NEWFLEET ASSET MANAGEMENT

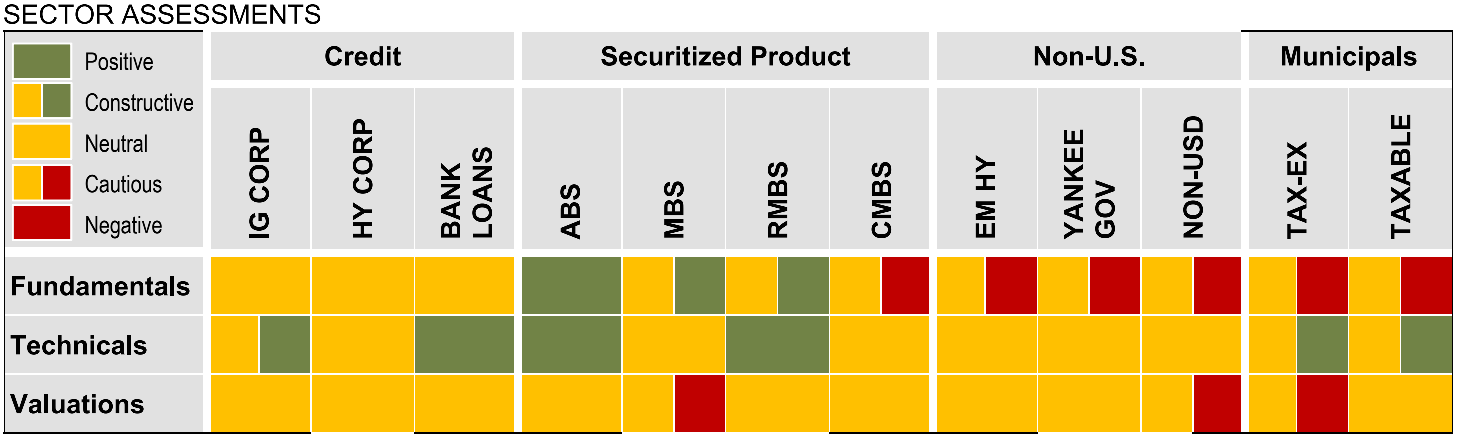
Fixed Income Sector Review

As of January 31, 2020

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- We remain long credit spreads and neutral interest rate duration as we expect both equities and Treasury rates to slowly drift higher.
- Credit spreads are only slightly tight to their long-term historical averages, while equities are rich and G-7 government bond yields are still near record lows. Excess liquidity will continue to be attracted to credit assets.
- In such a market environment, equity market support should produce a good backdrop for decent total returns in credit markets, even if Treasury yields continue to rise.
- After the strong post-COVID-19-driven recovery rally of the last nine months of 2020, the backdrop has shifted to a phase where the big capital gains from the rebound in risk assets have passed and returns in EM debt going forward should come mainly from carry; still positive, but not as dramatic.
- At the same time, we think the recovery, combined with excess liquidity in the financial system, will pull interest rates higher – albeit slowly, given remaining resource slack in the labor market and excess manufacturing capacity.

SECTOR ASSESSMENTS



Newfleet's assessments of non-government spread sectors as of January 31, 2021. 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.

Continued

SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds	• With roughly 50% of the S&P 500 reporting, earnings are beating consensus forecasts by 18%. Though metrics have deteriorated with massive debt growth and EBITDA declines, issuers have largely avoided burning cash and are sitting on elevated liquidity in early 2021 that potentially can go toward debt reduction. • Mutual fund inflows were steady at $5B/week with no evidence of a slowdown despite weak returns to start the year. Gross supply in January was $185B, slightly higher than the five-year average. Full-year supply will likely be significantly less than 2020's record-breaking $2.1T. • Spreads were essentially unchanged in the first month of the year. As rates moved higher, yields bounced slightly off the all-time low and are back to 1.86%.
High Yield Corporate Bonds	• Fourth quarter earnings growth remains strong with most sectors not exposed to COVID-19 posting double-digit growth. The upgrade to downgrade ratio, on an issuer basis, edged higher to finish January at 1.1, while the issuer-weighted default rate decreased to 5.41%. • January saw $3.6B leave the asset class, the second consecutive monthly outflow and the third in the last five months. With $55.7B issued, January's primary market activity was the most active January in history and the second busiest month on record. • The average spread widened by two basis points from +359 to +361 in January with a monthly range of +342 to +366. YTW ended the month at its highest monthly level of 4.31%, while the average dollar price finished the month at its lowest level of $104.687 after starting the year at $104.958.
Bank Loans	• The macroeconomic backdrop remains fragile, but increasingly constructive. Fourth quarter earnings are off to a good start – roughly 25% of the Russell 2000 has reported and both sales and earnings have exceeded estimates. After three straight months of no defaults, the trailing 12-month loan default rate has declined to 3.4%. • Retail inflows totaled $4.5B in January – the second straight month of inflows – alongside $8B of CLO issuance. Supply was not able to keep up with near-record levels of issuance ($95B) but that was largely for refinancings. • Loan market prices improved by over one point to 97.4, completely retracing the COVID-19 collapse. Loan spread to a 3-year life tightened to L+442 in January. While this level is inside historical long-term averages, we believe loans still have room to tighten on the back of an improving economy, increased demand if interest rates rise, market discount, LIBOR floors, and investor need for yield.
Securitized Product	• A third consumer stimulus package is currently in progress. Consumers used the majority of the previous stimulus packages to build up savings or to pay down debt. • Securitized product issuance continues to be met with robust demand. • A strong technical picture with continued improvement in consumer fundamental performance helped keep spreads steady for the month. • Historically low mortgage rates coupled with the pandemic and limited housing inventory create continued strong demand for residential real estate. • We continue to position the securitized portion of the portfolio around the U.S. consumer and single-family real estate.
Emerging Market Debt	• EM fundamentals softened a bit in January with the resurgence in COVID-19 cases around the globe. Aggregate EM PMI data for January was 52.1, down from the prior month's level of 54.1, but still at an expansionary level. • As we exit the month, case counts in many countries (including nine out of ten with the largest outbreaks) are on the decline; vaccine rollouts are accelerating led by the U.S. Our

Continued

Emerging Market Debt, cont'd	optimistic outlook is for a continued rebound in global GDP growth in the 4%-5% area in 2021, consistent with consensus expectations. • Retail investor flows have been strong in recent weeks and have helped to absorb elevated supply year to date. However, EM hard currency returns were slightly negative in January as the sector had difficulty absorbing the back-up in U.S. rates during the month. • In a world of low yields, EM bond valuations remain relatively attractive, despite being inside long-term averages. We are still in the early phases of a global economic recovery, which should support valuations.
Municipal Bonds	• The ongoing pandemic has severely impacted areas of the market, but very few issuers are expected to default. Municipalities have continued to benefit from federal stimulus, low borrowing costs, increased investment returns, an improved housing market, and access to capital as the municipal bond market has been favorable for issuers. • With the election now decided, we believe that the municipal market should benefit from further fiscal stimulus to states and local municipalities as well as the potential for major tax and regulatory changes. • Technicals remain mostly supportive for valuations. Given the amount of government stimulus, it is difficult to imagine an environment of lower taxes and therefore less demand for tax-exempt income, supporting continued demand. While recent supply of new bonds has been above average, much of this increase is a result of taxable municipal issuance.

For information about Newfleet's fixed income strategies, please contact us at 1-800-243-4361 or visit www.Virtus.com.