CALTRUST
Investment Trust of California
Service Center
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Monthly Market Update
October 2016 Volume 12 | Number 10

President's Perspective

With Economic Data Trending Modestly Stronger, CalTRUST Funds Are Positioned For Challenge Of Higher Rates

As expectations build for a hike in rates by the Fed, and modestly rising rates in the economy, fixed income investors face challenges – whether they be individuals or institutional investors like public agencies. The low yield environment since the 2008 financial crisis has presented investors with near zero yields for short-maturity securities and -- comparatively -- modestly higher yields for longer maturity investments. 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 "reaching for yield", however, exposes investors to interest rate risk. Since bond prices move in inverse relationship to yield and the general direction of rates, as rates rise the price of fixed income securities falls. In a rising rate scenario, this inverse relationship can result in negative rates of total return on an individual security or a portfolio; even on "safe-haven" instruments such as US Treasuries.

Public agency investors tempted to "reach" for additional yield by extending the maturity of their holdings need to understand the additional risk they are assuming. At CalTRUST, we are very mindful of this risk, and have positioned the CalTRUST Short- and Medium-Term portfolios toward the lower-end of their target durations, so as to manage this risk, to ensure sufficient liquidity to meet participants' cash needs, and to provide the flexibility to take advantage of higher rates when they do arrive.

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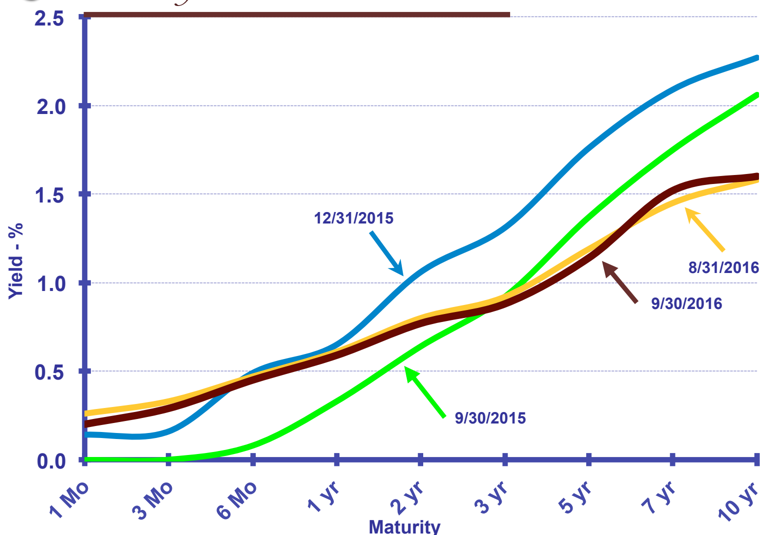
Treasury Yield Curve



CalTRUST Money Market Funds

Avg Annual Total Return (September 30, 2016)	1-year	3-year	5-year	10-year	Since Inception
CalTRUST Government MMF	0.21%	0.08%	0.05%	0.89%	3.27%
Lipper Instl Govt MMF Average	0.09%	0.04%	0.03%	0.85%	--
CalTRUST Heritage MMF	0.36%	0.18%	0.15%	1.10%	2.68%
Lipper Instl MMF Average	0.20%	0.09%	0.07%	0.97%	--

CalTRUST Portfolio Snapshot

(September 30, 2016) 2016)

	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]	0.81%		0.64%	1.01%		N/A
Effective Duration	0.59		N/A	1.78		1.90
Avg Maturity (yrs)	1.07		0.44	2.00		1.96
Returns:[2]						
One Month	0.06%	0.07%	0.05%	0.08%	0.08%	0.11%
One Year	0.71%	0.66%	0.50%	0.97%	1.16%	1.12%
Three Year[3]	0.52%	0.50%	0.35%	0.82%	0.95%	1.00%
Five Year[3]	0.50%	0.46%	0.34%	0.85%	0.84%	0.96%
Ten Year[3]	1.41%	1.37%	1.34%	1.96%	2.08%	2.45%
Since Inception[3, 4]	1.78%	1.75%	1.68%	2.11%	2.23%	2.54%

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

History Indicates That Equity Markets Will Keep Rising in 2017 -- If Earnings Growth Exceeds The 10-Year Treasury Yield

In his most recent ***Economic & Market Perspective*** (link), WellsCap Chief Investment Strategist, Jim Paulsen looks at the relationship between the US stock market and bond yields in the post-WWII era.

Jim shows that the equity market has done fine, even in periods of rising rates, provided the annual growth rate in earnings per share (EPS) exceeds the 10-year Treasury bond yield. To illustrate the point, Jim looks at the Earnings-Yield Indicator (EYI) – the annual growth in trailing 12-month S&P 500 EPS minus the 10-Year yield.

Looking at the history of the EYI since 1950, Jim finds that, when the EYI was above zero the stock market generated:

- Annualized returns more than twice as great as when the EYI was below zero -- 11.6% versus 4.7%;
- Positive monthly returns 62% of the time compared to only about 55% of the time when the EYI was below zero.

Moreover, in months when the 10-year bond yield rose and the EYI was above zero, the S&P 500 Index increased at almost a 10% annualized rate, versus only a 0.61% pace when the EYI was negative.

In looking forward to 2017, with commodity prices having stabilized and begun rising modestly, Jim sees a modest pickup in earnings growth and a positive EYI. This is probably sufficient to keep the market rising -- even in the face of Fed rate hikes.

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