MANAGER COMMENTARY

FIXED INCOME

Great Lakes Advisors
A Wintrust Wealth Management Company

FOURTH QUARTER 2016

Patrick M. Morrissey
Senior Portfolio Manager
and Managing Director

Emily Li, CFA
Senior Portfolio Manager
and Managing Director

Richard M. Rokus, CFA
Senior Portfolio Manager

Nancy Studenroth
Senior Portfolio Manager

Teodora Petrova
Associate Portfolio Manager

David Kopp
Associate Portfolio Manager

greatlakesadvisors.com

Bond prices dropped to start the quarter and end the year. Losses in the first two weeks of December reached around the world and exceeded 2%. During December losses on long Treasuries hit 3% before staging a two-point comeback in the final two weeks of the year. After mid-December, fixed income experienced a small boost from a dovish central bank in Europe, but a bigger push from the loss of momentum in global equities into the close of the year. December's opening sell-off was a reaction to expectations of stronger growth, a rebound in equity prices and an expected rate increase in Federal Funds on December 14. The late month rebound in prices was a technical bounce rather than a clear reversal of the quarter's decline.

For the quarter, the 10-year Treasury moved from a 1.60% to a high yield of 2.60% and ended the year at 2.45%. The shape of the yield curve changed dramatically, with the most telling steepness measured in two-year to ten year bonds. Despite the Federal Open Market Committee rate increase, the 3-year Treasury actually performed the best on a duration adjusted basis, followed by the 7-year; the 5-year and 10-year Treasuries took a hit.

December Winners

- High yield
- Long industrials
- Long municipals
- Emerging market bonds
- 20-yr conventional pass-through mortgages

Of Note

- High yield spreads fell 40bp versus Treasuries. Energy securities tightened an average of 65bp during the month. The gains capped a year that easily recouped the 6% losses of 2015 to produce the highest 2-year total in fixed income and almost surpassed the S&P 500 during that period. Nominal returns were almost 190bp, and excess returns were equally strong.

- Emerging markets couldn't rebound from the 4% nominal losses in November, but did chip away at its excess return deficit to bring the 2-month total to +25bp to Treasuries. December's nominal results were about 125bp. Excess returns for the quarter of less than 25bp were better than fixed-rate mortgages, but were distinctly third tier.

The Barclays Aggregate Index finished the quarter down 2.98%, and up 2.65% for the year, while the intermediate finished -1.74% and +1.97% for the same periods. On the tax-exempt side, the Barclays 1-10 year index was down 2.62% for the quarter, and down 0.10% YTD, while the 3-15 year index finished down 3.41% for the quarter and -0.05% YTD.

Our outlook for the near term is continued volatility driven mainly by Trump policy implementation and the overall economic recovery. We expect more Fed tightening over the next year, with two to three rate hikes possible.