Interest Rates and Portfolio Management

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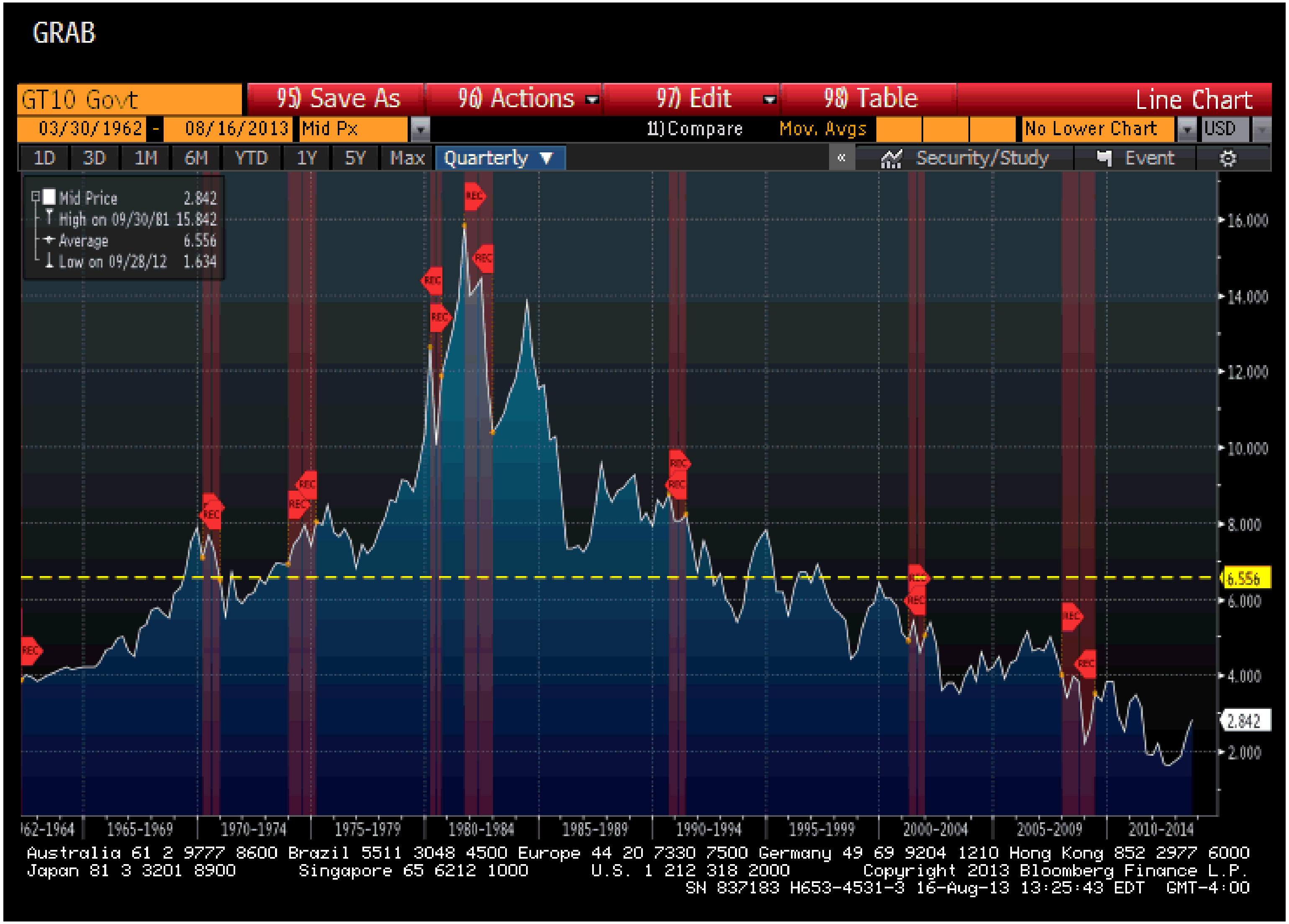
Portfolio Manager

Overview

- A historical view on interest rates
- The current environment
- The policy unwind
- Implying the future for rates
- Portfolio management strategies

Interest Rates- Historical Context

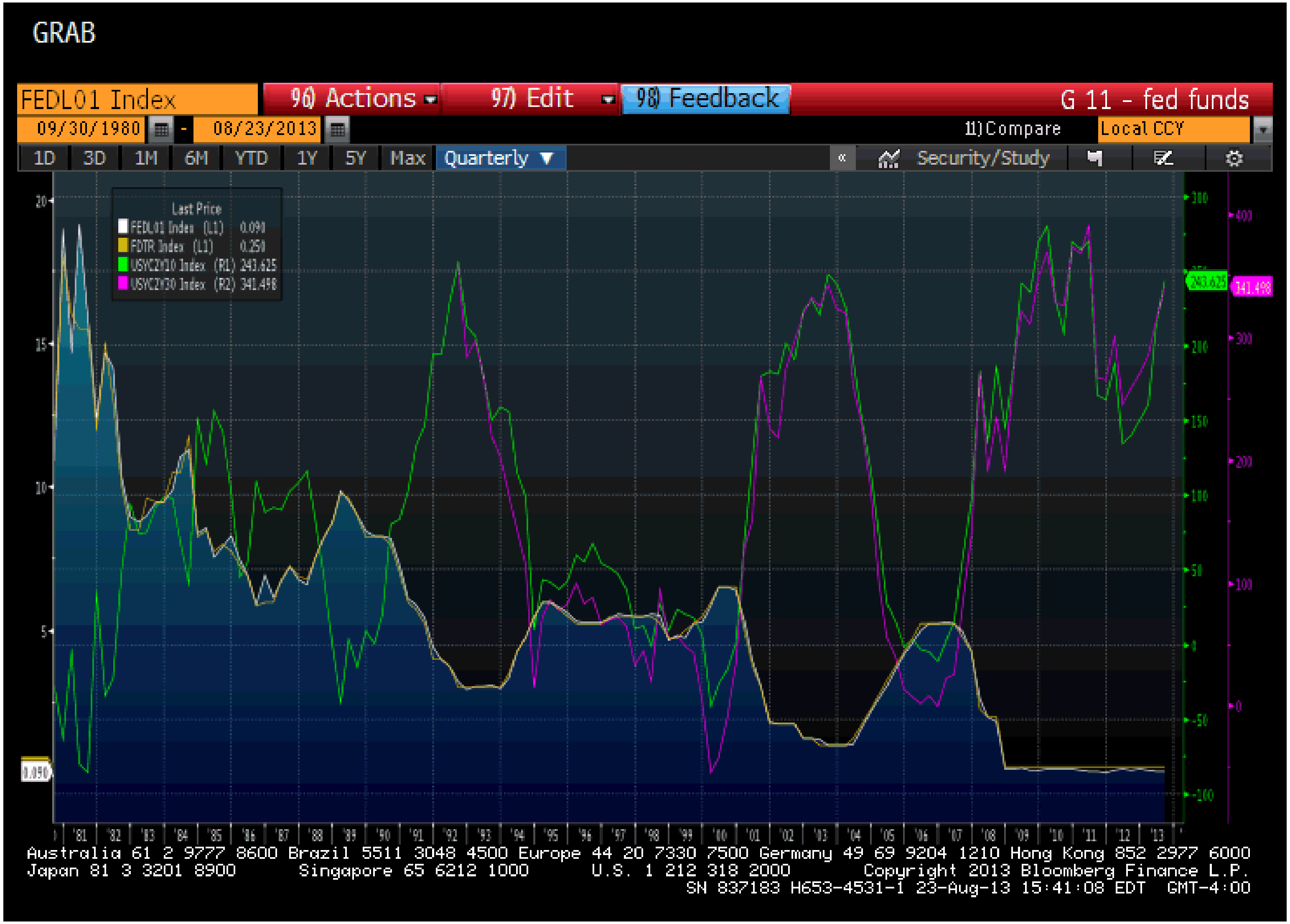


Source: Bloomberg

Interest Rates- Current Environment

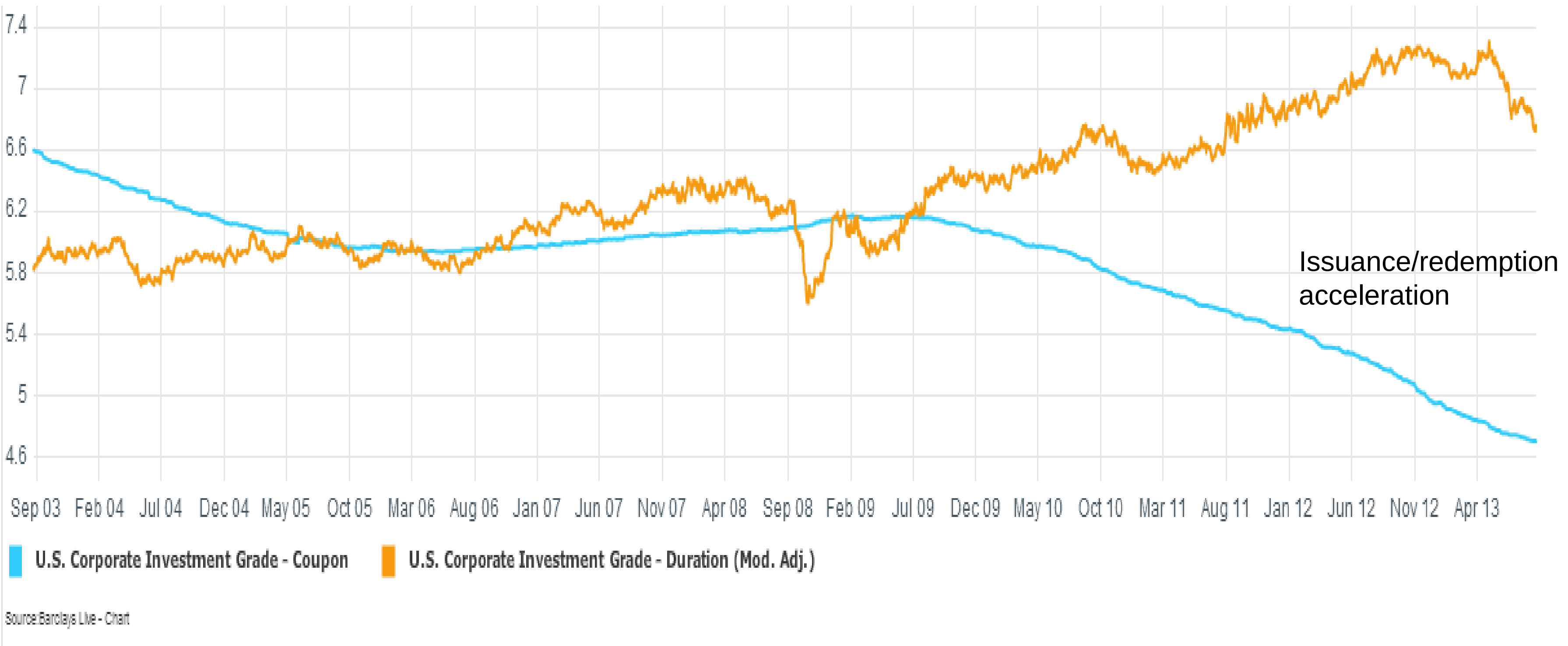
Source: Bloomberg

Curve Dynamics



Source: Bloomberg

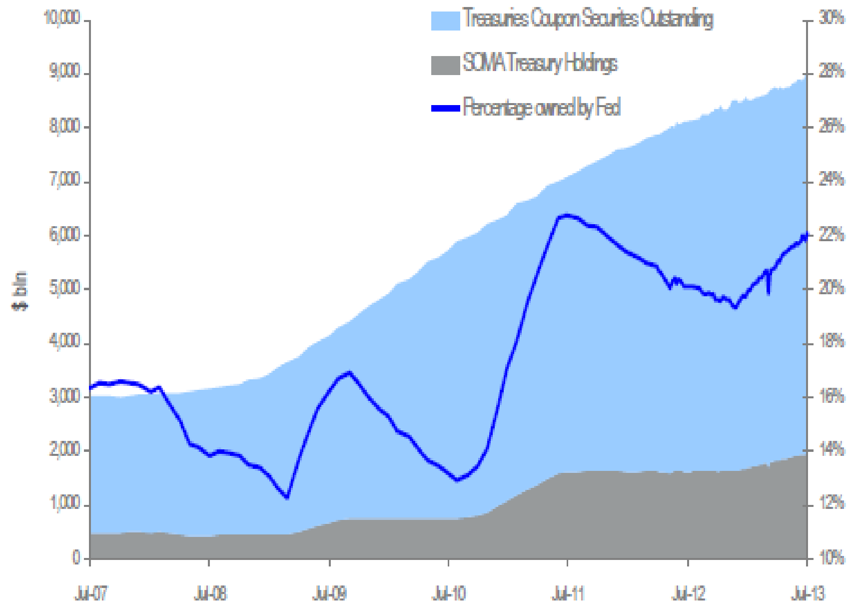
The Corporate Bond Profile Evolution



Source: Barclays

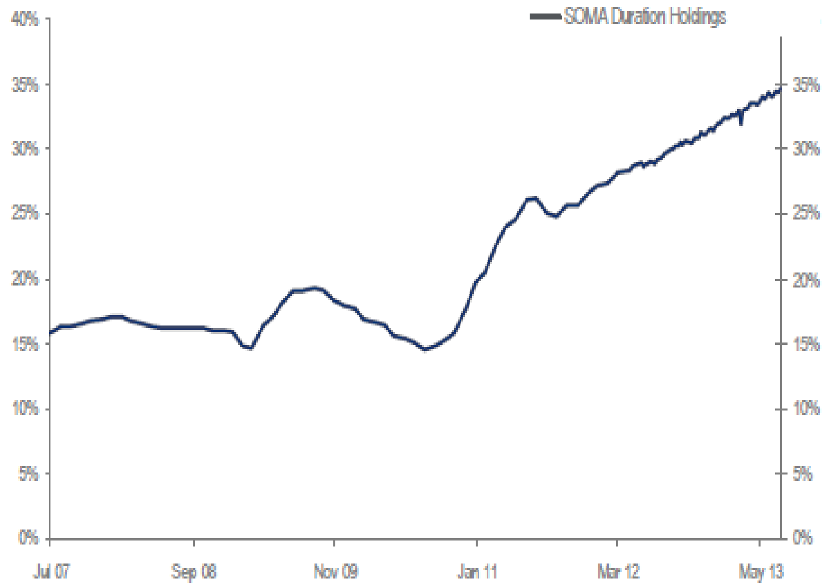
Federal Reserve Treasury Holdings

Figure 13. Size of Treasury Market and Fed Ownership



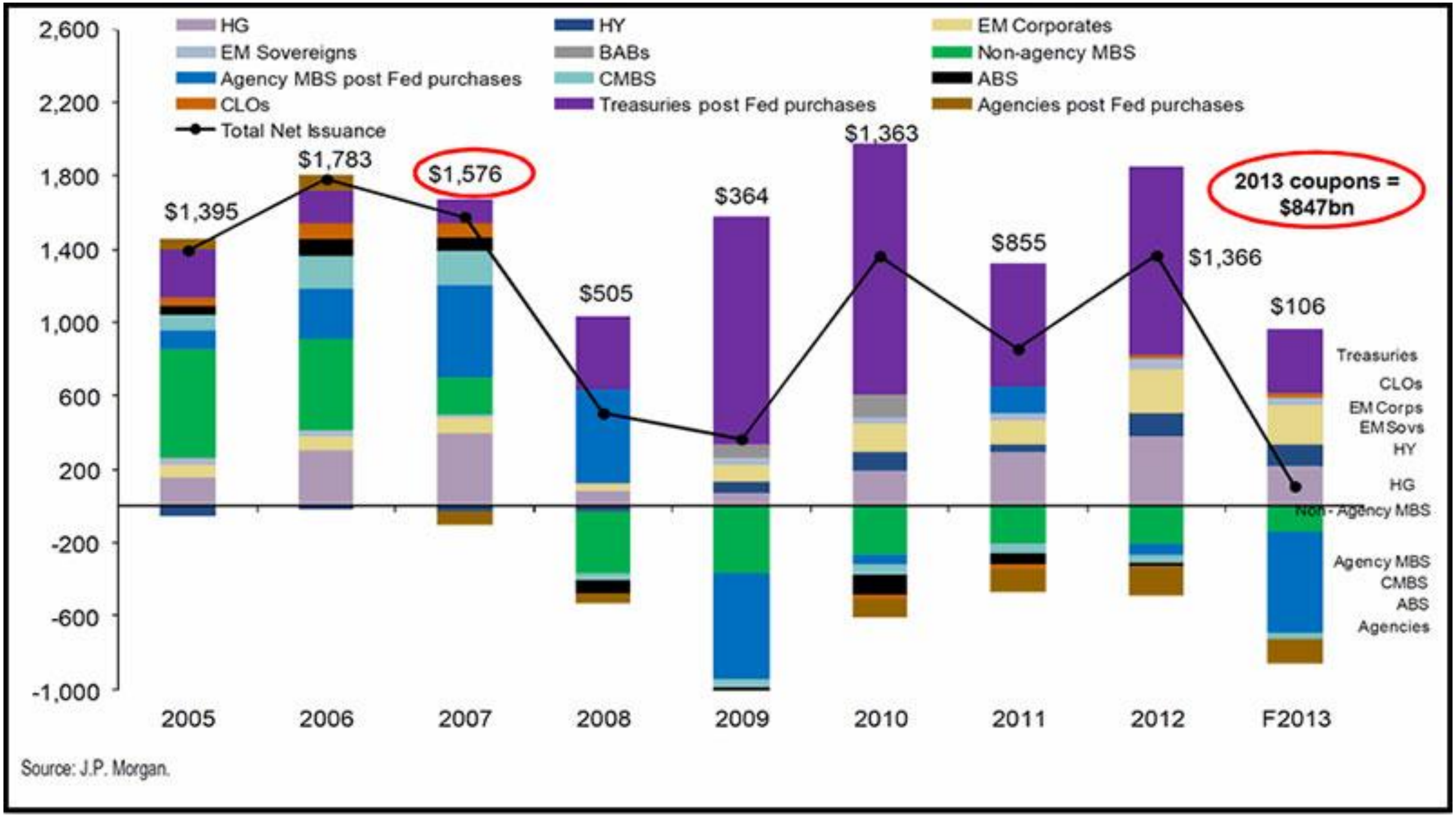
Source: Citi Research, Federal Reserve, US Treasury

Figure 14. Percentage of Treasury Duration Owned by Fed

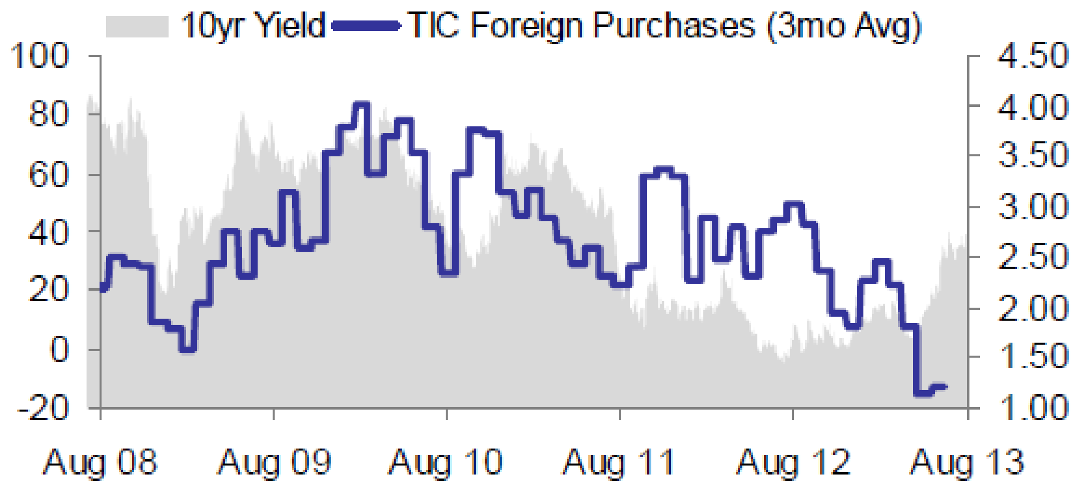


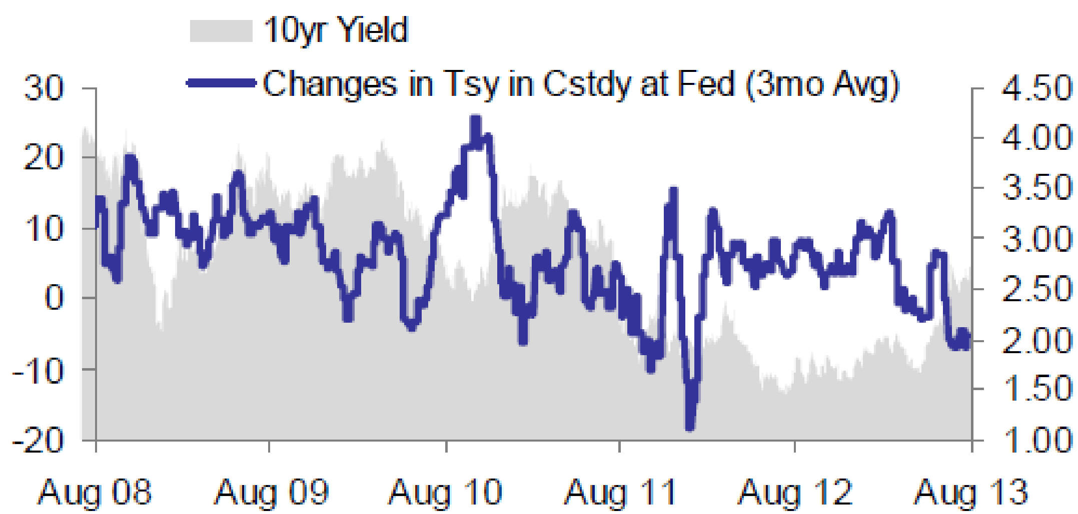
Source: Citi Research, Federal Reserve, US Treasury

A Shrinking Treasury Market



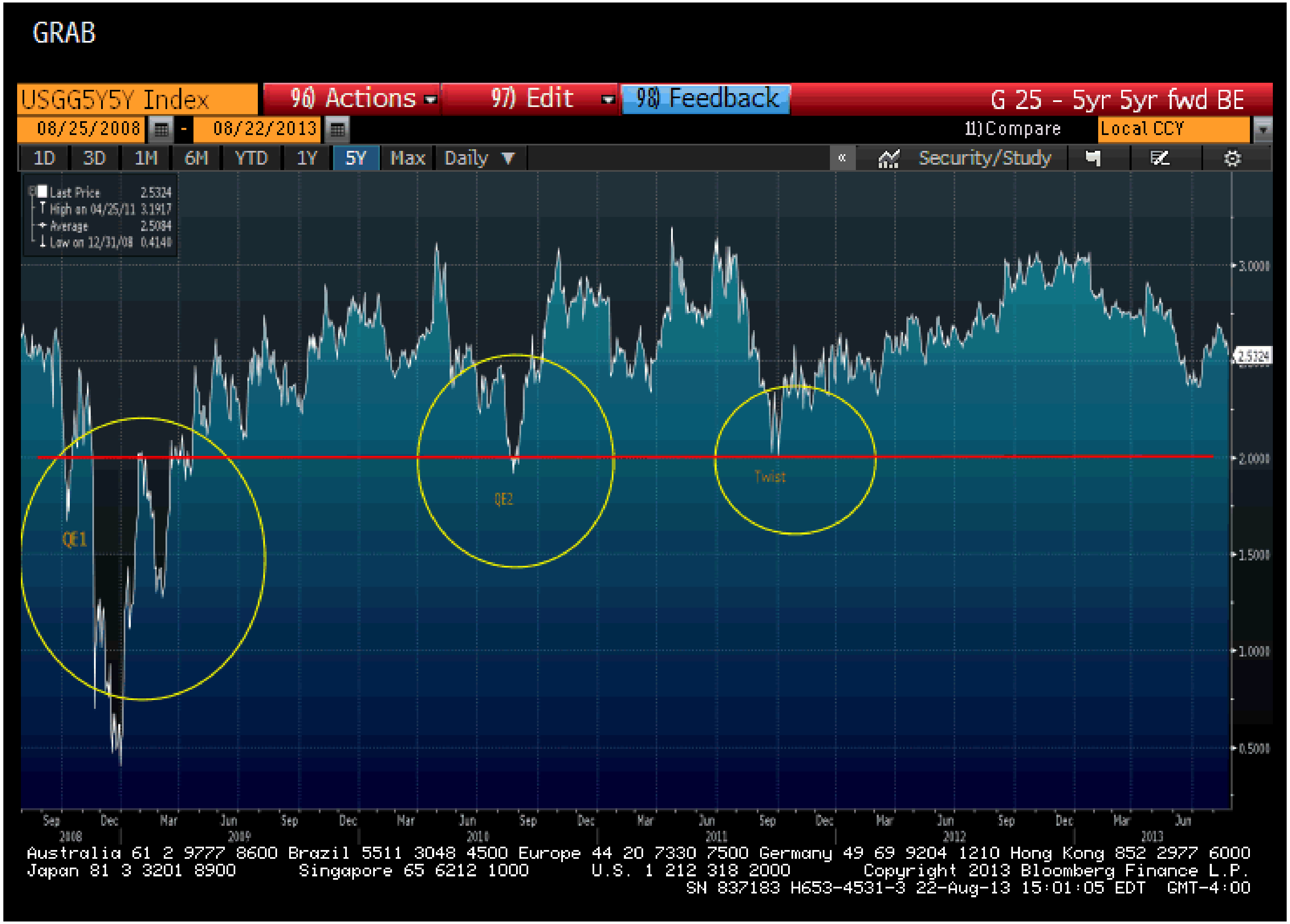
Foreign Pressure





Source: Citi Research, US Treasury, Federal Reserve and Bloomberg

Expected Inflation



Source: Bloomberg

Implying the Future

Dominant Factors	Factors	Effect on Interest Rates Over the Next 12 Months			Commentary
		Higher	Neutral	Lower	
	Fiscal Policy		o		After the summer recess, Congress will need to debate the 2014 fiscal year budget and debt ceiling. Prospects for a "grand bargain" have diminished significantly. We expect a last-minute agreement to further rein in spending, which may be coupled with targeted growth incentives.
➔	Economic Activity	o			Second-quarter GDP was initially reported at a stronger-than-expected 1.7% as companies invested in new equipment and construction projects. However, first-quarter GDP was revised down to 1.1% as effects from tax increases and the sequestration took their toll on consumer spending. With these effects fading, the economy appears to be gaining moderate momentum, supporting the Fed's bias to begin removing policy accommodation. We expect growth to improve to 2.0% - 2.4% in the second half of the year. In 2014, growth should average 3.0%.
	Technical		o		Sentiment in Europe remains positive with support from the European Central Bank and a more balanced view of austerity coupled with growth initiatives. The status quo is likely to continue into the September German elections. Peripheral risks remain and structural reforms are still needed to set the economy on a sustainable growth path and improve deficits in the long run.
➔	Monetary Policy	o			The July FOMC statement had a dovish tilt as the Fed grudgingly admitted that growth was proceeding at a "modest pace" and that higher mortgage rates were a concern for the housing sector. However, we think the Fed is on track to taper its asset purchases in September, barring any unexpected weak economic news.
	Foreign Markets		o		Most recently available data show that global demand for U.S. assets continued to fall as the improved outlook for economic growth decreased demand for the safety of risk-free assets. Net buying of long-term equities, notes and bonds fell to -$27.2 billion in May following a decline of -$21.8 billion in April.
	Inflation		o		The all-items CPI rose 0.5% in June, the highest in four months. However, a surge in gasoline prices accounted for much of the increase. Year-over-year inflation was up 1.8%. Core inflation remains under control as the core CPI was up 0.2% in April and 1.6% on an annual basis. We expect inflation to range between 2.0% and 2.5% over the next few years.
	Com-modities		o		Although long-term growth trends have started to reassert themselves, weakness in China and some emerging markets are pressuring most commodities in the short term. Oil prices are firm and are likely to rise above $110 per barrel by the end of 2014.
	Dollar		o		We expect the dollar to strengthen versus the euro, stabilizing at around $1.30 per euro, and the dollar/yen relationship to rise to 100 yen by the end of the year.

Source: Conning Inc.

Portfolio Management Strategies

- Short duration strategies
- Spread risk not rate risk
- Duration overlay strategies (KRD and aggregate duration hedging)
- Equity risk
- Inflation hedges
- The market has been heavy beta driven post recession
  - Security selection will likely become a more important value contributor going forward

Thank You! Questions?

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