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THE EDUCATION LIQUIDITY FUND LETTER

JANUARY 2019

MARKETS TAKE CENTER STAGE, INVESTORS SHAKEN

2018 started with a roar and ended with a whimper as markets across the globe experienced significant volatility and sold off over the last few quarters. While much of the volatility was concentrated in the equity markets, the fixed income markets did not escape the risk reduction trades. The "risk-off" positioning of investors caused a fairly dramatic divergence in returns across the different fixed income market sectors. Defensive sectors such as U.S. Treasuries performed much better than credit sectors.

A key factor contributing to the sell off was a high level of uncertainty surrounding political policy and more specifically policy around trade and tariffs. This uncertainty caused many investors to pull back from the market segments that could be impacted the most such as the credit sectors. In addition, worry that the US Federal Reserve (Fed) policy of raising rates has gone too far has begun to create some anxiety with investors. Finally, a partial inversion of the interest rate curve and the prospect for a full inversion, defined as the environment when long term interest rates have lower yields than short term interest rates, added to investor worries as historically that condition has preceded many U.S. recessions.

Changes in the overall level of interest rates drove fixed income returns for the quarter and the year. Interest rates, as measured by the 10 year U.S Treasury note, declined significantly for the quarter and ended the year at 2.69 percent, which was 0.38 percent lower than where it started the quarter. For the year, interest rates actually rose modestly for longer maturities and rose more dramatically for short term bonds due to the four Federal Reserve increases during 2018. The difference between the 10 year and 2 year yields has shrunk to levels not seen in over a decade, resulting in a very flat interest rate curve.

The Bloomberg Barclay's Aggregate index, a broad measure of the investment grade U.S. bond market, ended higher by 1.64 percent for the quarter, largely due to falling interest rates. However, returns for the full year were essentially flat as rising rates in the first half of 2018 and increasing risk premiums during the second half eroded total returns.

The recent market turmoil has understandably created some anxiety. But, we at Miles Capital believe it's important to step back and assess the longer term fundamental and economic trends, which remain solid, especially in the U.S. We expect 2019 will bring additional volatility while the markets contend with more political turmoil and further rate increases. While we constantly monitor the markets and the economy for new opportunities and risks, it is these longer term themes and trends which drive our major investment decisions. Clearly the markets have entered a new level of volatility but those investors who stick with their long term investment plan will likely be better served.

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EVENTS

March 5
Community College Day at the Capitol

March 27
IASBO Spring Conference

HOLIDAYS

January 21
MLK Day

February 18
Presidents' Day

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