Fixed Income Sector Review

As of April 30, 2019

MACRO ENVIRONMENT & MARKET CONDITIONS

- The U.S. 10-year Treasury yield has fallen since the beginning of the year, ending April at 2.51%.
- Nonfarm payrolls rose 263k in April, beating expectations of 190k. March was revised down 7k to 189k and February was revised up 9k to 56k.
- Average hourly earnings growth held at 3.2% over the past year, a notch below estimates of 3.3%. The unemployment rate fell to 3.6%, the lowest since December 1969.
- GDP growth beat expectations with a 3.2% rise vs an expected 2.5%. GDP for the first quarter was the best start to a year since 2015.
- Retail sales in March were strong at 1.6% month over month, ahead of the 1% expectation. March year-over-year growth was 3.6%, the strongest number we've seen since November. The increase was provided by a rebound in building supplies, motor vehicle & parts dealers, gasoline stations, clothing stores, and miscellaneous
- The housing sector is stable. We anticipate any further appreciation to be in line with overall wage growth.
- Economic data surprises, global developments, and the anticipated pace of rate hikes will drive further changes in the shape of the yield curve.

SECTOR ASSESSMENTS

Legend: 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	Constructive	Constructive	Constructive	Constructive	Constructive	Constructive	Neutral	Neutral	Neutral	Cautious	Neutral	Neutral
Technicals	Positive	Positive	Neutral	Neutral	Neutral	Positive	Positive	Constructive	Constructive	Neutral	Positive	Neutral
Valuations	Neutral	Cautious	Neutral	Neutral	Neutral	Constructive	Neutral	Constructive	Neutral	Constructive	Cautious	Neutral

Newfleet's assessments of non-government spread sectors as of April 30, 2019. 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

Sector	Highlights
Investment Grade Corporate Bonds	• With 80% of S&P companies reporting, 1Q19 earnings growth will likely settle in the 0% area. Though well below 2018's growth rate, it is still ahead of consensus forecasts. Tepid growth is largely the result of margin compression and the fading impact of tax reform. • Technical conditions have continued to improve as light supply has been met with robust demand. • Tightening by another 8 bps in the month, the market has now recovered nearly all of its 4Q18 widening. At +111 bps, spreads are now well inside of their three-year average (+125 bps), making valuations more challenging.
High Yield Corporate Bonds	• Issuer fundamentals continue to slow but first quarter earnings season is producing reasonable results thus far. April's U.S. issuer-weighted default rate ticked up to 2.7%. However, Moody's continues to forecast the default rate to decline over the next 12 months to finish at 1.7% in April 2020. • Fund flows continued to be positive in April ($2.4B) bringing the YTD total to $15B. Gross and net issuance are down year over year with an increase in secured issuance reflecting proceeds initially targeted for the loan market. • The high yield market has reclaimed 80% of the spread widening in 4Q18. April ended with an average index price of $98.98 and a YTW of 6.12%. The market can still perform well given still-solid fundamentals, a strong technical, and lack of income alternatives globally.
Bank Loans	• An accommodative Fed, strong macroeconomic data, and an acceptable earnings season have lessened the probability of a recession this year and bode well for risk markets. The annual loan market default rate ended April at 1.01%, close to a multi-year low. • Improving institutional demand (CLOs), loan repayments via High Yield bond issuance, and light new issuance have more than offset continued retail fund redemptions ($3.2B in April, $14B YTD), resulting in a stable technical environment. • Loan prices improved to 97.5 in April. With about 68% of the market trading at 99 or higher, the market has less value than at the start of the year. With a yield to maturity of 6.5%, however, loans provide an attractive income opportunity for long-term strategic investors with the additional benefit of retaining a senior secured position in the issuer's capital structure.
Securitized Product	• Low unemployment, strong consumer confidence, and a growing economy continue to provide a positive backdrop to consumer credit, housing/residential credit, and commercial real estate. • ABS supply continues to be met with good demand as investors seek short duration and spread. • Non-agency RMBS offer value versus agency MBS on the basis of incremental carry, naturally shorter durations, and high levels of credit support within the deal structures. • CMBS have low spread beta to corporates during heightened volatility environments. CMBS technicals are in great shape as commercial real estate debt as a percentage of GDP is well below its peak, unlike corporate debt that exceeds its peak. • Stable underlying deal performance and spread give ABS and non-agency RMBS attractive metrics versus U.S. Treasuries and other short duration alternatives.
Emerging Markets Hard Currency Debt	• EM debt moved sideways in the month as the expected slowdown in price appreciation materialized after the early first quarter run up. • EM's 6.22% YTM is attractive within the global macro context of stable U.S. Treasury yields, <1% yields in much of developed Europe, and negative yields in Japan. The dovish Fed and stable equity markets bolster the opportunity to find pockets of value in EM. • Our positive intermediate-term view on EM debt is supported by a continued strong EM country growth differential of ~2.8% above DM country growth. We see renewed Fed dovishness, with the ECB following, as the primary macro driver of performance in terms of technical buying support as well as a stimulus to growth.

Continue

Non-U.S. Dollar Local Market Debt	• Our exposure to local market EM debt is minimal (<1%) given our strong USD view, even in the face of oil price strength that typically correlates with a weaker dollar. Despite an acceptable macro backdrop, the >25% rise in the S&P 500 since 12/24/18 is not sustainable given average valuations at best, single-digit earnings growth, and moderating global economic growth. • Given good EM fundamentals, we will selectively add exposure in situations that offer incremental yield and attractive expected risk-adjusted returns -- but we're not there yet.
Municipal Bonds	• Credit fundamentals have been fairly benign, though underfunded pensions are still a concern. The impact of climate change is getting more attention as an underestimated risk that local economies will have to face, particularly in areas prone to natural disasters. • Technicals will likely continue to be supportive as strong demand for tax-exempt income should offset any increases in issuance, especially if state and local governments begin to fund long-delayed projects. Strong demand has pushed municipal bond flows to the strongest start to a year since the data series began in 1992. • Valuations of municipal bonds appear rich on a relative basis but are still attractive when considering their taxable equivalent.

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