NEWFLEET ASSET MANAGEMENT

Fixed Income Sector Review

As of August 31, 2020

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- The rally in global risk markets continued in August with stocks higher and credit spreads tighter.

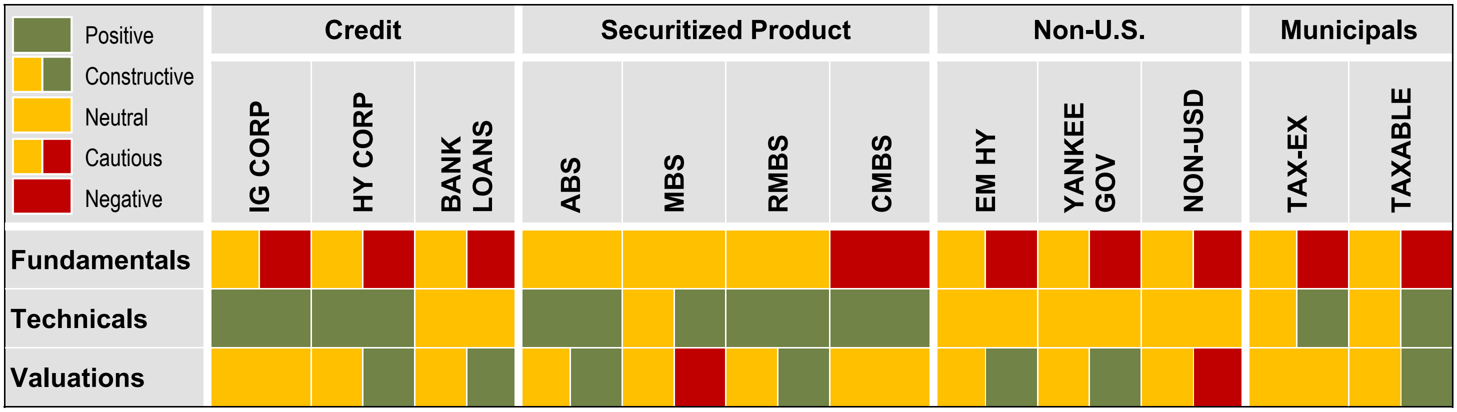
- Once again, government and central bank policies are offsetting the economic impact of the COVID pandemic. The combination of fiscal and monetary policy has restored confidence, which translates into better economic data and, in turn, supports risk asset prices.

- Credit spreads have good *relative* value – Excess liquidity has to go somewhere, equities are rich, Treasury yields are just about at all-time lows, and global debt with negative yields is back to near $17 trillion. Credit market spreads are still close to average and have above average relative value.

- We expect low and range-bound U.S. Treasury rates given suppressed aggregate demand and continued central bank bond purchases across the maturity and credit quality curves. Record M2 expansion is a risk, but not yet.

- Near-term risks include the size and scope of the CARES II act, an escalation of the trade war (verbal) as Trump tries to close the gap with Biden, and an increase in COVID case counts as students return to school and reopenings continue.

SECTOR ASSESSMENTS



🟩 Positive
🟨🟩 Constructive
🟨 Neutral
🟨🟥 Cautious
🟥 Negative

	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	🟨🟥	🟨🟥	🟨🟥	🟨	🟨	🟨	🟥	🟨🟥	🟨🟥	🟨🟥	🟨🟥	🟨🟥
Technicals	🟩	🟩	🟨	🟩	🟨🟩	🟩	🟩	🟨	🟨	🟨	🟨🟩	🟨🟩
Valuations	🟨	🟨🟩	🟨🟩	🟨🟩	🟨🟥	🟨🟩	🟨	🟨🟩	🟨🟩	🟨🟥	🟨	🟨🟩

Newfleet's assessments of non-government spread sectors as of August 31, 2020. 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.

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.

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SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds	• Earnings, while lower, were not as bad as the market expected, and we believe the overwhelming majority of the IG universe avoided burning cash. With all but one company in the S&P 500 having reported, collective revenues and earnings have fallen by 10% and 7%, respectively. Companies seemingly had the ability to hold margin despite declining sales. • August's $160B of supply (gross) was the largest on record for the month. Mutual fund inflows were steadily positive in the month, averaging $5B/week. YTD fund flows now total $110B. • Spreads ended August at 129 bps, on top of long-term averages, and have retraced 87% of the move wider YTD. Yields backed up a few basis points, but at 1.93%, they remain within 11 bps of the all-time lows achieved early in the month.
High Yield Corporate Bonds	• Fundamentals continue to be driven by exposure to virus-related economic shutdowns. The issuer-weighted upgrade to downgrade ratio decreased to 0.5 for August from 1.3 in July. The issuer-weighted default rate was 5.53% at the end of August. • August marked five straight months of inflows with over $5.3B entering the HY asset class ($43B YTD). August was the second busiest month of 2020 in the primary markets with over $54 billion of issuance. • The average spread tightened 11 basis points to close August at +477 bps, ranging from +471 bps to +503 bps during the month. The average YTW finished August at 5.34% and the average dollar price rose to $100.99 from $100.36 a month earlier.
Bank Loans	• Q2 earnings showed the deepest decline for public filers in the loan market since tracking began in 2002 (S&P/LSTA Loan Index). Results, however, exceeded very low expectations and macroeconomic data is slowly improving, which may bode well for 2H20. Nearly 40% of the loan market (by par) has been downgraded, though pace has slowed since March. • The loan market technical remains supportive driven by healing, albeit low, demand and a very light new issuance calendar and voluntary prepayments. Retail redemptions were roughly $944MM in the month and CLO issuance was the lowest this year at $3.2B. The forward calendar net of anticipated repayments remains negative. • The loan market closed August at an average price of 92.9, well above the 3/23 low of 76.2 but still below 96.7 to start the year. Loan spread to a 3-year life tightened to L+573, approaching the lifetime historical average of low/mid L+500s. The risk-adjusted income pickup relative to other risk and income asset classes provides a rationale for exposure to the space.
Securitized Product	• The market awaits a second consumer stimulus package to help unemployed consumers stay current on their debt service. • Strong issuance levels with respect to securitized product were met with robust demand. • Securitized spread product continued to tighten during the month as investors continued to search for yield. • An extremely strong technical picture with decent consumer fundamental performance sets up a positive backdrop for the month of September. • Historically low mortgage rates create continued strong demand for residential real estate. • The consumer, housing, and commercial real estate are all affected by the national shutdown. Lesser-leveraged consumers, real estate operators, and deal structures will eventually come out of the downturn.
Emerging Market Debt	• In terms of fundamentals, hard and soft data continue to indicate a broad recovery across most DM and EM markets including the U.S., Europe, and China; and within EM, in key markets like Brazil. On the virus, work on a vaccine(s) continues to progress while case counts have flared up in some parts of Europe and across some EM countries like India and Indonesia.

Continued

Emerging Market Debt, cont'd	• Retail inflows remain supportive although a heavy supply calendar for September may weigh on the technical backdrop. • EM hard currency valuations remain relatively attractive versus historical long-term average spread levels and in a low yield world. We see better value in EM high yield issues relative to EM investment grade.
Municipal Bonds	• The ongoing pandemic presents fundamental challenges to the municipal market, as municipalities are forced to manage with reduced revenue collections and growing budget shortfalls. The Federal CARES Act has provided some economic relief, with the possibility of another round of federal stimulus in the near future. • Technicals remain supportive for valuations as inflows remain positive. However, the pace of bond calls/maturities/coupon payments is expected to slow through the balance of the year and will likely fall short of new issue supply. • While recent supply of new bonds has increased, much of this increase is a result of taxable municipal issuance, mostly used to refinance outstanding tax-exempt debt. • Cheaper crossover ratios persist, relative to historical levels. Municipal yields, while low, still can look attractive on a taxable equivalent basis.

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

IMPORTANT INFORMATION

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