
Market Commentary: First Quarter 2015¹

Overview

Risk appetites improved over the quarter after a rough start in January and a partial reversal in March. Markets continued to focus on the direction of oil prices as West Texas Intermediate slipped to \$47.60 by the end of the quarter. While the geopolitical situation was without any major new worries – with the exception of the civil strife in Yemen – global economic activity outside of Europe was not as robust as previous quarters. Despite solid employment and wage data in the U.S., a number of economic releases indicated slower domestic growth due to, in part, another very cold winter. The situation may prove to be similar to the growth swoon early last year, which was followed by significant pent-up demand and a jump in GDP in 2Q. China, Brazil, and Japan also produced softer numbers as the quarter progressed, while Europe continues to look poised for a slow recovery, but a recovery, nonetheless. In fact, growth in lending and improving sentiment point to a rebound on the continent, which we view as sustainable. However, weakness in emerging markets economies, especially the commodity sensitive names in LatAm, seems likely to continue for the near-term.

The Federal Reserve removed “patience” from its language in March but sounded, generally, more dovish. Such comments coupled with the modest slackening in the domestic macro scene prompted the U.S. Treasury market to price in a longer glide path for Fed tightening, thus stretching some forecasts from a June rate hike to one later in 2015. The higher dollar may crimp U.S. based multi-nationals’ quarterly profits, and the American consumer appears to be saving much of their windfall from lower prices at the pump by paying down debt. These results coupled with a weaker durable goods report and ISM manufacturing surveys dampened the growth story slightly. Consequently, five- and ten-year Treasuries closed the period with slightly lower yields. The Financial Times reported a record-breaking \$811 billion of M & A activity in the first quarter. Among the deals announced was the Heinz takeover of Kraft which will likely result in the combined entity holding an investment grade credit rating.

We continue to see early signs of a European pick-up in demand for credit from the private sector that has been noticeably absent over the past couple of years. Furthermore, as the euro continues to fall, or remain low, against the dollar, exports from the region will benefit. The rapid decline in oil prices should also contribute to gross domestic product given Europe’s status as a net importer of oil. Indeed, market consensus is gradually accepting the potential for an uptick in continental economic activity. Negative yields across many core European sovereign yield curves are the result of the ECB’s outsized QE initiated during the first quarter. China remains a global growth variable as that nation switches from over-investment in infrastructure – and the subsequent demand for many commodities – to a more balanced, consumption-oriented glide path. Finally, the ongoing decline in oil prices and a burgeoning scandal at Brazil’s Petrobras served to remind investors that idiosyncratic risk is alive and well in emerging markets. The troubled state-owned oil giant was downgraded to junk in February and has hurt investor appetite for EM corporate debt.

Outlook

There have been no major changes in our outlook or positioning. The markets remain sensitive to economic activity and its impact on the timing of potential FOMC tightening. We are less concerned with the precise timing of a rate hike, and the volatility has not deterred us from maintaining a constructive outlook on both domestic growth and valuations within the credit markets. Given our outlook, we are still more concerned about keeping up in a market rally than we are that the cycle has

reached a turning point. Accordingly, we will maintain our base case outlook for domestic growth while emphasizing credit risk over interest rate risk. However, as idiosyncratic risks have risen, we have made moderate adjustments to portfolio positions. More specifically, we elected to pare back some of our higher beta, weaker credit positions, including those in the developing markets (where applicable). We also took advantage of an active new issue calendar, while moving up in the capital structure on a selective basis.

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