



# Fixed Income Perspectives

## Market Turmoil & Volatility

September, 2015

### Are My Safe Assets Safe?

Recent market turmoil has once again reminded investors that achieving return involves taking risk. When appropriately taken and prudently monitored, risk works. Returns for risk assets over the past 7 years have been strong. However, this multi-year bull market has led to the primary challenge investors face today: risk premiums have become so tight that potential reward may not justify the risk being taken in many asset classes. This is the basis for the belief that this recent correction is healthy, reestablishing more reasonable valuations in many overheated sectors.

Given current volatility and the perception that it will continue for a while, a good question to ask is, "Are my safe assets really safe?" For many of our clients, Reinhart Partners' fixed income strategies fill a key role as the anchor that allows them to take risk elsewhere in their allocation. We are keenly aware of this charge. We understand that our job is to provide competitive absolute and relative returns while protecting our clients' principal value. With that in mind, let's look at how Reinhart Partners' Active Intermediate Fixed Income Strategy is positioned.

### Historical Comparison

A good place to start is a comparison to the past – we are positioned in many ways as we were back in late 2006 and early 2007. At that time, spreads were tight, equity markets felt stretched, and macro risks seemed to dominate. We were shocked by the extent of the crisis that developed over the next 18 months, but we did realize that rewards for taking risk in the bond markets were minimal, so we positioned our client portfolios conservatively. It worked. Our portfolios held up very well in the violent markets of 2008-2009.

Today, risk/reward feels a bit like 2006 to us. Spreads, though a bit wider than a few months ago, are tight, equity markets feel expensive, and we seem to jump from one macro crisis to another. Therefore, our portfolios are positioned conservatively. From a high-level view, we can summarize our current approach as follows:

- Interest rate risk is slightly short versus our benchmark.
- Though always high quality, we have been increasing the average quality of the portfolio over the past few years.
- We are allocating our spread exposure (corporate bonds, ABS, and MBS) on the shorter end of the yield curve.
- We have maintained a barbelled yield curve position made up of government agency and government guaranteed student loan floating rate bonds on the front end and Treasury bonds on the longer end of the curve.
- We are particularly sensitive to liquidity, concentrating on the larger, more liquid corporate issuers and the deeper, more easily traded sectors of the MBS and ABS markets, while using Treasury Bonds for our longer maturity exposure.

### The Bottom Line

Please do not mistake our current positioning as a prediction by Reinhart that we are about to go through another credit crisis or market collapse. In fact, we are somewhat bullish on the U.S. economy. However, risk abounds, and reward is hard to come by in the fixed income markets. Clients, their advisors, and we portfolio managers must decide how to manage that reality. Some will choose to take on more risk in order to achieve a desired return. At Reinhart, however, we understand that we are considered a safe allocation. We will not risk our clients' portfolios, particularly when the rewards are so thin.