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EYE ON THE MARKET

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COMMENTARY ON SPECIFIC MARKET ISSUES AND ACTIONABLE IDEAS TO CONSIDER

WILL INVESTORS CEASE TO SEEK YIELD-ORIENTED INVESTMENTS?:

Not if the world of music has anything to teach us.

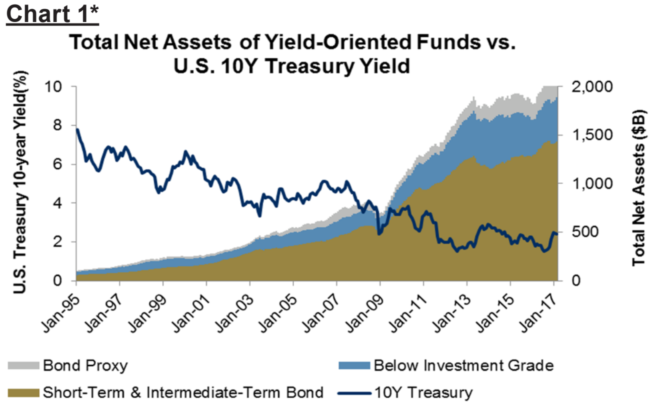
Since the start of December 2016, there have been two increases in the federal funds rate. While the Federal Open Market Committee ("FOMC") had been transparent about its intent to raise rates, what remains unknown is how investors will react over time to future increases. In March 2015, Eye on the Market ("EotM") looked at what was driving market participants into yield-oriented investments, including bond and bond-like portfolios. Now that short-term interest rates have risen, EotM revisits the topic and attempts to see whether investors will continue playing the same tune, or be inspired to create their own music.

THINK ABOUT IT (LYN COLLINS)

As Chart 1 indicates, the U.S. 10-year Treasury declined from its early 1995 high to its low in the summer of 2016. Over this same period of time, assets in bond and bond-like funds increased rather dramatically, especially following the financial crisis. In addition to interest rates falling for most of this period, the demographics of the United States changed. It was during this window of time that the baby-boom generation began to retire.

Probably the most noticeable shift on Chart 1 was the near exponential growth of yield-oriented investments beginning in the summer of 2009 until the summer of 2013, when the pace of growth began to slow. During this four-year period, the compounded annual growth rate of assets in these strategies was nearly 20%. Since that time, the total net assets of yield-oriented mutual funds has continued to grow, but at a much slower pace. If the FOMC continues to raise interest rates as it has indicated, investors **may not** feel the need to reach for yield as they have in the past. With this shifting pattern, investors should heed Lyn Collins' guidance and *Think About It*.

Chart 1*

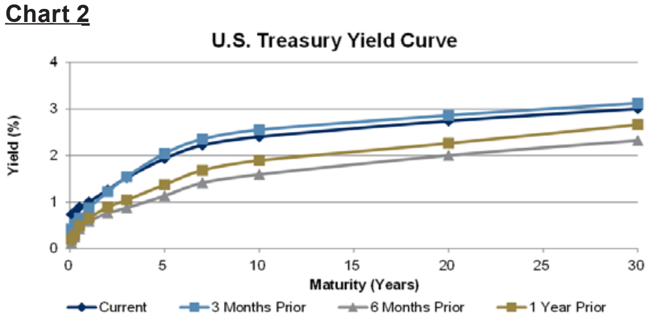


*Source: St. Louis Federal Reserve, Morningstar Direct, Raymond James. All data is as of February 28, 2017. Short & Intermediate-Term Bonds are representative of Morningstar's Short-Term and Intermediate-Term categories. The Below Investment Grade category contains Morningstar's Emerging Market Bond, Bank Loan, and High Yield categories. The Bond Proxy category represents Morningstar's Global Real Estate, Real Estate, and Utility categories.

KEEP ON TRUCKIN' (EDDIE KENDRICKS)

EotM encourages investors to take a long-term view by acknowledging that interest rates cycles occur over time and that the need for income will likely remain in place regardless of what rate cycle the market is in. Chart 2 shows that even with two increases in the Federal Funds rate since December 2016, the yield on longer-term maturities has declined from three months ago, highlighting that changes in interest rates impact the yield curve in different ways.

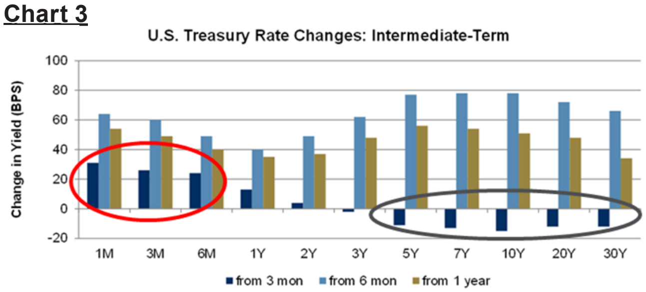
Chart 2



Source: St. Louis Federal Reserve and Raymond James. All data is as of March 25, 2017.

This is further illustrated in Chart 3, which shows the change in yield for all U.S. Treasury securities ranging from one-month bills to 30-year bonds. It is clear that over the six-month and one-year periods, yields increased, with longer-dated maturities showing the greatest increase over the six-month period. Over the one-year period, the change in yield was most pronounced for one-month and five-year maturities.

Chart 3



Source: St. Louis Federal Reserve and Raymond James. All data is as of March 25, 2017.

You may be asking, what does this mean for my portfolio? In short, there is an inverse relationship between price and yield for fixed-income securities, so as yields rise, bond prices typically fall.

More importantly, Chart 3 illustrates that even with the most recent increase in short-term rates, shorter maturities (circled in red) were clearly impacted while longer maturity yields (circled in grey) actually declined.

Yes, our investor is likely thinking about her long-term needs for income and should be cognizant of these yield changes, but more importantly she should *Keep on Truckin'*, as markets shift over time presenting new opportunities and risks.

O-O-H CHILD (THE FIVE STAIRSTEPS)

EotM would love to say that things are going to get easier and that they will be getting brighter, but trying to predict market movements is very difficult and often results in the loss of capital over the long run. The FOMC has been vocal in noting that it intends to raise interest rates again in 2017. What remains unknown is will this continue into 2018 and future years, or will there be a need at some point to lower rates because of a change in the broader economy.

Furthermore, uncertainty surrounding equity market movements, industry rotation, and style-bias among other things, can all impact portfolio performance.

Table 1 shows just how this can play out. Over the first six months of 2016, higher dividend-yielding companies within the S&P 500 drove performance, while the lowest-yielding quintile was the worst performing group. This dynamic shifted during the second half of 2016 and has shifted again for the year-to-date period. Investors should interpret the last refrain from the Five Stairsteps song *O-o-h Child* is "…some day, yeah, we'll get it together and we'll get it all done…" as encouragement that over longer periods of time, a disciplined approach can, and usually will, generate the desired outcome.

Table 1

Contribution to Returns - S&P 500				
	Dividend Yield Quintiles	Jan. 2016 - June 2016	July 2016 - Dec. 2016	YTD 2017
Low - High	Quintile 1	3.15	1.49	0.31
	Quintile 2	1.75	1.21	0.92
	Quintile 3	(0.26)	2.01	1.43
	Quintile 4	(0.12)	1.92	1.05
	Quintile 5	(0.71)	1.23	1.45

Source: Morningstar Direct and Raymond James. All data is as of March 25, 2017.

FLY LIKE AN EAGLE (THE STEVE MILLER BAND)

No one will deny that as time keeps on slippin' into the future, investors need to be prepared for an ever-changing landscape. Just because a certain investment approach works today does not mean that it will work going forward. By remaining focused on long-term goals, investors will allow much of the clamor to pass by. For those investors relying on their portfolios for income, the past few years have been challenging given this prolonged low interest-rate environment. EotM does see the light at the end of the tunnel, as higher interest rates in the future will allow investors to generate more income through less risky investments without reaching for yield as has recently been the case for many.

SIDE NOTE

The origins of rhythm and blues ("R&B") music dates back to early 1900s and has influenced a wide range of artists and other music genres since then. As such, each of the artists referenced in this EotM were influenced by earlier R&B artists. Just as these artists were influenced by their predecessors, their music influenced other artists. To that end, each of the songs referenced have also been used in other songs or have been covered/remixed by other artists. Whether you enjoy easy listening, hip hop, or rock, jazz, among many other genres, each successive generation builds on the one before it. (Extra credit – figure out what songs used portions of the ones referenced in this EotM.)