Miltonian Capital Management, LLC

Core Bond Strategy

Q1 2019 Commentary

“*It is easier to find men who will volunteer to die, than to find those who are willing to endure pain with patience” - Julius Caesar*

Miltonian Capital patience is rewarded

Patience is a key element of success. Patience does not mean “enduring pain”. It means being able to *respond* with confidence to changing situations, and not *react* out of fear, or greed. Patience is the base of management of the Core Bond Portfolio. We construct these portfolios with a long time-horizon in mind, relative high cash flow requirement and capital gains built in to compensate for inflation, taxes, fees, and other factors that would erode value. We try not to trade in and out of positions, not to react to every piece of news and the changing macro picture. We do this by sticking to a general mix of sectors, looking for relative value between sectors and individual names, and by staying conservative with credit risk.

Miltonian Core Bond Portfolio

The Core Bond Portfolio performed exceptionally well this quarter. All our buckets were positive, resulting in a composite performance of 3.6% gross of fees, versus 2.9% of the Aggregate Index. We want to highlight two credits which did particularly well this quarter: Navient (NAVI) and Commercial Metals (CMC).

Navient: the student loan servicing company has been branching out into other areas, such as government and business. Navient manages the largest portfolio of FFELP education loans as well as the largest portfolio of private education loans. We like this company’s loan portfolio, which generates steady cash flows well in excess of unsecured debt plus market cap.

Commercial Metals: this company manufactures, recycles and markets steel and metal products for primary and secondary markets used in the construction, energy and transportation markets. This is an exceptionally well-run company, which has been implementing strategic growth initiatives in a favorable market. CMC has been implementing creative strategies, such as pioneering the use of micro mills and IT solutions to efficiently manage the construction season. Revenue increased 33% year over year. Incidentally, this company is run by three awesome women in the positions of CEO, COO, and CFO.

On the Municipal side, the Puerto Rico Sales Tax bonds (COFINA) exchange took place. Holdings of old COFINA bonds were replaced by new, liquid, paying bonds plus cash. We think the new bonds have great security, attractive yields and have potential for outsized performance as they have two possible catalyst events in the horizon. They will be most certainly eventually be rated, and we fully expect the rating to be in the investment grade universe, and some of the bonds that were issued as taxable bonds could gain non-taxable status. Both these events together with the market getting more comfortable with Puerto Rico as it exits the restructuring process, would lead to tightening of the spreads and contribute to performance.

Portfolio yields and characteristics

Putting together a portfolio is an exercise on balancing risk and reward. It is somewhat similar to planting a garden. For the Core portfolio, here us a simplified list of classes to choose from[3]:

Class	Index	Effective Yield	Duration	Rating
Corporate IG	C0A0	3.7	7.1	A
Corporate HY	H0A0	6.1	3.6	B
Muni IG	U0A0	2.5	6.8	AA
Muni HY	U0HY	4.2	5.8	B
Treasuries 1-3 years	G1O2	2.4	1.8	AAA
Preferreds	PFF	5.9		B
Cash				
Total		**3.4**	**5.0**	**A**

With our particular selection, the yield of the composite Core Bond portfolio taken as an aggregate of all the accounts in the strategy, is about 3.6. The duration of about 3.0, and the average rating is BBB+.

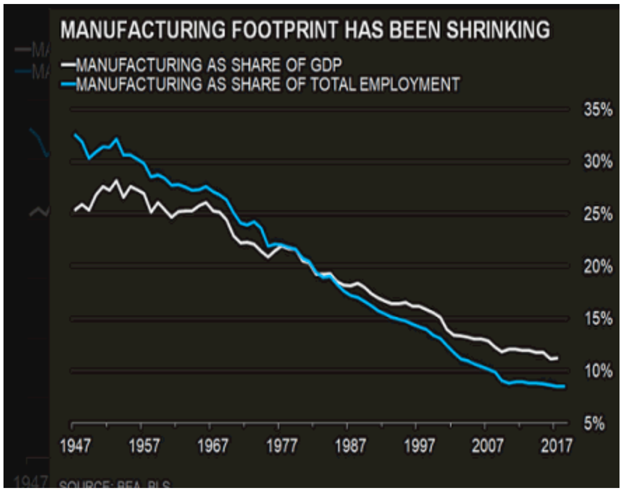
Portfolio	Yield to Maturity	Duration	Rating
Core Bond Portfolio	3.6	3.0	BBB+

The economic environment and credit markets

Economic indicators are still pointing to an economy that is still growing, but with moderated growth, and likely to decelerate towards 2 percent. Some of the weak readings have to do with the psychological fallout from the 4Q market turbulence, slowing global growth, the government shutdown and tax-refund sticker shock.[4]

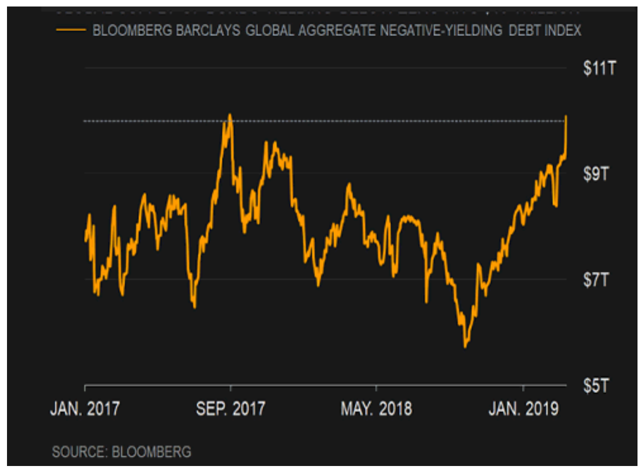
[3] Data from Bloomberg as of 04.16.19

[4] Bloomberg Economic Brief April 16, 2019



There is a substantial inventory glut, due to 2018 trade tensions, but perhaps the shrinking footprint of the factory sector could soften the blow in terms of GDP growth. For sure, the bill is coming due on the cost of trade saber rattling. According to the GDP accounts, inventory accumulation was $90 billion in 3Q and $97 billion in 4Q. That is much larger than the $32 billion per quarter which prevailed for the preceding three years, or the $68 billion average since the Great Recession.

To be sure, the markets are grasping for yield. The Saudi Aramco's blockbuster $12 billion bond sale comes on the wings of a red-hot market. The sale accounted for less than 2% of global corporate debt sales this year. It points to the fact that the hung for yield is still on, with some $10 trillion of bonds mostly issued by government offering negative yields. Sales of company notes have soared to a record of more than $695 billion this year. [5]



Looking forward

We continue to evaluate relative value risk-reward in the portfolio in search for opportunities to improve on yield. Some of these opportunities arise from restructuring situations that are being resolved in more risky parts of our portfolios. For example, we expect that Puerto Rico will substantially complete the restructuring of most of its credits this year, providing excellent opportunities of return and future investment

We are grateful for your trust and welcome your questions and comments.

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[5] Bloomberg Credit Brief, April 11, 2019