A.H. Williams

Spinnaker Report

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AHW &Co Quarterly Commentary

December 31, 2015

We have lift off!

The Federal Reserve officially ended its zero interest rate policy by raising short term interest rates by .25%. Similar to the ending of QE3 and outright bond purchases this move was widely anticipated. What is surprising has been the performance of the municipal bond market in the 4th quarter. Seasonal factors usually produce softness during October and November as new issuance increases and the supply/demand equation shifts since coupon reinvestment and bonds maturing are lower, thus reducing reinvestment cash needing to be put to work. As expected, the calendar has provided significant new issuance of approximately $65 billion. Unexpectedly, demand has been insatiable and rates have declined as tax exempt bonds responded to the scarcity. Fund flows into the municipal securities market have been consistently strong for the past 12 weeks. In 2015, municipal securities have rewarded investors with returns above almost all other investment classes.

As we wind down the year and look towards 2016 it is always helpful to look back, review and continue to refine our program strategies. Our firm now is reaching some important milestones by achieving validated track records of 3 to 6 year performance results on almost all of our investment programs. Performance results are periodically submitted to various data bases including Morningstar Direct and Barclay Hedge. We are proud to be considered as “best in class” after having placed in the very top percentiles versus the universe of other US fixed income managers (see included graphs). And itditionally, Barclay Hedge ranked our “Advantage” program #1 its peer group – US Fixed Income Long Only.

For most managers, 2015 has been a difficult year. While volatility had been expected, many investment classes have suffered, most notably the energy sector. It wasn’t that long ago that oil prices were predicted to exceed $150 per barrel by Goldman Sachs and many other notable Wall St. firms. Investors poured billions of dollars into high dividend stocks in the chase for yields with devastating results. What this demonstrates is the unpredictability of markets even among so-called experts. We mention this because our strategy is to view the markets and especially the municipal bond market with as much peripheral vision as possible. Instead of trying to predict market direction, we employ a preparedness assessment and react to opportunities rather than attempting to forecast. Regardless of market direction the fragmented nature of the tax free bond market and its inherent inefficiencies produce unique trading opportunities.

Each year the municipal market experiences a January and July effect when a disproportion of principal and interest is redeemed, producing anticipated shortages. In the majority of observations this has produced lower rates and rising prices. This past year produced a significant price rally early in the year but the 2nd quarter supply quickly reversed market direction. We view 2016 with the same cautionary bias as we envisioned 2015. In our opinion, the “January” effect will be evident but short lived. Positions we established in the 4th quarter to take advantage of the phenomenon are intended to be liquidated earlier in 2016 than in prior years. As noted in prior newsletters, tax free securities continue to be cheap on a relative basis versus their taxable counterparts in longer maturities. This enhanced relative value should provide a buffer and mitigate any surprising interest rate increases. Our expectation is for rates to drift more than to increase dramatically.

Thank you for the opportunity to manage your assets.

From all of us at A.H. Williams & Co we wish you Happy Holidays and best wishes for 2016.

Not surprisingly municipal bonds again finished 2015 as the best fixed income investment class. Reduced volume and higher demand continues to produce a huge appetite. The negative correlation to equity markets has also provided more attention and participation from asset allocators.

Fixed Income Asset Class Return Analysis (%)

Strategies for Taxes

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	YTD 11/15
Higher	EM (Local Currency) 6.27	EM (Local Currency) 15.22	EM (Local Currency) 18.11	Treasury 13.74	High Yield 58.21	EM (Local Currency) 15.68	Municipal 10.70	EM (Local Currency) 16.76	High Yield 7.44	Municipal 9.05	Municipal 2.58
	Bank Loan 5.06	High Yield 11.85	Global Agg Ex-U.S. 11.03	MBS 8.34	Bank Loan 51.62	High Yield 15.12	Treasury 9.81	High Yield 15.81	Bank Loan 5.29	Investment Grade 7.46	MBS 1.54
	Municipal 3.51	Global Agg Ex-U.S. 8.16	Treasury 9.01	Global Agg Ex-U.S. 4.40	EM (Local Currency) 21.98	Bank Loan 10.13	Investment Grade 8.15	Investment Grade 9.82	MBS -1.41	MBS 6.08	Treasury 1.01
	Treasury 2.79	Bank Loan 6.74	MBS 6.90	Municipal -2.47	Investment Grade 18.68	Investment Grade 9.00	MBS 6.23	Bank Loan 9.66	Investment Grade -1.53	Treasury 5.05	Bank Loan 0.37
	High Yield 2.74	MBS 5.22	Investment Grade 4.56	Investment Grade -4.94	Municipal 12.91	Treasury 5.87	High Yield 4.98	Municipal 6.78	Municipal -2.55	High Yield 2.45	Investment Grade 0.10
	MBS 2.61	Municipal 4.84	Municipal 3.36	EM (Local Currency) -5.22	Global Agg Ex-U.S. 7.53	MBS 5.37	Global Agg Ex-U.S. 4.36	Global Agg Ex-U.S. 4.09	Treasury -2.75	Bank Loan 1.60	High Yield -2.00
	Investment Grade 1.68	Investment Grade 4.30	Bank Loan 2.08	High Yield -26.16	MBS 5.89	Global Agg Ex-U.S. 4.95	Bank Loan 1.52	MBS 2.59	Global Agg Ex-U.S. -3.08	Global Agg Ex-U.S. -3.08	Global Agg Ex-U.S. -7.17
Lower	Global Agg Ex-U.S. -8.65	Treasury 3.08	High Yield 1.87	Bank Loan -29.10	Treasury -3.57	Municipal 2.38	EM (Local Currency) -1.75	Treasury 1.99	EM (Local Currency) -8.98	EM (Local Currency) -5.72	EM (Local Currency) -12.98

Source: Morningstar as of 11/30/15

Data provided is for informational use only. Past performance is no guarantee of future results. See end of report for important additional information. Investment Grade represented by Barclays U.S. Corporate Index. MBS represented by Barclays U.S. Mortgage Backed Securities (MBS) Index. Treasury represented by Barclays U.S. Treasury Index. High Yield represented by Barclays U.S. Corporate High Yield Index. Municipal represented by Barclays Municipal Bond Index. Bank Loan represented by S&P/LSTA Leveraged Loan Index. Global Agg Ex-U.S. represented by Barclays Global Aggregate Ex-USD Index. EM(Local Currency) represented by JPMorgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified.

January Effect Lives On As Municipal Bond Funds Flush With Cash
2016-01-05 05:01:00.1 GMT

By Brian Chappatta

(Bloomberg) -- Mutual funds in the $3.7 trillion municipal- bond market are flush with cash heading into 2016.

Individuals added $1.3 billion to funds focused on state and local-government debt in the week through Dec. 30, the most in almost a year, Lipper US Fund Flows data show. It marked the 13th consecutive week that they've gained money, the longest streak since the end of 2014.

The surging demand for tax-exempt debt means the market may be headed for its fifth-straight January gain, said Peter Hayes, head of munis at BlackRock Inc., the world's largest money manager. In each of the past two years, the first month proved to be the best for returns: Munis rallied 1.8 percent in January
2015 and 2.3 percent in 2014, Bank of America Merrill Lynch data show.

"January is usually a positive performance month and we think this January will be positive," said Hayes, who oversees
$111 billion of the debt. "Demand should remain strong."

The muni market has posted six straight monthly gains, shaking off concerns about Puerto Rico's escalating fiscal crisis as defaults decline and the finances of most governments continue to improve along with the economy. State and local debt was less volatile than stocks, commodities and other bonds in 2015, providing higher returns both on an absolute basis and when adjusting for price swings.

January tends to deliver a predictable performance. The market has rallied in all but six years since 1989, Bank of America data show. The last time it dropped was at the start of 2011, after analyst Meredith Whitney rattled investors with a prediction for widespread defaults that later proved off base.

Individual investors hold the majority of munis through private accounts or mutual funds. They sometimes chase performance by pouring money into the market when it's rallying and withdrawing it during routs.

That phenomenon was on display after munis began a three- month losing streak in April 2015, when signs of economic gains increased speculation that the Federal Reserve would soon raise interest rates. Beginning that May, individuals yanked money from mutual funds for 11 straight weeks, the longest stretch of outflows in 18 months. The withdrawals subsided when the market rebounded and the Fed delayed its move.

Most muni analysts expect moderate gains for 2016 as the Fed pushes forward with plans to tighten monetary policy further this year, after increasing rates last month for the first time since 2006. Yet with U.S. manufacturing contracting in December at the fastest pace in more than six years and the S&P 500 Index touching its lowest price since October, any positive return may make it stand out in the U.S. financial markets.

"It's really the sweet spot for muni investors: The U.S.
growing fast enough to improve credit quality, but not too fast to generate a lot of inflation," said David Hammer, who runs a
$583 million high-yield fund at Pacific Investment Management Co. in New York. "That means investors are going to focus on the income portion of their portfolio to drive total returns. Munis fit perfectly into that."

Refinancing Wave Drives Record Muni-Bond Sales as Projects Wait

2015-10-20 04:01:00.3 GMT

By Elizabeth Campbell

(Bloomberg) -- The record pace of U.S. municipal bond sales is doing little to address the deteriorating state of the nation's roads, bridges and other infrastructure.

With the Federal Reserve wavering on whether to raise interest rates for the first time in more than nine years, state and local governments are rushing to refinance debt instead as yields hold near a half-century low. They've sold more than $320 billion this year, the most for the period since at least 2003, according to data compiled by Bloomberg.

The flood will continue as governments sell about $40 billion of securities a month for the rest of the year, according to Phil Fischer, head of municipal research for Bank of America Merrill Lynch in New York, the top underwriter of tax-exempt debt during the first half of 2015. Most of the sales are for refinancing as states and cities once battered by the recession remain wary of running up new debt for public works. "This is an environment of low yields," said Vikram Rai, head of municipal strategy in New York at Citigroup Inc. "It's a great opportunity to actually fund this country's infrastructure needs, and they're missing out on that." The borrowing will cause the $3.7 trillion municipal market to grow for the first time since 2010, the last year of a federal program that subsidized bonds for construction projects. The dearth of new debt since and the refinancing wave has eased the fiscal pressure on state and local governments. Their annual interest payments slipped to about $188 billion by the end of June from as much as $204 billion in early 2013, according to U.S. Commerce Department figures.

Market Gains

The shift in supply hasn't tempered the market's gains, with tax-exempt debt returning about 2.1 percent through Oct.
16, according to Bank of America's indexes. That's about triple the return on corporate debt and matches the gain for Treasuries. Demand has been fueled by an influx of money into municipal-bond funds, which have received about $5.4 billion from investors this year, according to Lipper US Fund Flows data. Meanwhile, the refinancing has caused some debt to be paid off early. "You've got really too much money chasing too few bonds," said Robert Miller, a senior portfolio manager at Wells Fargo Asset Management, which oversees about $39 billion of munis. "There's enough cash still on the sidelines to be invested where we can absorb additional supply."

California is among borrowers that are refinancing. The most-populous state is selling about $961 million of general- obligation bonds Tuesday in an auction among underwriters. Last week, New York's Long Island Power Authority raised $1 billion to pay off higher-cost debt.

It's not a sure thing that the pace of refinancing will hold up, said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees $9.7 billion of munis. Many borrowers probably did so earlier this year because of anticipation that the Fed would raise interest rates by September, he said. "I would expect the pace of refundings to decline," said Johnson, who is based in Solana Beach, California. "There was likely some front-loading of refundings due to an expected rise in interest rates."

Building Needs

The long-brewing need to finance infrastructure projects may drive new bond sales if refinancings wane. Governments can't keep putting off needed work on everything from mass transit lines to water and sewer systems, said Dan Heckman, senior fixed-income strategist at U.S. Bank Wealth Management, which oversees about $126 billion of assets. The American Society of Civil Engineers has estimated that more than $3 trillion of such work should be done. "It's a lot of demand building up," said Heckman, who is based in Kansas City, Missouri. "There's a real good possibility that that will be the trigger that will change kind of this dynamic of new issuance." There's a tendency for issuers to rush to the market at the end of the year, said Bank of America's Fischer, who forecasts that bond sales will reach a record $450 billion in 2015. The bank estimates that only about a third of sales this year have raised new funds, instead of refinancing previously issued debt. "I have a lot of confidence that we'll get more infrastructure financing and the reason for it is I have chemistry on my side," Fischer said. "Paint will not hold up the bridge."

Muni Buyers Plow Into Long Bonds to Win Once Fed Increases Rates

2015-12-08 13:56:39.76 GMT

By Brian Chappatta

(Bloomberg) -- Municipal-bond investors are snapping up the longest-maturing tax-exempt debt as the Federal Reserve prepares to raise interest rates, even though yields signal it's the worst time to do so in almost three years. That's because if history is any guide, the securities will be the best performers in the $3.7 trillion market when the Fed tightens monetary policy, a move it may take next week after seven years of holding borrowing costs near zero. The buying spree pushed the extra yield buyers pick up for holding 10-year debt instead of two-year securities to as little as 1.34 percentage points on Monday, near the lowest since January 2013, according to data compiled by Bloomberg. The shift shows how investors are positioning to gain from higher interest rates, which are typically a drag on returns in the fixed-income market.

When the Fed last boosted interest rates from 2004 through 2006, munis maturing in 22 years or more delivered annual returns of 6.5 percent, more than triple the gains on securities due in 3 years or less, according to Bank of America Merrill Lynch indexes. The market is primed for a repeat, according to John Dillon, managing director at Morgan Stanley Wealth Management in Purchase, New York. Analysts at Janney Montgomery Scott and RBC Capital Markets are predicting the same.

"My expectation is that you do see out-performance on the mid-part of the curve to the back-end of the curve," Dillon said in a telephone interview. "You could get a lot more flattening of the muni curve as we go forward." Investors agree. They've poured $3.1 billion into long-term muni mutual funds over the course of nine weeks, the longest stretch of inflows in at least a year, Lipper US Fund Flows data show. Muni buyers have been projecting that longer-dated bonds would fare well once the Fed starts raising short-term rates, with the securities seen as the best positioned to remain stable or gain because of subdued inflation expectations over the next year. There's a 78 percent chance the Fed will raise its benchmark at its Dec. 15-16 meeting, according to futures data compiled by Bloomberg.

Risk and Reward

Investors usually demand greater yields to own bonds that mature far in the future because of the risk that inflation will erode the value of fixed interest payments. When buyers are confident that inflation won't pick up, they can capture more yield by extending the maturity of their holdings.Prices are expected to hold relatively stable: the Fed expects inflation of 1.7 percent next year, according to forecasts released in September, less than the 2 percent rate that it targets. "The risk-reward calculation when you extend duration at this point indicates that people are getting paid for moving out on the curve," said Chris Mauro, head of muni strategy at RBC in New York. "There doesn't seem to be a lot of pressure on the longer end of the curve right now given the economic backdrop."

Benchmark 30-year muni yields touched 3.02 percent last week, the lowest since April and down 0.23 percentage points over a two-week span, Bloomberg data show. By contrast, two-year yields have jumped to the highest since June 2013. That has narrowed the difference between the two to 2.3 percentage points, a 10-month low.

Over the past four weeks, investors have added $1.8 billion to muni mutual funds as the central bank assures markets that the pace of increases will be gradual, the Lipper data show. That suggests investors are less concerned about the impact of a rate increase then they were in September, when they yanked $1.4 billion from the funds in the four weeks leading up to the Fed's decision.

"Investors should feel comfortable moving out on the yield curve: Long-term rates aren't going to go shooting up just because the Fed is hiking short-term rates," said Alan Schankel, a managing director at Janney Montgomery Scott in Philadelphia. "That's based on a lethargic economic growth scenario and a lack of inflationary concerns."

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Muni-Bond Buyers Say Forget the Fed as Market Set for Top Gains
2015-12-16 13:24:01.979 GMT
By Elizabeth Campbell

(Bloomberg) -- As municipal bonds head toward the strongest returns in the U.S. fixed-income markets this year, investors say the end of near-zero interest rates will do little to knock state and local-government debt off its stride. Money has been pouring into muni funds at the fastest pace since January. Defaults are falling for a fifth straight year.
State and cities are being aided by an influx of tax revenue, thanks to rising real estate prices and falling unemployment. And the push to lift borrowing costs comes after a years-long refinancing wave may have run its course: Most analysts predict that new bond sales will hold steady or even fall in 2016. “Demand for munis has been tremendous,” said John Bonnell, a senior portfolio manager in San Antonio at USAA Investment Management Co., which oversees $20 billion of local debt. “There’s just so much cash in our market looking to get invested.”

The $3.7 trillion muni market has returned 3.3 percent this year, on track for a second straight annual gain, as the income bondholders pocketed from interest outstripped any drop in prices, according to Bank of America Merrill Lynch’s index. That’s nearly three times the return for Treasuries and compares with a 0.4 percent loss in the corporate-bond market amid a selloff in the riskiest securities in anticipation of higher borrowing costs.

Long-Awaited Move

The bond markets have long been preparing for Fed Chair Janet Yellen to raise interest rates from near zero, where they’ve been since the depths of the credit crisis in 2008. There’s a 76 percent chance the Fed will raise its benchmark rate at the conclusion of its meeting Wednesday, according to futures data compiled by Bloomberg. A gradual tightening of monetary policy may be a boon to some segments of the market, if history is a guide. That’s because long-term rates often fall in anticipation of slower economic growth and diminished expectations for inflation, which erodes the value of fixed interest payments. From 2004 to 2006, the last time the Fed was boosting rates, munis maturing in 22 years or more saw annual returns of 6.5 percent, more than triple the gains on securities due in 3 years or less, according to Bank of America’s indexes. U.S. Bancorp., USAA Investment Management Co., Barclays Plc and Citigroup Inc. are all projecting a so-called flattening of the municipal yield curve, or a narrowing of the gap between short- and long-term rates. When that happens, bonds with longer maturities tend to outperform. Investors appear to be expecting just that. In the week through Dec. 9, they added $742 million into tax-exempt funds, the most since January, according to Lipper U.S. Fund Flows data. More than $3 billion has flooded into long-term muni funds over the past 10 weeks.

Fiscal Recovery

The influx comes as governments continue to recover from the financial toll of the recession, which led then to pay down debt from 2011 through last year. State tax revenue rose by 6.8 percent in the second quarter from a year earlier, according to the Nelson A. Rockefeller Institute of Government in Albany. A survey by the National League of Cities released in September found that 82 percent said they were better off than a year earlier, the most since at least 1990. Piper Jaffray Cos. and U.S. Bancorp say the pace of securities offerings will slow next year, while BlackRock Inc. predicts it will be little changed. While Citigroup Inc. projects that issuance will rise to $413 billion from about $397 billion this year, Vikram Rai, the bank’s head of muni strategy in New York, says demand will be strong enough to keep prices in check. “Demand is strong; issuance is low,” said Peter Hayes, who oversees $111 billion as head of munis at New York-based BlackRock, the world’s biggest money manager. “Our theme for next year is really about maximizing carry, or income, in an environment where rates are fairly benign and don’t rise dramatically.” This is probably the "most well-advertised rate hike” in Fed history, said Dan Heckman, senior fixed-income strategist at U.S. Bank Wealth Management, which oversees about $130 billion. He said the most important thing to investors is how quickly -- and by how much -- policymakers act again. “The move will be actually a little more positive for munis than other parts of the bond market,” Heckman said.

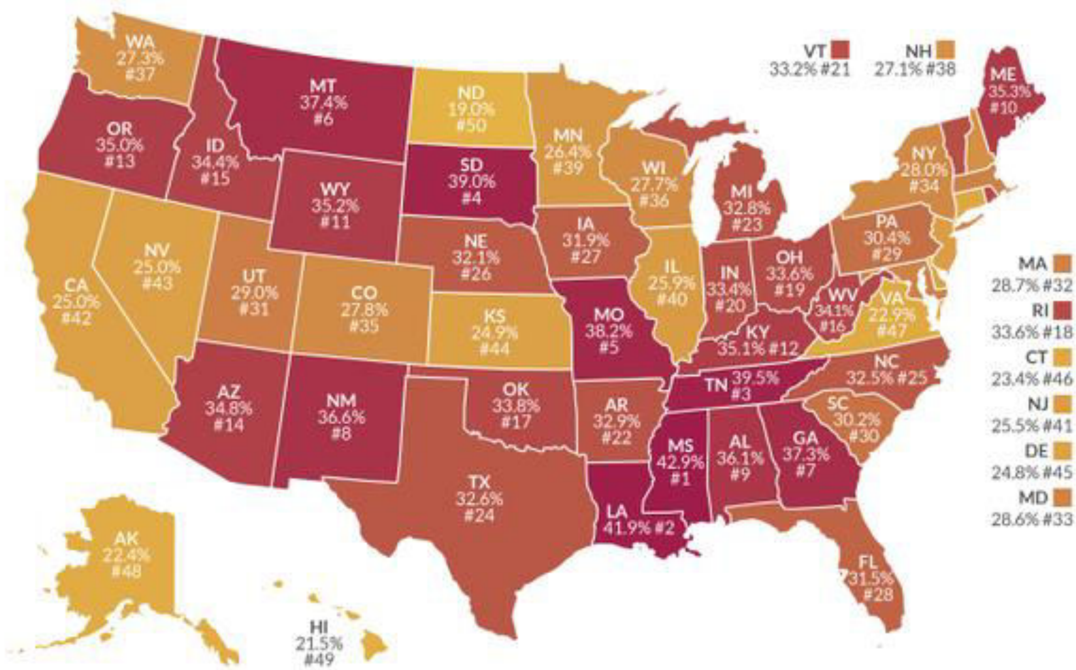
Table 1: Select Fixed Income Indices Yields and Total

Index Name	YTW	YTD Returns
S&P Municipal Bond Investment Grade Index LAUNCH DATE: DEC 31, 2000	2.01%	3.09 % ▲
S&P 500 Investment Grade Corporate Bond Index LAUNCH DATE: JUL 08, 2015	3.33%	-0.09 % ▼
S&P Municipal Bond High Yield Index LAUNCH DATE: DEC 31, 2000	6.20%	2.51 % ▲
S&P 500 High Yield Corporate Bond Index LAUNCH DATE: JUL 08, 2015	6.70%	-3.68 % ▼
S&P/BGCantor Current 10 Year U.S. Treasury Bond Index LAUNCH DATE: SEP 13, 2013	2.23%	1.66 % ▲

Source: S&P Dow Jones Indices, LLC. Data as of December 14th, 2015.

Which States Rely Most on Federal Aid?

Federal Aid as a Percentage of State General Revenue (FY 2013)



Notes: Figures are calculated by dividing each state's "Intergovernmental Revenue" by its "General Revenue." "General Revenue" includes all tax revenue but excludes utility revenue, liquor store revenue, and investment income from state pension funds. D.C. is designated as a local entity by the U.S. Census Bureau and thus not included here.

Source: U.S. Census Bureau; Tax Foundation.

Federal Aid as a Percentage of State General Revenue

TAX FOUNDATION @TaxFoundation

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