ENTASIS ASSET MANAGEMENT

QUARTERLY NEWSLETTER

3Q2019

Before our firm was founded, the three of us spent a considerable amount of time discussing the topics that shaped our investing beliefs. We believed it was important to ensure we were on the same page about the elements of our business that would define us.

When we discussed the topic of Focus, we did so in the context of the ever more complex industry that we operate in. We like to think that way back at the beginning, you could lend money and earn interest (bonds) or provide capital to a business and invest in its growth (stocks). That time is long gone. Now there are many derivatives of each of those things, complex investing strategies driven by those derivatives, computer driven arbitrage of inefficiencies around those derivatives, more mutual funds than stocks, exchange-traded bond funds, etc., etc., etc. We could fill a dictionary. In most instances, all we see is unnecessary complexity with little value. We will talk about that more in our Client Focus.

However, as our firm has evolved, the definition of focus has taken on another meaning. Every day we are bombarded with news. Congressional inquiries, Presidential tweets, natural disasters, trade wars, etc. We are not attempting to minimize the importance of any of those news items, but from an investing standpoint, the impact rarely extends beyond sentiment. And yet, over the last 12 months, the S&P 500® Index had monthly returns ranging from +8% to -9%. Put simply, this means too many investors are distracted. As a result, we believe there is an information advantage to be gained by staying focused. So, we intend to do just that.

We hope you find a portion of this newsletter useful.

Thank you for taking the time to read it. If you have any feedback, it is always appreciated.

Bob

Market Performance

Market Notes

Equity Portfolio Comments

Fixed Income Portfolio Comments

Research Focus

Client Focus

Click on any button to skip to a new section.

Market Performance

Annualized % Returns (As of 9/30/19)

Source: Morningstar Direct

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	4.25	13.39	10.84	13.24
Russell 1000 Index	Mid/Large Cap Stocks	3.87	13.19	10.62	13.23
Russell 1000 Growth Index	Growth Stocks	3.71	16.89	13.39	14.94
Russell 1000 Value Index	Value Stocks	4.00	9.43	7.79	11.46
Russell 2000 Index	Small Cap Stocks	-8.89	8.23	8.19	11.19
MSCI EAFE Index	Non-U.S. Developed Market Stocks	-1.34	6.48	3.27	4.90
MSCI Emerging Markets Index	Emerging Markets Stocks	-2.02	5.97	2.33	3.37
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	-5.63	4.64	3.98	6.13
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	10.13	5.50	6.66	7.66
Barclays Municipal Bond Index	U.S. Municipal Bonds	8.55	3.19	3.66	4.16
Barclays Aggregate Bond Index	U.S. Bonds	10.30	2.92	3.38	3.75
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	8.17	2.40	2.68	3.05
BofAML U.S. Treasury Master Index	Treasury Bonds	10.75	2.30	3.06	3.16
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	7.98	2.38	2.83	3.17
BofAML U.S. Corporate Master Index	Corporate Bonds	12.87	4.51	4.65	5.60
BofAML U.S. High Yield Master II Index	High Yield Bonds	6.30	6.07	5.37	7.84
BofAML Convertible Bonds Index	Convertible Bonds	2.48	11.03	8.36	10.55
BofAML Euro Broad Market Index	European Bonds	2.61	1.23	0.18	1.34
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	12.82	4.30	1.43	2.99

Calendar Year % Returns (QTD, YTD as of 9/30/19)

Source: Morningstar Direct

	QTD	YTD	2018	2017	2016	2015	2014	2013
S&P 500 Index	1.70	20.55	-4.38	21.83	11.96	1.38	13.69	32.39
Russell 1000 Index	1.42	20.53	-4.78	21.69	12.05	0.92	13.24	33.11
Russell 1000 Growth Index	1.49	23.30	-1.51	30.21	7.08	5.67	13.05	33.48
Russell 1000 Value Index	1.36	17.81	-8.27	13.66	17.34	-3.83	13.45	32.53
Russell 2000 Index	-2.40	14.18	-11.01	14.65	21.31	-4.41	4.89	38.82
MSCI EAFE Index	-1.07	12.80	-13.79	25.03	1.00	-0.81	-4.90	22.78
MSCI Emerging Markets Index	-4.25	5.89	-14.58	37.28	11.19	-14.92	-2.19	-2.60
MSCI ACWI Ex USA Small Cap Index	-1.19	10.28	-18.20	31.65	3.91	2.60	-4.03	19.73
BofAML Preferred Stock Fixed Rate Index	3.05	15.40	-4.34	10.58	2.32	7.58	15.44	-3.65
Barclays Municipal Bond Index	1.58	6.75	1.28	5.45	0.25	3.30	9.05	-2.55
Barclays Aggregate Bond Index	2.27	8.52	0.01	3.54	2.65	0.55	5.97	-2.02
Barclays Intermediate U.S. Gov/Credit Index	1.37	6.41	0.88	2.14	2.08	1.07	3.13	-0.86
BofAML U.S. Treasury Master Index	2.51	7.95	0.80	2.43	1.14	0.83	6.02	-3.35
BofAML U.S. Mortgage Backed Securities Index	1.44	5.82	1.00	2.45	1.67	1.46	6.07	-1.39
BofAML U.S. Corporate Master Index	3.07	12.94	-2.25	6.48	5.96	-0.63	7.51	-1.46
BofAML U.S. High Yield Master II Index	1.22	11.50	-2.27	7.48	17.49	-4.61	2.51	7.41
BofAML Convertible Bonds Index	-0.83	13.59	0.68	16.03	11.94	-1.15	9.97	26.60
BofAML Euro Broad Market Index	-1.57	3.36	-4.39	14.61	0.37	-9.30	-2.48	6.89
BofAML Local Debt Market Plus Index	1.01	10.69	-4.90	14.71	6.53	-12.02	-4.50	-5.75

How should you use the information provided in the table?

- The returns are not projections. They are historical. Future returns will vary.
- Annualized returns can generally be used to understand historical return trends.
- Calendar returns provide a general understanding of year-by-year return volatility.

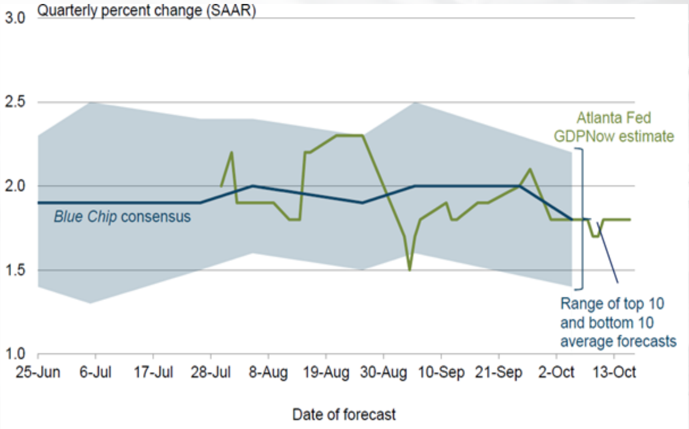
Global Market Drivers

The third quarter started out on a positive note as the U.S. and China struck a reconciliatory tone and U.S. Federal Reserve (Fed) Chairman Jerome Powell testified before Congress that policymakers were set to act to counter any signs of economic weakness. Unfortunately, trade optimism didn't last for long as President Trump announced the U.S. would enact a new 10% tariff on approximately $300 billion (USD) in Chinese imports. China's response, that the yuan would be allowed to fall below 7.0 yuan per U.S. dollar, caught the market by surprise since that level had not been broached in the last 10 years. In response the U.S. labeled China as a "currency manipulator," which then prompted the Chinese to respond with retaliatory tariffs on $75 billion (USD) in U.S. goods, a halt in U.S. farm product purchases and the reinstatement of tariffs on U.S. autos and auto parts. The rollercoaster of threats and reconciliation continued in September as both sides struck a more conciliatory tone in their public comments, which helped to boost overall market sentiment. Following the end of the quarter, the U.S. announced a tentative deal with China (similar in structure to a deal that was nearly signed two years ago), which boosted the equity market, but only slightly, because of a lack of acknowledgement from China, and a degree of back peddling on both sides. At the end of the day, despite a lot of announcements and rhetoric, the U.S. and China trade situation remained highly fluid, and to use a technical phrase, as clear as mud.

Stepping back from trade, investors remained highly sensitive to announcements from the Fed during the quarter. On this front, after starting the quarter relatively optimistic, investors were left somewhat disappointed because of a more measured pace of rate reductions by the Fed (announced rate cuts of 0.25% to the Fed funds rate at the end of July and mid-September) because investors had been hoping for a more significant easing of rates. Disappointment became more pronounced throughout the period because U.S. economic data showed signs of accelerating weakness and corporations grappled with rising wages, softening margins, weakening global growth and U.S. dollar strength.

The Economy

Federal Reserve Bank of Atlanta Fed 3Q19 GDPNow Estimate

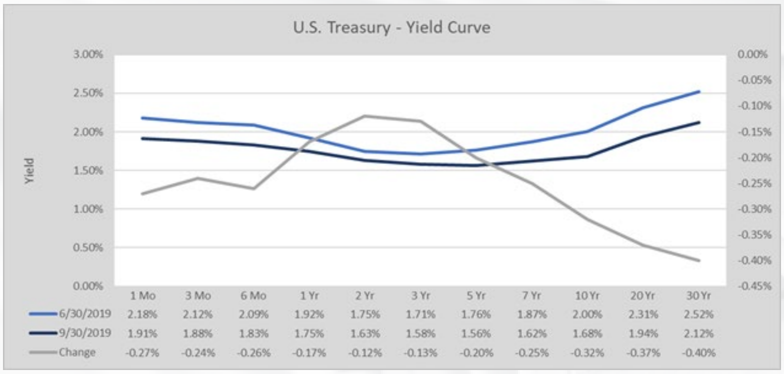


Final economic growth numbers, released in late September 2019, showed U.S. GDP grew at a +2.0% pace in 2Q19, which was down significantly from +3.1% the previous quarter. Economists are projecting GDP growth continued to slow in 3Q19. The Atlanta Fed GDPNow cast is projecting 1.8% growth for the quarter (see chart to right). Looking deeper into the projections, results continued to be mixed. On the positive side, personal consumption is projected to add +1.8% to growth, as low unemployment continued to fuel consumer spending. On the negative side, trade continues to be a drag, as Chinese trade relations continue to cause uncertainty. Overall, trade is expected to detract -0.4% for the quarter.

Global growth rose approximately +3.0% during the first half of the year and is on a similar trajectory for 3Q19. This pace is significantly lower than the 2017-18 period, which averaged 3.7%. The weakness in growth is driven by a sharp deterioration in manufacturing activity and global trade, with higher tariffs and prolonged trade policy uncertainty damaging investment and demand for capital goods. Overall, trade volume growth in the first half of 2019 has fallen to +1%, the weakest level since 2012. In addition, the global automobile industry is contracting due to a variety of factors, such as disruptions from new emission standards in the euro area and China.

Interest Rates

Due to slowing economic growth and subdued inflation, the 10-year U.S. Treasury yield declined -32 basis points (0.32%) in the third quarter ending at 1.68%. The 2-year U.S. Treasury yield finished the quarter at 1.63% down -12 basis points (0.12%) from the previous quarter-end. The muted decline was partially influenced by Fed policy uncertainty. The widely followed 10-year to 2-year U.S. Treasury spread (the difference between yields on two different bonds) tightened by 20 basis points (0.20%) to finish the quarter at a mere +0.05%. See chart below.



	1 Mo	3 Mo	6 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
6/30/2019	2.18%	2.12%	2.09%	1.92%	1.75%	1.71%	1.76%	1.87%	2.00%	2.31%	2.52%
9/30/2019	1.91%	1.88%	1.83%	1.75%	1.63%	1.58%	1.56%	1.62%	1.68%	1.94%	2.12%
Change	-0.27%	-0.24%	-0.26%	-0.17%	-0.12%	-0.13%	-0.20%	-0.25%	-0.32%	-0.37%	-0.40%

Earnings

Corporate earnings growth (year-over-year) is expected to decline -4.6% (S&P 500® Index) for the third quarter, which would be the largest year-over-year earnings decline since 1Q16 (-6.9%). If the quarter were to end with negative earnings growth, it would be the first time the S&P 500® Index has reported three straight quarters of year-over-year earnings declines since 4Q15 through 2Q16. From a sector perspective, utilities and real estate are projected to report earnings growth, while sectors such as energy, materials and technology are expected to report earnings declines.

For the full calendar year (2019), earnings growth is expected to finish at a relatively paltry +1.1%. However, analysts currently project earnings to ramp higher in 2020 (+10.6% for calendar year). Based on these estimates, it could be surmised that analysts are optimistic that corporate earnings will rebound in the coming year.

Equity Market Results

Despite the negative news and uncertainty facing markets, including the opening of a House of Representatives impeachment inquiry of President Trump, the U.S. equity market eked out a gain of +1.70% (as measured by the S&P 500® Index) for the quarter. On a more granular basis, there was minimal difference among styles as growth (+1.49% Russell 1000® Growth Index) and value (+1.36% Russell 1000® Value Index) registered similar gains. There were, however, significant differences in performance when segmenting stocks into classifications based on their underlying qualities. Low volatility stocks (S&P 500 Low Volatility Index) posted a gain of +5.80%, while stocks that are more sensitive to movements in the equity market (S&P 500 High Beta Index) fell -3.02%. Companies that pay dividends also performed well (+3.58% Dow Jones U.S. Select Dividend Index), which contrasted with companies that benefit from price momentum (+0.71% S&P 500 Momentum Index). There was also a large degree of dispersion among sectors of the U.S. equity market as income producing equities such as utilities (+9.33% S&P 500 Utilities) and real estate (+7.71% S&P 500 Real Estate) generated outsized returns, while commodity-sensitive sectors such as materials (-0.12% S&P 500 Materials) and energy (-6.30% S&P 500 Energy) finished in negative territory. Lastly, large-cap companies (+1.70% S&P 500® Index) outperformed small-cap companies (-2.40% Russell 2000® Index).

Foreign markets were not spared from the spike in volatility. Markets tended to be adversely impacted because of unclear U.S. trade practices and softening economic data. Uncertainty surrounding "Brexit" in the U.K. and violent protests in Hong Kong added to the overriding negative sentiment. Developed foreign stocks (as measured by the MSCI EAFE® Index) ended with a loss of -1.07% for the quarter. Emerging markets equities also retreated (-4.25% as measured by the MSCI Emerging Markets Index) due to trade uncertainty and economic weakness in China.

Before moving on to other topics, we thought it would be beneficial to pause at this point to provide perspective on recent market performance. Among investors, we have generally seen two different opinions; those that believe the stock market has performed very well and those that believe the stock market has been a disappointment. Neither is necessarily wrong. Rather, it depends on perspective. For investors that are focused on year-to-date returns (12-31-18 through 9-30-19), performance has been very good (+21% as measured by the S&P 500® Index). For those focused on the last 12 months (9-30-18 to 9-30-19) returns have not been as favorable (+4% as measured by the S&P 500® Index). Furthermore, depending on the mix of an individual's underlying investments, the perspective also may be very different. For instance, over the past year (9-30-18 to 9-30-19) returns have varied widely in equity markets; +4% for the S&P 500® Index, -9% for U.S. small caps (Russell 2000® Index), -2% for emerging markets equities (MSCI Emerging Markets Index), +25% for real estate (S&P 500 Real Estate) and -19% for energy stocks (S&P 500 Energy). Undoubtedly, investors have exposure to some, or all, of these segments of the global market. During periods of widely divergent returns, we believe the key for investors is not to focus on any one segment of the market (positive or negative), but rather to understand that these times demonstrate why diversification is important. Over any short timeframe, there may be sizable winners and losers, but history has taught us that today's winners (losers) may also be tomorrow's losers (winners). This is why we build diversified portfolios and focus on risk-adjusted returns over a complete market cycle when determining the success of portfolios. More on "cycles" in this quarter's Research Focus.

Equity Market Comments

The apparent optimism among many market analysts that corporate earnings growth will rebound in the coming year is not one we share. This primarily stems from the fact that we seem to be more concerned about corporate profit margins in the near term.

Profit Margins

Profit margins are crucial to stock price movements because they play a pivotal role in determining the direction and overall level of earnings. In very simplified terms; earnings = revenues X margins. All else being equal, as margins increase, earnings increase. As margins decrease, earnings decrease. The direction of this relationship can be offset by changes in revenues, but if revenue growth is tepid, then margins (and the direction of margins) become more important. Once margins begin to falter, revenue growth must ramp higher if there is any chance of earnings improvement.

While many factors come into play in determining the direction of margins, in the short run, we are most concerned about the potential negative impact of the following:

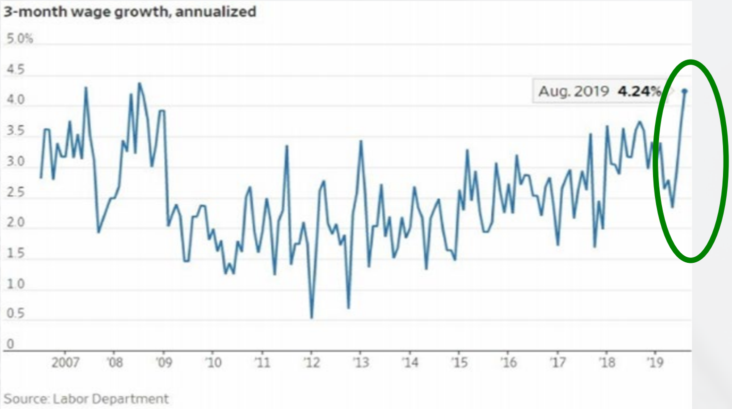
- U.S. dollar strength, particularly for multi-national corporations that derive a significant portion of their revenue from overseas;
- Softening global growth, which puts downward pressure on revenues as demand decreases (inventories have also ballooned to cycle highs, which pulls future revenue to the present);
- We believe we are in the late stages of the economic cycle, which has historically been a timeframe when margins compress as competition increases and competitors fight to keep or gain market share;
- Rising input costs, in part because of trade protectionist policies;
- Rising wage growth, which has recently increased at the fastest pace since 2007 in the three months through August (See chart to right).

In conclusion, we believe corporate earnings have a meaningful chance to surprise investors on the downside, in large part, due to greater than expected margin pressure.

Earnings Relative to Stock Prices

In the past we noted that stock market returns generally follow the path of earnings over the long-term. However, over shorter timeframes, other factors can cause a divergence in the relationship. The trade war between the U.S. and China, along with an uncertain path for further rate cuts from the Fed, have resulted in one of these short-term periods. (See chart to right).

The chart plots the direction of 3Q19 earnings per share (EPS) expectations for the S&P 500® Index (left axis) relative to the change in price of the S&P 500® Index (right axis) over the quarter. Notice that the rebound in the


3-month wage growth, annualized

Source: Labor Department

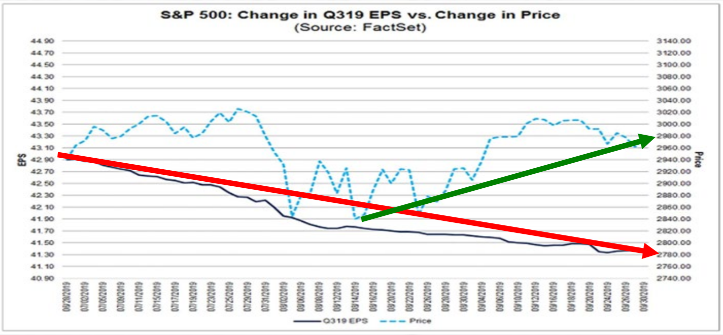

S&P 500: Change in Q319 EPS vs. Change in Price
(Source: FactSet)

Chart courtesy of FactSet Earnings Insight (October 4, 2019) equity market (green line) did not coincide with an improvement in 3Q19 earnings expectations (red line), which declined throughout the period.

Based on the data in the chart, it could be determined that market-making headlines (such as the "ping pong match" of trade announcements between the U.S. and China) were the primary determinants of intra-quarter market moves. While we believe a U.S. and China trade deal is indeed important, we do not believe the announcement of a deal will serve as a "magic wand" for corporate earnings to suddenly improve. With this in mind, we believe that the most recent market rebound may be fleeting, unless we begin to see less in the way of margin pressure and more in the way of earnings improvements.

In the absence of a resumption in earnings growth, we believe the environment is ripe for disappointment in shorter-term equity moves. As a result, we remain committed to a more defensive posture in the U.S. equity segment of portfolios.

Equity – Valuation

The S&P 500® Index's forward P/E ratio (price-to-earnings ratio) was 16.6x at the end of the third quarter. As a reminder, 16.6x is roughly the amount investors are willing to pay for $1 of future earnings. This is higher than the 10-year average of 14.8x, and in line with the 5-year average of 16.6x. See the chart to the right.

In examining the chart, note that much of the equity market gain so far this year (green arrow) has come as a result of multiple expansion (i.e. essentially a willingness by investors to pay more for each dollar of earnings as opposed to paying for increased earnings). This means that the price of stocks has increased even in the absence of corporate earnings improvement. As we noted in the earnings section, the relationship between earnings and stock prices can diverge over shorter-term periods, but in the long run, this relationship is highly correlated. In simple terms, this most likely means that earnings must recover as expected (2020 earnings), or there may be a heightened risk of stock market disappointment.

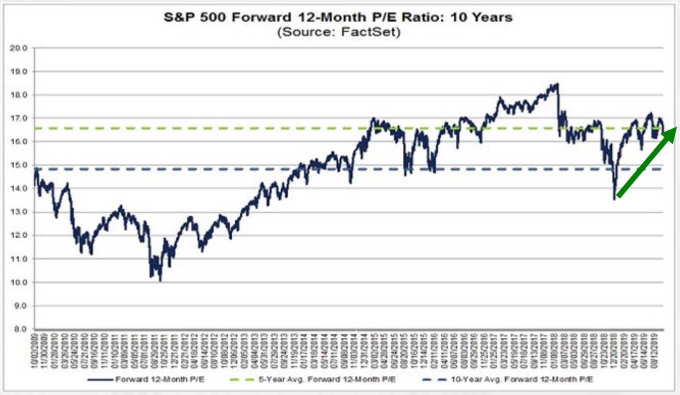


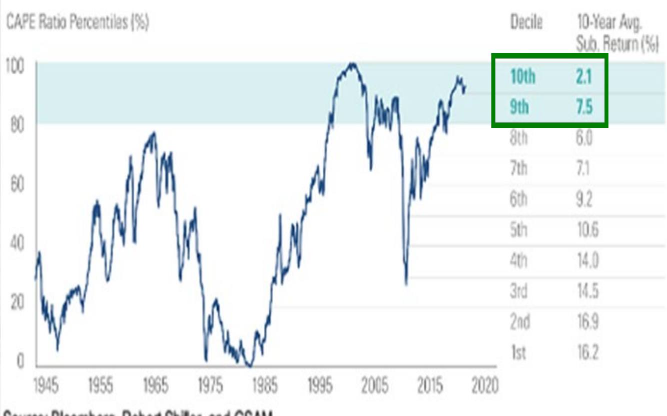
Chart courtesy of FactSet Earnings Insight (October 4, 2019)

If earnings do indeed disappoint, we believe there are few options that could send equity prices higher, outside of a significant policy response from the Fed and/or the government. The odds of a government response, especially given a divided Congress, and an impeachment inquiry, is highly unlikely in our estimation. This leaves the Fed as the only potential option to stave off unexpected economic weakness and a deterioration in the stock market. Even if we were to receive a significant policy response from the Fed, we question the amount of flexibility and tools at the Fed's disposal given the already low level of rates. We are certainly not saying this cannot (or will not) happen, but unlike some market participants, we do not base our investment decisions on hope. Another way of stating this (to use a football analogy) is that we are not fully discounting the possibility of a "Hail Mary" from the Fed. However, we would much rather focus on the higher percentage plays in our playbook, even if that means potentially giving up some upside in the event of a Fed "Hail Mary" being delivered.

At the risk of sounding too focused on the short-term, especially for a firm that espouses the merits of a long-term investment strategy, we thought it would be helpful to provide an update on our longer-term outlook for the equity market as it relates to current valuation levels. On this front, one of the many measures that we commonly review to gain a better understanding of long-term return potential is the CAPE ratio. We highlighted this valuation measure in a previous newsletter, but as a reminder, CAPE stands for “cyclically adjusted price-to-earnings.” Rather than only focus on valuation measures that are based on relatively short periods of earnings (i.e. 12-month forward or trailing earnings, which are used in the more commonly reported forward and trailing price-to-earnings ratios), we also like to review the CAPE ratio because the measure uses 10 years of earnings, adjusted for inflation. The ratio is a notoriously poor predictor of short-term movements in the stock market (and has its critics), however, it has a better track record for estimating returns over long-term investment horizons.

The chart below plots the CAPE ratio based on where the ratio stands in relation to historical values extending back to 1945. The table on the right then ties together decile rankings (groupings of 10%) and relates them to subsequent 10-year average market returns.

The current CAPE ratio is hovering between the 9th and 10th decile (green box – the higher the decile the more “expensive” the market is relative to history). Based solely on this data, investors should expect roughly mid-single digit equity market returns (on average) over the next 10 years. Will this come to fruition? We obviously can’t say with certainty, but a wide swath of valuation measures (we do not rely on any one measure) point towards more muted returns moving forward compared to what investors have experienced over the last 10 years.



Decile	10-Year Avg. Sub. Return (%)
10th	2.1
9th	7.5
8th	6.0
7th	7.1
6th	9.2
5th	10.6
4th	14.0
3rd	14.5
2nd	16.9
1st	16.2

Source: Bloomberg, Robert Shiller, and GSAM.

In summary, we are less constructive on equity market returns in the near term, which forms the basis for our current positioning. In addition, we have structured portfolios to be relatively resilient in a more challenging period for U.S. equity markets over the longer-term.

Client Portfolio Impact

Based on our overriding tone from the earnings and valuation sections, most readers can probably infer that we are not as optimistic as many investors and market forecasters. While this assumption is correct, it does not mean that we are negative on all areas of the global equity market either. In order to form our opinions, we monitor a wide variety of economic, business and market data to inform our general views on markets and investment opportunities. While we cannot cover all data points, two data series were of interest this quarter – one economic and one equity market-related.

The first data series is the ISM Manufacturing PMI (purchasing manager’s index), which is a measure used to gauge the overall health of manufacturing activity in the U.S. As a general rule, a PMI greater than 50 (and rising) reflects an expansion in manufacturing activity, while a level below 50 (and declining) reflects a contraction in manufacturing activity. While some believe the gauge may not be as important as it once was because of an overall decline in the U.S. manufacturing sector over recent decades, we still view it as a solid barometer for the overall health of the economy.

Unfortunately, this measure fell to 47.8 in September, which is a decline of 13 points from where the data series stood one year ago. The September level also marks the lowest it has been since 2009 during the global financial crisis. The current PMI also reflects an overall weakening in the sector, and directionally may portend to further weakening in the broader economy (especially if the decline were to continue). If we were to relate this data to the stock market, we see that when PMI's are contracting, the market has not performed as well as it has during expansionary periods. See the chart below.

When PMI was below 50 and contracting, the S&P 500® Index advanced by only approximately 1% on average over the subsequent 12-month period. However, when PMI was below 50 and rising, the market has generated relatively solid returns. Unfortunately, we cannot say when this data series may "bottom;" however, based on another data series, new export orders, it appears that further weakening may be in store.

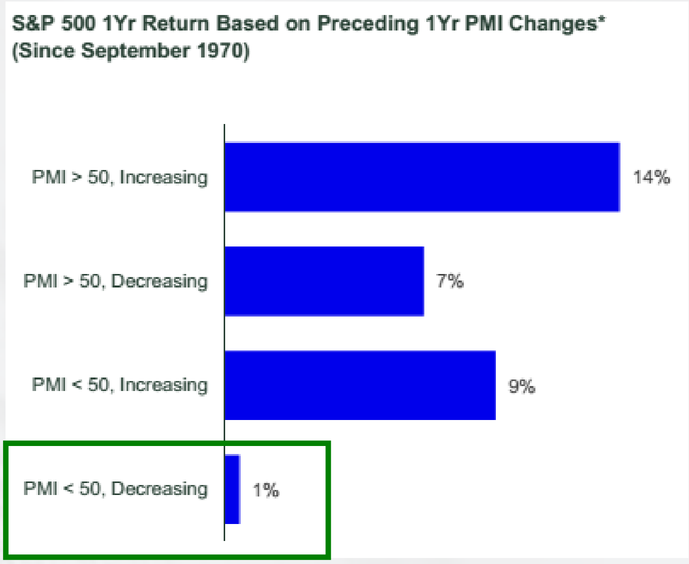

S&P 500 1Yr Return Based on Preceding 1Yr PMI Changes*
(Since September 1970)

Chart courtesy of SPDR ETFs Chart Pack (October 2019 Edition)

The second data series relates to IPO (initial public offering) activity in the U.S. equity market. In general, IPO's tend to be one of the more speculative areas of the equity market as investors can purchase, for the first time, companies that had not been traded on a public exchange before. While not perfect, the overall level of activity and reception of IPO's by investors provides a glimpse into investors' views on the market and their desire to take on added risk in their portfolios (since these companies tend to be relatively unproven, and in many cases, unprofitable businesses). What we have seen thus far in 2019 is a complete reversal of IPO performance compared to the 2012-2018 timeframe. The chart to the right looks at median 2019 IPO performance (1-month) relative to the performance of the broad equity market as measured by the Russell 3000® Index.

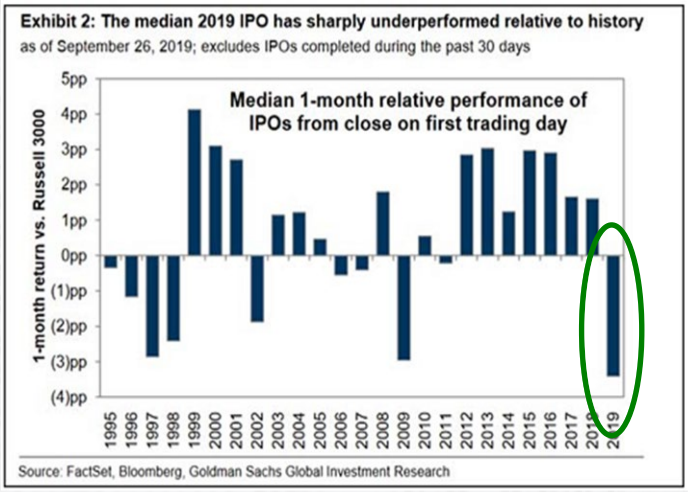


Exhibit 2: The median 2019 IPO has sharply underperformed relative to history
as of September 26, 2019; excludes IPOs completed during the past 30 days

Source: FactSet, Bloomberg, Goldman Sachs Global Investment Research

Based on this data, IPO's have not been well-received by the market in 2019. In fact, performance has not been this weak since the periods immediately following the tech boom/bust in 2002 and the global financial crisis in 2009. We believe this signals that investors have become more focused on company fundamentals, are more sensitive to price and less prone to blindly piling into stocks in the absence of earnings and underlying business strength.

Equity Portfolio Comments

We believe that when taking these data points (and many others) into consideration, along with our views on earnings and valuation levels, it warrants a cautious approach in our U.S. equity positioning.

This cautious view has been reflected in our positioning over the past 12+ months and was reinforced with further adjustments over the last two quarters. Most notably, we remain heavily invested in high quality (companies with strong balance sheets) U.S. large-cap companies, with an added emphasis on the real estate sector and companies that have consistently grown their dividends. We also became slightly less aggressive in foreign markets as we shifted exposure away from Asia (notably China). In a subset of portfolios (that have a specific, unique investment strategy), we also increased exposure to frontier equity markets this year. We believe the net impact of our adjustments over the past 12+ months will be a reduction in portfolio volatility and may provide additional downside protection during periods of market weakness. This has been the experience during market selloffs over the past 12 months as portfolios have proven to be relatively more resilient when compared to broad U.S. and foreign equity benchmarks. We are cognizant that because of our relatively more defensive positioning, portfolios may not perform as strongly during periods of market strength (especially when markets rise sharply). However, we are comfortable with this given our views and where we reside in the current market cycle.

Two future investment opportunities that have increasingly piqued our interest recently are value-oriented stocks and U.S. small-cap stocks. From a valuation perspective, value stocks have reached historically "cheap" levels when compared to growth stocks, and U.S. small-caps have gotten increasingly "cheap" relative to large-caps, which is in part because of their significant underperformance over the past 12 months (highlighted in the equity market review section). Nonetheless, as we have stated many times, valuation levels alone are not good predictors of shorter-term results since "cheap" may get "cheaper," especially without the presence of a catalyst to unlock perceived value. As a result, we will continue to monitor these areas, but have not yet seen a clear impetus to make adjustments in portfolios.

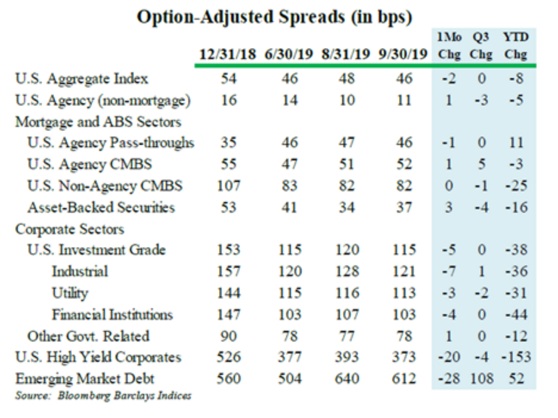
Fixed Income Portfolio Comments

Fixed Income Market Results

With rates down considerably and spread movements muted, fixed income subsector performance was again driven by interest rate risk. In general, sectors with the highest sensitivity to falling U.S. Treasury yields did the best, while those with less sensitivity did worse. Due to a near 7-year duration, investment grade corporate bonds led the rally by generating a return of +3.07% during the quarter. Other sectors that posted strong gains were preferred stocks (+3.05%) and U.S. Treasuries (+2.51%).

After a significant rally during the first half of 2019, changes in credit spreads were a mixed bag in 3Q19. High yield corporate bonds (-4 basis points), asset-backed securities (-4 basis points), and agency debentures (-3 basis points) all finished the quarter tighter. On the other hand, emerging market debt (+108 basis points), and commercial mortgage-backed securities (+5 basis points) both finished the quarter wider. Investment grade corporate bonds and agency mortgage-backed securities both finished the quarter unchanged. See table below.

The tax-exempt municipal market, as represented by the Bloomberg Barclays Municipal Bond Index, returned +1.58% during 3Q19, which increased the year-to-date return to 6.75%. Despite strong absolute performance, municipals underperformed Treasuries, as is typical during a strong Treasury rally. Looking under the hood, long-term maturities (22+ year bonds) led the way, generating a gain of +2.64%, as yields fell proportionately more in this area. High yield municipals generated +2.84%, leading other rating categories, as credit spreads narrowed.



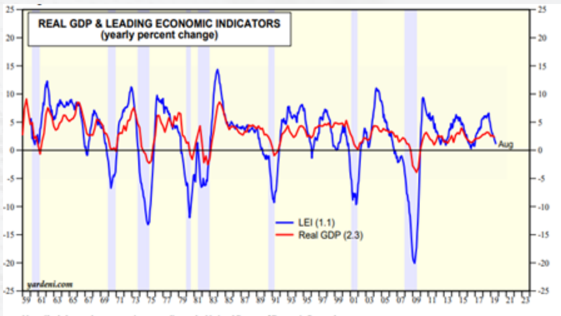
Option-Adjusted Spreads (in bps)

	12/31/18	6/30/19	8/31/19	9/30/19	1Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	54	46	48	46	-2	0	-8
U.S. Agency (non-mortgage)	16	14	10	11	1	-3	-5
Mortgage and ABS Sectors							
U.S. Agency Pass-throughs	35	46	47	46	-1	0	11
U.S. Agency CMBS	55	47	51	52	1	5	-3
U.S. Non-Agency CMBS	107	83	82	82	0	-1	-25
Asset-Backed Securities	53	41	34	37	3	-4	-16
Corporate Sectors							
U.S. Investment Grade	153	115	120	115	-5	0	-38
Industrial	157	120	128	121	-7	1	-36
Utility	144	115	116	113	-3	-2	-31
Financial Institutions	147	103	107	103	-4	0	-44
Other Govt. Related	90	78	77	78	1	0	-12
U.S. High Yield Corporates	526	377	393	373	-20	-4	-153
Emerging Market Debt	560	504	640	612	-28	108	52

Source: Bloomberg Barclays Indices

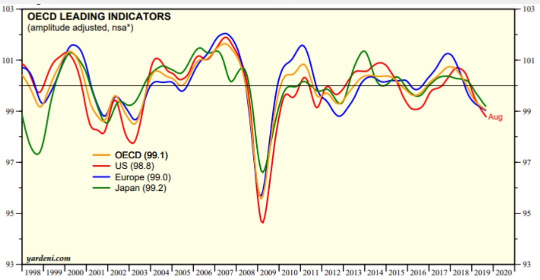
Fixed Income Market Comments

Looking ahead, we are seeing some signs that growth may be turning a corner, at least momentarily. The rate at which U.S. leading economic indicators have been slowing has changed course; both the 3- and 6-month average rates of change have turned positive. From an absolute perspective, leading economic indicators are projecting growth will be positive over the short-term (6-12 months), but likely below +2%. See chart to right. Over the medium-term (12-36 months) the domestic outlook continues to face risks from global and domestic headwinds, including weak economic growth internationally, trade war uncertainties, and global political risks, including the 2020 U.S. elections. At the December 2018 meeting, the Fed had planned to increase rates by 50 basis points in 2019, which had us extremely concerned. However, because of its pivot to cut rates, this may provide enough cushion to absorb the downside economic risks. The fundamentals supporting consumption continue to be strong, as a healthy employment market provides the foundation for continued gains in disposable income. Households also have more of a cushion to absorb negative shocks given their relatively elevated 8% savings rate.



Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Conference Board.

Internationally, the OECD's composite of leading indicators has fallen considerably over the past 12 months. This led to a cut in the 2019 global growth forecast to 2.9%, which marks the lowest annual pace since the financial crisis. See chart to the right.



* A reading above 100 that is rising predicts expansion, above 100 and falling a downturn, below 100 and falling a slowdown, and below 100 and rising a recovery.
Source: OECD and Haver Analytics.

Most of the weakness centers around trade, which may be turning a corner as the Trump administration and China have agreed to a partial deal. However, even if trade uncertainties were to resolve themselves, there are numerous sources of potential downside risk including a disorderly Brexit, the Italian-EU budget fight and rising tensions in the Middle East. On the positive side, central banks around the world are loosening policy. Of the top 30 central banks globally, over half of them, including the Fed and the European Central Bank, have cut rates during the past three months. The current synchronization is now the most concentrated easing cycle since the global financial crisis. However, the dynamic we are currently dealing with seems to be testing the limits of monetary policy, which continues to keep medium term (12-36 months) risks elevated.

U.S. Interest Rates

The Fed continues to view the U.S. economy as strong and considers its rate cuts preemptive due to notable headwinds from weak global growth and trade policy uncertainty. Chairman Powell has emphasized his commitment to take action "as appropriate" to sustain the economy but did not commit to additional easing at the latest meeting. Despite Powell's words, the market continues to expect at least one more rate cut in 2019. Based on the probabilities we have assigned to likely economic scenarios; we believe fair value for the 10-year Treasury is between 1.27%-2.39%. It ended 3Q19 at 1.68%, which is at the midpoint of our fair value range.

Yield Curve

It is likely the Fed will cut interest rates at least one more time in 2019, which would match the expectations priced into the front-end (short maturities) of the U.S. Treasury yield curve. Many economists are projecting an uptick in inflation over the next two quarters, which could lead yields on the back-end (long maturities) of the curve to increase modestly. However, with the curve mostly flat and long-term U.S. Treasuries valuations near fair value, any change in the shape of the yield curve should be muted.

Sector & Quality Management

- **Corporate Credit –** With interest rates near all-time lows, corporations took the opportunity to raise cash via debt markets to fund share repurchases and acquisitions. Evidently, CEO's saw this as a better alternative than investing in their businesses to grow organically. However, with economic growth slowing, corporate earnings forecasted to decline, and leverage near all-time highs, it is likely we see an uptick in debt ratings downgrades.
- **Securitized Credit –** As the U.S. consumer continues to thrive, securitized sectors continue to provide attractive opportunities to generate stable returns with better downside protection than corporate credit.

- **Non-U.S. Credit –** Emerging markets continue to face headwinds created by the U.S.-China trade war. As a result, growth and inflation have slowed in many regions. However, many regions continue to be better positioned (based on underlying fundamentals) than developed markets, which makes their higher yields much more attractive from a valuation standpoint.

- **Alternative Credit –** Infrastructure assets continue to offer yields equivalent to corporate credit but are collateralized by hard assets that are essential to the economy. In our view, this makes them much more attractive at this point in the business cycle. Finally, the uncorrelated nature of insurance-linked securities, combined with significantly higher premium income (because of 2017 and 2018 claims), makes them an attractive investment.

- **Municipal Credit –** After reaching historically expensive valuations during the summer, municipal bonds underperformed during September's U.S. Treasury rally. Valuations are more attractive relative to recent history but remain elevated when compared to their intermediate- to long-term levels. Generally, municipal credit fundamentals are stable as continued economic growth has led to increasing tax revenue. Many municipalities at the state and local levels have used the opportunity to boost "rainy-day" funds and limit debt burdens. From a technical perspective, demand from corporations, most notably banks and insurance companies, will likely remain constrained as they adjust to lower rates, and access the opportunity relative to taxable fixed income alternatives.

Investment Vehicle Selection

At this point in the economic and credit cycles, our broad positioning remains consistent. We favor idiosyncratic opportunities such as non-agency mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities and municipal bonds. We also believe that the illiquidity premiums offered in insurance-linked securities and infrastructure debt are attractive.

Client Portfolio Impact

- In early 1Q19, as growth slowed and the outlook deteriorated, we added some high-quality duration (duration measures sensitivity to changes in interest rates) to client portfolios. The goal was to move portfolios from being a fraction shorter than respective benchmarks to approximately neutral. We plan to keep client portfolios close to their benchmarks from a duration perspective over the short- to intermediate term.
- Our emphasis continues to be on higher quality and non-cyclical parts of the credit markets. Given recent weakness, we may add exposure to mortgage-backed securities and emerging market debt. Conversely, due to recent outperformance, our bias is to reduce exposure to Treasuries.
- Despite a solid fundamental backdrop, we are more inclined to reduce public market municipal exposure in our tax-aware strategies due to valuations. Public municipal valuations continue to be historically rich relative to Treasuries. Until this dynamic changes, we favor investments in the private and direct origination markets.
- To express our views, we continue to partner with active managers that have expertise in these markets. We are also selectively investing in individual securities in markets we can analyze and trade efficiently. As a result, we continue to de-emphasize the use of passive index-based mutual funds and exchange-traded funds on the credit side. We believe the best way to take advantage of the illiquidity premiums offered in the insurance-linked and infrastructure markets is to gain access using interval funds. Interval funds do not offer daily liquidity, as a result they can hold a much higher percentage of their assets in illiquid securities compared to open-end mutual funds.

Research Focus

Charles (CJ) Batchelor, CFA
Chief Investment Officer – Equity

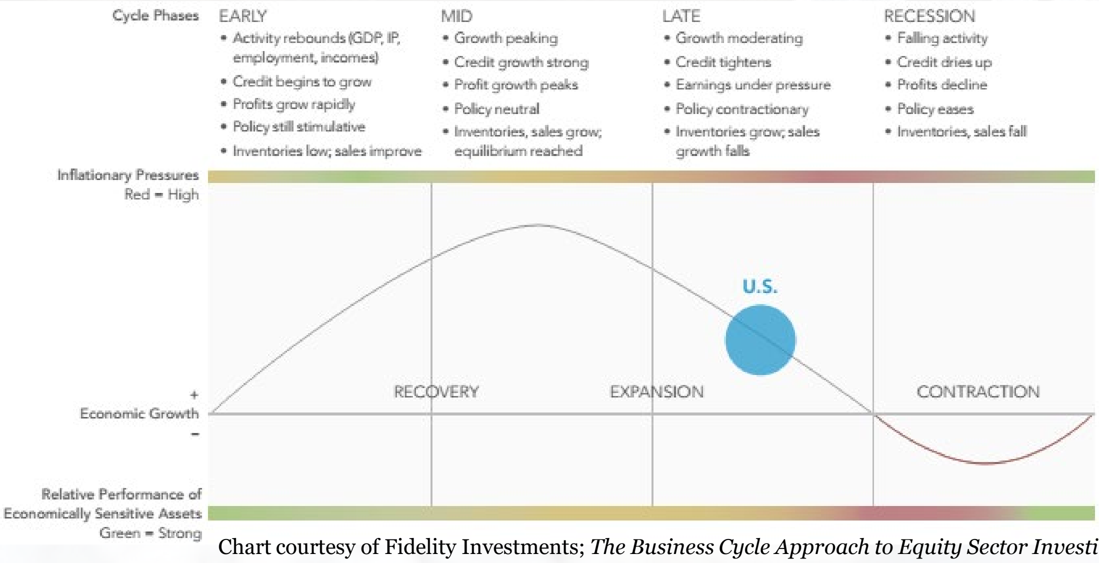
Cycles

Cycles are everywhere. Astronomical cycles are usually the first that come to mind since these types of cycles occur on a regular basis. Whether it be day and night due to Earth's rotation, meteorological seasons driven by Earth's orbit around the Sun, or tidal cycles caused by the gravitational impact from the moon, cycles are constantly occurring around us. While many other types of cycles impact us, we may not be as aware of these cycles because they do not occur as regularly (and are not as easily observable) as astronomical cycles.

We certainly do not claim to be scientists, but we do spend a significant portion of our time understanding and researching cycles – in financial markets. In fact, if you have read any of our newsletters, including the first part of this newsletter, you will have undoubtedly seen us refer to some sort of a cycle in our writing. The most commonly referenced cycle across fixed income and equity discussions is the business cycle. Some individuals may be familiar with the general definition of what a business cycle is, but may not understand how it impacts financial markets, or our decision-making process for portfolio construction.

What is the business cycle?

At a very basic level, the business cycle reflects fluctuations of activity in an economy. There are generally four stages in a business cycle: early-cycle, mid-cycle, late-cycle and recession. The early-cycle is commonly marked by a recovery from recession, driven by a change from negative to positive economic growth, followed by relatively rapid growth. The mid-cycle stage is generally the longest of the business cycle. Growth moderates from rates experienced during the early-cycle stage, but growth continues. The late-cycle stage marks a peak in economic activity and a deceleration in growth. During this phase, inflation may increase, and corporate profit margins may be squeezed by rising wage growth. The last stage, recession, reflects an overall decline in economic activity as corporate profits decline. The graphic below summarizes the stages of the business cycle and typical characteristics.



Cycle Phases
EARLY
• Activity rebounds (GDP, IP, employment, incomes)
• Credit begins to grow
• Profits grow rapidly
• Policy still stimulative
• Inventories low; sales improve
MID
• Growth peaking
• Credit growth strong
• Profit growth peaks
• Policy neutral
• Inventories, sales grow; equilibrium reached
LATE
• Growth moderating
• Credit tightens
• Earnings under pressure
• Policy contractionary
• Inventories grow; sales growth falls
RECESSION
• Falling activity
• Credit dries up
• Profits decline
• Policy eases
• Inventories, sales fall
Inflationary Pressures
Red = High
U.S.
RECOVERY
EXPANSION
CONTRACTION
+
Economic Growth
–
Relative Performance of
Economically Sensitive Assets
Green = Strong

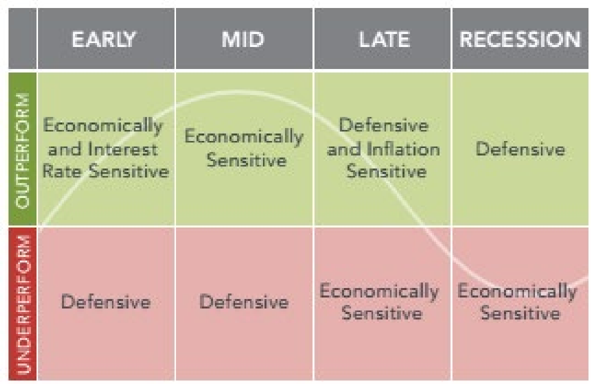
Chart courtesy of Fidelity Investments; *The Business Cycle Approach to Equity Sector Investing*

Research Focus

How does the business cycle relate to the stock market?

The chart below and to the right provides a basic outline of the types of economic sectors that perform relatively well (or poorly) during the four stages of the business cycle.

In general, this means that sectors such as consumer discretionary and industrials (utilities, energy, health care) perform well (poorly) during the early part of the business cycle. Sectors including technology and communication services (utilities, REITs, consumer staples) outperform (underperform) mid-cycle. Sectors such as REITs, consumer staples and energy (consumer discretionary, financials) generate relatively good (weak) returns during the late-phase. Health care, REITs and utilities (technology, industrials, financials) tend to outperform (underperform) during the recessionary phase.



	EARLY	MID	LATE	RECESSION
OUTPERFORM	Economically and Interest Rate Sensitive	Economically Sensitive	Defensive and Inflation Sensitive	Defensive
UNDERPERFORM	Defensive	Defensive	Economically Sensitive	Economically Sensitive

Chart courtesy of Fidelity Investments; *The Business Cycle Approach to Equity Sector Investing*

Why is this important?

We believe it is important to have a view on where the U.S. (and other countries) reside in the business cycle because different asset classes and sub-asset classes perform better (worse) during the various stages. If we are confident in our estimation of the business cycle phase, we may be able to emphasize or de-emphasize certain areas of the market in portfolios, with an overarching goal of generating relatively better (compared to the broad market) risk-adjusted returns for our clients.

Our views?

We believe the U.S. is in the late-stage of the current business cycle, in part because of decelerating economic growth, rising wage growth and declining corporate profits. This is one of many reasons that we have had a relatively defensive posture for our U.S. equity investments over the past 12 months, including an emphasis on REITs, and relatively minimal exposure (no direct investments) in U.S. small-cap stocks (these types of companies tend to be more economically sensitive).

In closing, while this may seem like a relatively simple exercise, it becomes more difficult when considering that no two business cycles are the same; the stages of the cycle typically vary in length and each stage may not follow a regular progression through the four phases. This is because external factors can significantly impact the business cycle, including, but not limited to, fiscal policy (tax cuts, government spending) and monetary policy (central bank increasing/decreasing interest rates). This is especially true during the current period as both fiscal and monetary policy have had a large impact on the economic expansion. For instance, when examining data going back to 1900, the average expansionary period has been 48 months, while the average recessionary period has been 15 months. However, the current economic expansion has lasted 123 months, which is the longest economic expansion in history. Does this mean that we're overdue for a recession? Not necessarily. But what it does demonstrate is that the U.S. government and the Fed (FOMC) have had a meaningful impact on extending the current expansion. In our opinion, this cements our view that we are in the latter stage of the current business cycle. It also raises the question of how much longer intervention may be able to withstand economic gravity. Cycles have occurred in the past and they will continue in the future. If experience and studying market history has taught us anything, it is that this time is not different.

Client Focus

This quarter our Client Focus lives up to its name. We are going to spend time discussing one of our four Core Beliefs – Focus Matters.

In our industry, some of the most respected institutional investors are the largest university endowments. Schools such as Harvard, Yale, Stanford and Princeton – to name a few. They are discussed often as benchmarks for asset allocation strategy and investment return outcomes.

We appreciate the emphasis many endowments have on risk-adjusted returns and very long-term investment horizons. The biggest endowments also tend to be very cutting edge as it relates to the asset classes they invest in. Endowments added foreign equity, private equity and alternatives to their portfolios early in the development of those asset classes. In fact, in a recently released article from Yale, its asset allocation has less than 10% in U.S. stocks and bonds and cash. See table below.

Asset Class	% of Portfolio
Absolute Return	23.0%
Venture Capital	21.5%
Leveraged	16.5%
Foreign Equity	13.75%
Real Estate	10.0%
Bonds & Cash	7.0%
Natural	5.5%
Domestic Equity	2.75%

Source: Yale

We have a strong appreciation for the research behind those conclusions but are highly practical about the execution and skeptical of the value in the complexity. We are not averse to any asset class in client portfolios. They just need to meet our cost, liquidity and risk-adjusted return hurdles for consideration.

Most investors do not have billions to invest and a perpetual timeline. As a result, the cost and liquidity of those investments are often not practical in execution. Unfortunately, a lot of investors and other advisors end up chasing asset classes like absolute return, venture capital and leveraged buyouts because of the allure and cachet that comes with them. What they end up getting, more often than not, is excessively priced or illiquid deals that crush goals and returns. For example, it is not uncommon for us to see private investment opportunities that charge 2-3% management fees annually while asking for 20-30% of profits, sometimes without a visible exit date. Those are significant hurdles.

Excluding the practical elements of cost and liquidity, we also demand a return outcome that compensates for the cost and liquidity of investments. In our opinion, there is not enough evidence to suggest that is the case. The last 10 years have certainly proved this out. See table below. (Most endowments have fiscal years that end June 30, so investment returns shown are as of June 30, 2019.)

	10-year return
Endowment Average	8.5%
S&P 500® Index	14.7%
MSCI EAFE® Index	6.9%
Barclays Agg Bd Index	3.9%
60/40 Portfolio*	8.4%

*34% S&P 500® Index, 26% MSCI EAFE® Index 40% Barclays Agg Bd Index. S&P and MSCI weights based on MSCI All Country World Index.

We are not naïve to the fact that this may not always be true, but we believe there are plenty of investment options at our disposal, so we do not need to take the risk of finding out. Therefore, we are focused on a simple mix of investments. Highly complex and excessively engineered portfolios may generate more exciting cocktail hour conversation, but we rarely run into investors that state that as their investment goal. (Heavy sarcasm.) So, we will leave those complexities to Yale.

Our Team

Bob Batchelor, CFA
CEO
Co-Founder

Bob J. Batchelor, CFA is Co-Founder and Chief Executive Officer of Entasis Asset Management. Bob has 20 years of experience in the investment industry. Prior to founding Entasis, Bob worked at Artisan Partners where he held a variety of roles including Head of Corporate Communications, Managing Director, Head of Marketing and Technology and Head of Marketing and Communications. He also served as a member of Artisan Partners Executive Committee. Before Artisan Partners, Bob worked at Strong Capital Management as Client Account Manager and Director of Investment Research and Communication.

Bob holds an M.B.A. from Marquette University and a B.B.A. from the University of Wisconsin-Madison. He has earned the right to use the CFA designation. Bob is a member of the CFA Institute and CFA Society of Milwaukee.

C.J. Batchelor, CFA
CIO – Equity
Co-Founder

Charles J. (C.J.) Batchelor, CFA is Co-Founder and Chief Investment Officer – Equity of Entasis Asset Management. C.J. has 15 years of experience in the investment industry. Prior to founding Entasis, C.J. worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Director of Investment Research. He also served as a member of Cleary Gull's Investment Policy Committee, Investment Committee and Equity Strategy Group.

C.J. holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. C.J. is a member of the CFA Institute and CFA Society of Milwaukee, where he currently serves on the Board of Directors.

Mike Peters, CFA
CIO – Fixed Income
Co-Founder

Mike Peters, CFA is Co-Founder and Chief Investment Officer – Fixed Income of Entasis Asset Management. Mike has 15 years of experience in the investment industry. Prior to founding Entasis, Mike worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Fixed Income Portfolio Manager. In his role he served as voting member of Cleary Gull's Fixed Income Strategy Group and Complement (Alternative) Strategy Group. Before Cleary Gull, Mike worked for several years at Madison Investment Advisors, a multi-billion dollar asset management firm, as a Fixed Income Analyst.

Mike holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. Mike is a member of the CFA Institute and CFA Society of Milwaukee.

David LaCroix
Senior Financial
Advisor

David D. LaCroix is a Senior Financial Advisor at Entasis Asset Management. David has more than 45 years of experience in the investment industry. Prior to joining Entasis, David worked at Cleary Gull Advisors, a Johnson Financial Group Company, and Cleary Gull Inc., a prior affiliate of Cleary Gull Advisors, where he most recently served as Vice President, Relationship Manager responsible for high net worth clients. Before Cleary Gull, David worked in a variety of portfolio management and client relationship management positions with A.G. Edwards and M&I Capital Markets Group.

David received his M.B.A. and B.B.A. in Finance from the University of Wisconsin-Madison. He has served as a member of the Archdiocese of Milwaukee Investment Committee, as a Trustee for the Village of Shorewood and as Director/Treasurer of Milwaukee Summerfest.

IMPORTANT INFORMATION

Statements may be forward looking and are not intended as specific investment advice without further review of individual circumstances. Commentary, opinions, analysis, and recommendations may be subjective, do not guarantee future performance, and could change at any time without notice. Under no circumstances does the information contained within represent a recommendation to buy or sell any security. Charts and graphs provided are for illustrative purposes only.

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The **Dow Jones Industrial Average^{SM}** is a price weighted index that measures the performance of thirty component large-cap U.S. stocks. The **S&P 500® Index** is a market capitalization weighted index that measures the performance of 500 leading companies in leading industries of the U.S. economy. The **Russell 1000® Index** measures the performance of roughly 1,000 U.S. large-cap companies. The **Russell 1000® Growth** Index measures the performance of U.S. large-cap companies with higher price/book ratios and forecasted growth values. The **Russell 1000® Value Index** measures the performance of U.S. large-cap companies with lower price/book ratios and forecasted growth values. The **Russell 2000® Index** measures the performance of roughly 2,000 U.S. small-cap companies. The **MSCI EAFE® Index** is a market capitalization weighted index that is designed to measure the performance of developed markets, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** is a market capitalization weighted index that is designed to measure equity market performance of emerging markets. **The MSCI ACWI Ex USA Small Cap Index** is a market capitalization weighted index that represents the performance of smaller capitalization companies in developed and emerging markets excluding the U.S.

The **Barclays Aggregate Bond Index** tracks the performance of intermediate-term government bonds, investment grade corporate debt securities and mortgage-backed securities with at least one year to final maturity. The **Barclays Intermediate U.S. Gov/Credit Index** tracks the performance of intermediate U.S. government and corporate bonds. The **Barclays Municipal Bond Index** is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year.

The **BoAML Fixed Rate Preferred Securities Index** tracks the performance of fixed rate U.S. dollar denominated preferred securities in the U.S. domestic market. The **BoAML Treasury Master Index** tracks the performance of the direct sovereign debt of the U.S. Government. The **BoAML U.S. Mortgage Back Securities Index** tracks the performance of U.S. dollar denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. market. The **BoAML U.S. Corporate Master Index** tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market. The **BoAML High Yield Master II Index** is a broad based index consisting of all U.S. dollar-denominated high-yield bonds with a minimum outstanding of $100 million and maturing over one year. The **BoAML All Convertibles All Qualities Index** measures convertible securities' performance of U.S. dollar denominated convertible securities not currently in bankruptcy with a total market value greater than $50 million at issuance. The **BoAML Euro Broad Market Index** gives exposure to euro-denominated investment grade debt publicly issued in the Eurobond or euro member domestic markets including government, quasi-government, corporate, securitized and collateralized securities. The **BoAML Local Debt Markets Plus Index** is a broad composite designed to track the performance of local currency sovereign debt of emerging markets countries.

Past performance is no guarantee of future results. All indices are unmanaged. Investors cannot invest directly in an index. Index returns do not include expenses.

Investment Terms

Valuation levels are typically shown by calculating the price level of an index or a company relative to any number of characteristics of an index or company. For instance, the price-to-earnings valuation metric looks at the price of an index (or stock) divided by the total earnings of an index (or stock). Based on the multiple (in this instance, the multiple is how much investors are willing to pay – the price – for a given amount of earnings), it provides investors with a general sense of how expensive, or cheap, the overall market is at the present time. While there are a significant number of valuation metrics that are used in practice, and many ways to vary/modify the calculation of the price-to-earnings ratio, in this summary we are focused on the price investors are willing to pay (the level of the S&P 500® Index) divided by earnings expectations for the equity market (S&P 500 Index) over the next 12 months. This valuation metric is referred to as the forward P/E. A **yield curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. A **basis point** is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% (0.0001). **Interest coverage** is a measure of a company's ability to meet its interest payments on its debt. **Federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. It is one of the most influential interest rates in the U.S. economy, since it affects monetary and financial conditions, which in turn have a bearing on key aspects of the broad economy including employment, growth and inflation.

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