Reserve. Typically higher yields are demanded from the market when investors believe that inflation, a key metric that the Fed aims to control, is increasing. Yet, the spread between two-year and ten-year notes are at the lowest in over a decade and could very well be a better barometer of economic health than unemployment figures or housing starts.

But really it was not that frightening…

Despite the vacillations in the rates market, there are several positives for investors to focus on. One is an increase in short-term rates, an increasingly positive net benefit to savers. For example, the U.S. Treasury 3-month bill money market yield has increased almost 51 basis points this year to 1.95%. With almost a decade of rates in the single basis point range, the run up, which started in earnest in late 2017, seems poised to continue.

Another positive in the market right now is that the mere threat of a yield curve inversion may be enough to cool the jets of the Federal Reserve. Historically, yield curve inversions have been precursors of a broader recession. It should be noted that several Federal Reserve offi-

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cials have been vocal on trying to avoid such an outcome. While other financial pundits, such as former Fed Chairman Alan Greenspan, are in the camp that believes the flattening shape of the yield curve and a recession are not coterminous.

Municipal bonds have historically performed better in Fed tightening cycles. During past Fed hiking cycles, muni/Treasury ratios have declined, meaning that muni bond prices increased by a larger amount relative to Treasuries. This makes the current move higher of the ratios over the past month all the more attractive. The yield curve could flatten even more as the short end rises with future rate moves by the Federal Reserve, while long-term rates remain impacted by larger macro issues.

Lastly, portfolio allocations using barbell strategies appear poised to perform well in the current flattening yield curve environment. The benefits of a barbell portfolio include the ability to reinvest the proceeds (liquidity) of shorter term bonds at higher rates, thus providing the opportunity for higher yields than a traditional bulleted portfolio approach. The strategy also provides the potential for higher yield income from longer dated bonds. With long duration bonds more sensitive to price fluctuations, diversification in both ends of the yield curve could provide price protection.

Taxable Bond Portfolio

Yield curve flattening continued during the second quarter. The 2- to 10-year spread contracted another 15 basis points to 33 basis points according to Bloomberg data. We continue to look at the front end of the yield curve outside the money market range to invest in a barbell strategy for the portfolio.

Tariffs have caused spreads to widen in the investment grade corporate bond market. Credit spreads can widen when investors demand more return for the risk of uncertain economic outcomes due to possible trade wars.

We like the widening spreads and welcome the higher yields as an opportunity for investors to increase cash flow. We hold a widely diversified list of bonds across multiple sectors of the economy and believe this can smooth out returns.

In regards to the tariffs, we hope that cooler heads will prevail and trade negotiations will prove beneficial to all parties. The likely outcome is a "saving face" on all accounts and every nation declaring themselves the winner. They better all be winners, as there was a mountain of debt created in the last 10 years, and it all will be refinanced at higher interest rates in the coming months and years.

Tax-Free Portfolio

Can municipals continue to outperform? Municipal bonds have held their own in a fixed income universe where most sectors produced negative returns, and we anticipate this trend will continue. The Bloomberg Barclays Municipal Bond Index returned 0.87% in the second quarter, compared to -0.1587% for the Bloomberg Barclays US Aggregate Bond Index and just 0.10% for the Bloomberg Barclays US Treasury Index. The tax-exempt market has momentum and seasonality on its side as it heads into the summer season, which has become known for scarcity of bonds. The supply/demand dynamics will firmly take hold during the next few months as over $130 billion of money will flow back to investors during the summer and we believe they will be looking for bonds to reinvest in. Demand continues unabated as shown by both weekly ICI fund flows and municipal bond ETF reporting figures. After some tax time outflows, ICI has reported seven consecutive weeks of positive prints totaling $1.9 billion, and bringing the year-to-date tax-exempt inflow figure to $10.5 billion. Municipal ETFs have added almost $2.5 billion for the year, outpacing the general ETF market by 5% on a flow basis. Our focus in the Tax-Free Fixed Income strategy continues to center on current income and decreasing duration and looks to slide down the credit spectrum opportunistically. Scarcity of bonds has driven high grade muni spreads to tighter levels, allowing for more opportunistic purchases in sub-AAA credit and revenue-generating bond sectors. Focus on essential service issuers, as well as well capitalized healthcare and higher education names, provides portfolio diversification away from public pension and fixed cost ratio risk that are growing trends in the tax-backed sector.

We continue to believe that municipal bond insurance is priced attractively and have been adding these policies to our holdings in an effort to effectively enhance asset protection and lower credit risk. We have purchased insurance on several general obligation names held throughout the strategy that we believe will be an additional measure in preserving portfolio principal value.

Source: Bloomberg, Ned Davis Research

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The Dow Jones Industrial Average is a stock market index that shows how 30 large publicly owned companies based in the U.S. have traded during a standard trading session in the stock market.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performers of developed markets outside the U.S. and Canada.

The MSCI Emerging Markets Index is a freefloat-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

The S&P 500 Index measures the performance of 500 large companies in leading industries of the U.S. economy, capturing 80% of U.S. equities.

The Bloomberg Barclays U.S. Government and Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries, government-related, and investment grade U.S. corporate securities that have a remaining maturity of greater than 1 year. In addition, the securities have $250 million or more of outstanding face value, and must be fixed rate and non-convertible.

The Bloomberg Barclays U.S. Corporate High-Yield Index covers the U.S. dollar denominated non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

The Bloomberg Barclays 30-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments.

The Bloomberg Barclays 10-Year U.S. Treasury Bellwethers Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The index assumes reinvestment of all distributions and interest payments.

The Bloomberg Barclays 5-Year Municipal Bond Index is the 5 Year (4-6) component of the Municipal Bond index. It is a rules-based, market-value-weighted index engineered for the tax-exempt bond market. The index tracks general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds rated Baa3/BBB- or higher by at least two of the ratings agencies.

The CBOE Volatility Index (VIX) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices and which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk. The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 75% of U.S. equities. The Bloomberg Barclays Capital U.S. Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. Municipal bonds, and Treasury inflation-protected securities are excluded, due to tax treatment issues. The index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in U.S. The Bloomberg Barclays Capital Aggregate Bond Index is an intermediate term index.

The volatility (beta) of a client's portfolio may be greater or less than its respective benchmark. It is not possible to invest in these indices.

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