MANAGER COMMENTARY

FIXED INCOME

Great Lakes Advisors
A Wintrust Wealth Management Company

THIRD QUARTER 2017

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Market Review

The broad fixed income market posted gains for the 3rd quarter, with the Investment Grade Corporate, High Yield, and Municipal sectors performing the best. Treasuries, specifically the long end, lagged behind because of a quick yield reversal in September. The Bloomberg Barclays Aggregate Index returned 0.85% for the quarter.

In stark contrast to how well Treasuries performed in July and August, September saw a significant reversal in the treasury markets. The losses across the curve can mostly be attributed to the Republicans releasing a business friendly tax plan, and the Fed re-confirming its commitment to raising rates in December and reducing the balance sheet in October.

Our overweight in spread product continued to help performance with ABS, CMBS, Agency and Corporates all performing well. Our underweight in MBS detracted from performance as we anticipated greater spread widening in this sector leading up to the Fed's balance sheet reduction.

Sector Highlights

- **Credit:** Lower-rated Corporate credits did well, as did longer credit. Investment Grade spreads tightened 9 basis points for the quarter. Telecom and Energy were top performers, and REITs lagged the field. High Yield Spreads tightened about 30 basis points in September, which negated the nearly 30 basis point widening in August.

- **Treasuries:** On September 7th, the 10 year Treasury yield was 2.05%, but finished the month at 2.33%, a nearly 14% backup in yield. The aforementioned flattening was a result of less give-up on the long end, where the 30 year Treasury moved 16 basis points higher in yield.

- **MBS:** Mortgage-backed bonds had their best excess returns in over a year in September. As interest rates rallied over the course of the summer, prepayment fears once again began to take hold of the mortgage market. The subsequent sell-off in rates in late September erased most of those concerns.

- **CMBS:** CMBS tripped up at quarter end, resulting in losses similar to intermediate credit. CMBS was wider by 2bp over September and by 9bp for the quarter. CMBS widened in sympathy to overall credit as the sector bounced off its low for the year in June.

	Q3	YTD
BB Aggregate	0.85%	3.14%
Corporate	1.34%	5.18%
Treasuries	0.38%	2.26%
Mortgages	0.96%	2.32%
High Yield	1.98%	7.00%
Municipal	1.06%	4.66%
2-year Treasury	0.19%	0.57%
10-year Treasury	0.49%	3.56%
30-year Treasury	-0.04%	12.14%

- **Yield Curve:** The belly of the intermediate curve had the worst duration-adjusted performance as increased inflation expectations of 13-16bp after August CPI arrived as forecasted. In addition, there was an increase in real interest rates of 3-7bp as the FOMC remained hawkish on September 20, shrugging off dovish summer debates about inflation.

- **Municipals:** Tax-Free bonds were relatively stable after an announced proposal to change the tax system. After tax, Munis about matched the performance of the broader bond market.

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Market Outlook

With guidance from the Fed that it will indeed continue to tighten by raising rates and reducing quantitative easing, we believe that our approach of being shorter than the duration benchmark and underweight to mortgages will work to our advantage. We think that the next rate increase will occur in December, and will be followed by several rate increases in 2018. Inflation and growth are on the increase, albeit a mild increase.

Our current credit allocation favoring Financials, Energy, and Industrials will remain intact for now. Exposure to ABS, CMBS, and shorter duration securities will continue until we see a better entry point to return to what we consider a normal exposure to mortgages.