CALTRUST
Investment Trust of California

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# Monthly Market Update

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## President's Perspective

### Expectations Of Higher Rates Challenge Fixed-Income Investors: CalTRUST Funds Positioned To Manage Risk Of Higher Rates

Current expectations for rising rates present a challenge to fixed-income investors, be they individuals, corporations or public agencies. The exceedingly low rate environment of the past six years has presented investors with near-zero yields for short maturity securities. Given the persistence of this low rate environment, it is understandable that many investors have been tempted to look to longer maturity securities to boost the yield on their portfolios.

This "reach for yield", however, comes at a price, as it exposes investors to additional interest rate risk. Since bond prices move in inverse relationship to yield and the general direction of interest rates, as rates rise, the price of fixed income securities falls. In a rising rate environment, this inverse relationship can result in negative rates of total return on a security or a portfolio; even for US Treasury bonds.

Market observers differ on the likely timing of Fed action: some argue it will move to force rates higher in the June/July timeframe; others argue for the October/November period. At this point, however, it is almost universally agreed the Fed will act before the year is out.

At CalTRUST we are mindful of the challenge presented by this expectation of higher rates and have positioned the Short- and Medium-Term portfolios toward the lower-end of their target durations, so as to manage interest rate risk, to ensure sufficient liquidity to meet participants' cash needs, and to provide the flexibility to take advantage of higher rates whenever they do arrive.

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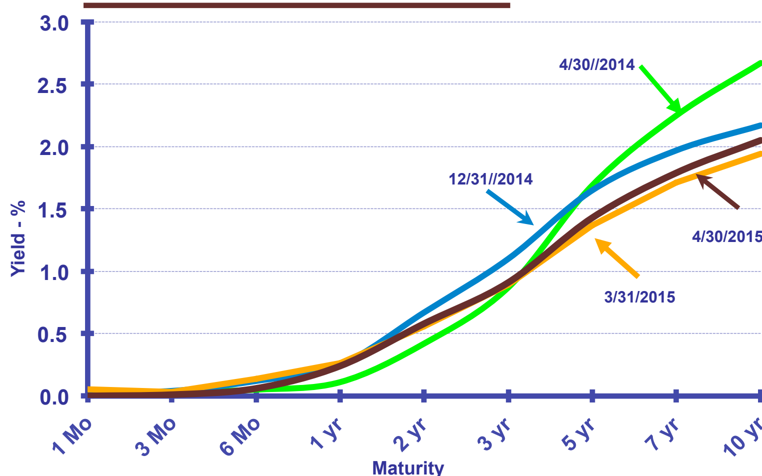
## Treasury Yield Curve




## CalTRUST Heritage Money Fund

| Avg Annual Total Return (April 30, 2015) | 1-year | 3-year | 5-year | 10-year | Since Inception |
|---|---|---|---|---|---|
| CalTRUST Heritage MMF | 0.08% | 0.09% | 0.12% | 1.65% | 2.85% |
| Lipper Instit MMF Average | 0.03% | 0.04% | 0.05% | 1.49% | -- |

## CalTRUST Portfolio Snapshot (April 30, 2015)

| | CalTRUST Short-Term | | LAIF | CalTRUST Medium-Term | | Merrill 1-3 Year |
|---|---|---|---|---|---|---|
| | Total Return | Yield Return | Yield Return | Yield Return | Total Return | Gov't & Corp "A" or Better |
| Distribution Yield[1] | 0.44% | | 0.28% | 0.78% | | N/A |
| Effective Duration | 0.64 | | N/A | 1.70 | | 1.88 |
| Avg Maturity (yrs) | 1.37 | | 0.59 | 2.10 | | 1.94 |
| **Returns:[2]** | | | | | | |
| One Month | 0.05% | 0.04% | 0.02% | 0.06% | 0.04% | 0.06% |
| One Year | 0.37% | 0.41% | 0.26% | 0.74% | 0.76% | 1.00% |
| Three Year[3] | 0.41% | 0.38% | 0.28% | 0.75% | 0.68% | 0.85% |
| Five Year[3] | 0.49% | 0.45% | 0.34% | 0.97% | 1.05% | 1.22% |
| Since Inception[3, 4] | 1.95% | 1.91% | 1.86% | 2.27% | 2.39% | 2.75% |

1. CalTRUST Short- and Medium-Term and LAIF yields are net of fees. The Merrill Index is unmanaged, and does not reflect any deduction for administrative fees or expenses.
2. CalTRUST and LAIF returns are net of all investment advisor, administrative and program fees.
3. Annualized.
4. CalTRUST Short- and Medium-Term portfolios commenced operations February 13, 2005.

## Financial Markets Update

### The Economy: When The Fed Hikes Rates, Will Anyone Notice?

In their May ***Market Outlook*** (link) Wells Fargo Advantage Funds Market Strategists, John Manley, James Kochan and Brian Jacobsen, ponder the state of the economy, and what a Fed rate hike might mean for the markets.

With regard to the economy, they point out we have seen this pattern for the past five years: the economy slows in winter; then spring comes and it thaws. Despite this seeming "Groundhog Day" nature, they argue it is not a bad environment for investors. It can mean fewer excesses in the economy; continued growth in corporate profits; and, importantly, it can also mean inflation stays low, keeping the Fed accommodative and interest rates from rising too far too fast.

As to the effect of a Fed rate hike on the markets, ***when*** rates go up is less important than ***why*** and ***how***. In short, the Fed will raise rates as part of the road back to 'normal', "not because it is trying to slow the economy down or get in front of inflationary forces. They posit that, in order to increase short-term rates in the economy, the Fed may have go beyond just increasing the Fed funds rate. Most likely it will increase interest on reserves, and uncap its overnight reverse repo program.

As for longer-term rates, they feel much depends on where the 10-year Treasury is at the start: if it is below 2%, the upward move likely will be muted; if it is above 2%, the upward move could be much more abrupt.

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