

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- ▶ We are adding exposure on dips and tactically booking gains in rallies. We think risk markets will continue to move roughly sideways, and we have a neutral view on credit.
- ▶ We just witnessed 450 basis points of policy rate hikes in just under a year. This has been the most aggressive move since the early 1980s, when the macro environment faced worse obstacles, including stagflation, the Volcker Federal Reserve (Fed), the Arab oil embargo, and the LDC debt crisis.
- ▶ As a result, bonds have decent value. Yields are competitive with earnings yields, and wide versus dividend yields.
- ▶ Our central case economic outlook anticipates a soft landing/mild recession. We think the Fed will pivot only when the labor market starts to weaken, and ex-post inflation (not forecasts) shows clearer signs of decline.
- ▶ More hikes are likely needed to ensure inflation's nascent decline persists, bringing real rates to a small positive while disrupting growth as little as possible. The Fed remains attuned to market signals and has demonstrated a high degree of willingness to adjust, if necessary.
- ▶ The key risk to our view on economic fundamentals is that what we have been classifying as mild stagflation persists but does not translate into a hard landing.

SECTOR ASSESSMENTS

	Credit			Securitized Product				Non-U.S.			Municipals	
	IG CORP	HY CORP	BANK LOANS	ABS	MBS	RMBS	CMBS	EM HY	YANKEE GOV	NON-USD	TAX-EX	TAXABLE
Fundamentals	Neutral	Positive	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral
Technical	Positive	Positive	Neutral	Neutral	Neutral	Neutral	Positive	Neutral	Neutral	Neutral	Neutral	Neutral
Valuations	Neutral	Neutral	Neutral	Neutral	Positive	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral

Newfleet's assessments of non-government spread sectors as of February 28, 2023. Assessments are determined by analyzing a sector's fundamental data, technical indicators, and relative valuations. Sectors (l to r): **Credit:** Investment Grade (IG) Corporate Bonds, High Yield (HY) Corporate Bonds, Bank Loans. **Securitized Product:** Asset-Backed Securities (ABS), Agency Mortgage-Backed Securities (MBS), Non-Agency Residential MBS (RMBS), Non-Agency Commercial MBS (CMBS). **Non-U.S.:** Emerging Markets HY, Yankee Government, Non-U.S. Dollar. **Municipals:** Tax-Exempt, Taxable.

SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds

- Investment grade corporates returned -3.18% for the month as spreads and rates both moved higher in February, erasing much of January's hot start.
- A record February for issuance saw \$180 billion of gross supply – 30% ahead of the prior record (2021). The year-to-date (YTD) supply of \$396 billion beats the 2021 record by 22%.
- Fourth quarter earnings came in soft, registering a 4% earnings decline. An earnings recession is now the base case scenario as consensus forecasts call for mid-single-digit declines in earnings for the first half of 2023.

Newfleet Asset Management's industry trends and observations are the result of research conducted by the portfolio management / research team. These observations reflect their industry expertise and have been prepared using sources of information generally believed to be reliable; however, their accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice.

High Yield Corporate Bonds

- The high yield index finished with a -1.29% return for the month, with January jobs data prompting U.S. Treasury yields to increase as fears of a surging economy and untamed inflation resurfaced.
- While fourth quarter earnings have been generically in line, we have seen more dispersion in earnings across industries, particularly within wirelines and cable satellite.
- As we head into March, we will continue to monitor earnings releases as private companies file financials, along with the macro issues of economic growth, inflation, and employment.

Bank Loans

- Loans returned 0.59% in February – a 0.09% decline in price completely offset by 0.66% of income return. The asset class benefited from a lack of duration risk and a healthy technical.
- Fourth quarter earnings season has been disappointing, posting the lowest number of results that beat forecasts since the Great Financial Crisis. That said, recent positive economic indicators have led consensus to lower the probability of recession to 60% from 65% last month.
- The technical is constructive due to diminished M&A and LBO activity, leaving healthy demand without any net new issuance supply. CLO issuance jumped to \$15.7 billion from 36 distinct transactions – the most since November 2021, and above the trailing monthly five-year average of \$11 billion.

Securitized Product

- The yield curve went sharply higher in February after some negative inflation news and a very strong jobs report. The 2-year U.S. Treasury reached its highest yield in 17 years while the 10-year U.S. Treasury approached 4%, leading to negative returns across all securitized products.
- Strong flows into money market accounts combined with muted new issue supply – especially for CMBS and RMBS – contributed to a positive technical for the month.
- We took advantage of higher yields and spreads in February to add investment grade ABS mezzanine paper that we believe will be accretive to performance throughout 2023.

Emerging Markets Debt

- The EM debt market total return for the month was -2.21% – a bit better than the return of the broader bond market as represented by the Bloomberg Agg, which was down by 2.59%. Interest rate duration was the primary culprit for the negative returns.
- At the sector level, relative returns by credit quality show that EMD has continued to underperform U.S. corporate debt in both investment grade and high yield. However, we sense the performance gap is closing.
- The recent Treasury-driven selloffs may have a positive side: EM debt now has better value than even just over a year ago. The all-in yield-to-maturity of high yield EM debt is now at historically attractive levels.

Municipal Bonds

- The municipal bond index returned -2.26 for the month, and 0.29% YTD as of March 2.
 - According to Lipper, YTD outflows are now at \$1.3 billion as of March 1.
 - Issuance is now down by -27.9% YTD.
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