PRUDENT MAN ADVISORS

WHITE PAPER

PMA INSIGHT

DECEMBER 2015

TIGHTER POLICY COMING – STAY CALM AND CARRY ON

While U.S. economic growth has disappointed versus typical expansions, sufficient progress has been made toward achieving the Fed's dual mandate of full employment and price stability to allow monetary policy to tighten. This begs the question, what does our research indicate for the direction of interest rates here in the U.S.?

We believe the front end of the yield curve tends to trade off of economic expectations. The long end of the curve tends to value itself based on inflation expectations. Federal Reserve policy certainly plays an important role in setting short-term rates as well. Importantly, FOMC forward rate guidance continues to indicate a higher Fed Funds rate than what the market currently anticipates. Our view is that while short-term rates will likely move higher, much of the expected rate increase has already been priced into the market. As short rates rise, bond prices will fall, but not precipitously given their shorter duration.

Trying to time the market can be dangerous to your financial health. It continues to make good sense to keep your laddered short-term bond investment strategy in place, reinvesting cash flows and maturities out the curve at what we expect to be higher rates in the year ahead. Plan your maturities to align with your cash flow liabilities. According to our research, one year expected returns are projected to remain positive despite higher rates. Interest rates have already moved considerably quarter-to-date as it's priced in tighter Fed Policy. Please contact Prudent Man Advisors if you have questions or would like to discuss further.

Expected Returns (PMA Forecast)

	Yield	Duration	Income	Roll Down	Total Return
Cash	0.30	0.00	0.03	--	0.30
1 Year	0.70	0.97	0.70	--	0.70
2 Year	0.94	1.98	0.94	(0.09)	0.85
3 Year	1.23	2.92	1.23	(0.42)	0.81

	Yield 12/4/15	Yield 10/1/15	Yield Change	PMA Forecast	1 Yr Forward
Cash (Net Yield)*	0.05	0.01	--	0.30	--
1 Year	0.70	0.29	0.41	1.00	1.22
2 Year	0.94	0.64	0.30	1.40	1.55
3 Year	1.23	0.91	0.32	1.70	1.74

**Cash yield is an estimate*

Contact Information

JOHN H. HUBER, CFA

Senior Vice President, Chief Investment Officer

Prudent Man Advisors, Inc.

Tel: 630.657.6510

Email: jhuber@pmanetwork.com