Post-U.S. Election Fixed Income Review & Outlook Call
with Newfleet Asset Management
Conducted November 10, 2016
Transcript edited for clarity

Tom Franco: *Thank you and good afternoon everyone. I'm Tom Franco, divisional sales manager at Virtus Investment Partners and it's my pleasure to welcome you to our call today. Joining me are Joe Terranova and two investment professionals from Newfleet Asset Management, David Albrycht and Steve Hooker. The global bond market has evolved significantly and understanding both opportunity and risk is essential to implementing a strong fixed income program. Newfleet is a pioneer in enhanced multi-sector investing. The core team implementing the firm's process has worked together for an average of 20 years, and with a purview that is nearly double the size of the traditional core bond market, Newfleet is in an enviable position to help investors leverage the opportunities in today's market.*

Joe, whom many of you will recognize as an ensemble member of CNBC's "Halftime" program, is Virtus's chief market strategist. David Albrycht is president and chief investment officer of Newfleet Asset Management and serves as portfolio manager of numerous strategies managed by Newfleet, including the flagship Virtus Multi-Sector Short Term Bond Fund. David has over 30 years of investment experience and has successfully driven the firm's multi-sector approach since 1993. Steve Hooker is head of the foreign team and sector head for emerging markets at Newfleet. Steve is also a co-portfolio manager of the Virtus Emerging Markets Debt Fund and has been a part of the Newfleet team for 17 years.

Today, we'll begin with the election's impact on global markets, and then turn to David and Steve to provide portfolio-level insights. Joe, I'll begin with you to discuss the U.S. election results; we're interested in your insights. Please provide some thoughts around the impact of the Republican victory on the markets, both in the near term and in the new year.

Joe Terranova: Clearly markets were surprised by the outcome of Tuesday's election. I firmly believe that what the market has done in the 48 hours or so since Americans went to the polls and voted is — and the quote that I'm going to share with you comes directly from Nelson Peltz who shared it with us on CNBC the other day —"The mainstream media took Donald Trump literally and didn't take him seriously." I think what voters did on Tuesday, and what the markets have done since the 1000-point decline, is that they are taking Donald Trump seriously, but not taking him literally. And that's why you're seeing the positive impact on select asset classes. That's why you're seeing the appreciative response in the S&P 500® because the markets are taking him seriously, not literally. They don't necessarily believe that the man they saw in the primaries and in the campaign is going to be the president that's going to enact some of those policies.

So we're focusing right now on growth. We're focusing on the ability to stimulate the economy, and that's important because this was an election about economic populism in this country. This was really the result of an eight-year Great Recession that might have ended when you look at it in terms of paper asset pricing. I don't know we could make the argument that the Great Recession has ended for everyone in this country.

Lastly, the last couple of years has been about central banks supporting asset pricing through monetary policy. But in the last couple of years, Mario Draghi, Janet Yellen, and other central bankers have messaged fiscal policy makers and said, hey, we need to hand the baton in the recovery, if there is to be a recovery, off to someone. The next leg of growth has to come from fiscal policy. One of the things that I said on Monday at CNBC was that while we all expected Secretary Clinton to win the White House and have a Republican

House, we weren't sure which way the Senate was going to go, and markets seemed to be comfortable with that, because they like gridlock. But I don't know if gridlock is what this country needs right now. This country needs fiscal policy because monetary policy is not going to be there in either the next crisis or in the moment of economic growth. And that's what we need right now, not gridlock but fiscal policy. That's what we've got so you're seeing it represented in the markets. And that's obviously a positive thing, based on where we were at 9:00 o'clock Eastern Time on Tuesday.

Tom Franco: *Joe, as a follow-up, do you see the potential for a move away from globalization toward a more nationalistic approach?*

Joe Terranova: That's a more difficult question. That's not something that's going to be answered in the here and now. We're going to be talking about taxes, about what could potentially replace the Affordable Care Act, and about Common Core. I think those are the things in the here and now. Yes, there seems to be a global sentiment, absolutely, towards a nationalistic approach and away from globalization. But I think over time we are clearly a divided country. We are clearly divided globally. I think over time we will grow to understand what the impact is and how far we do make the move away from globalization and more towards nationalization, and what the impact would be on asset pricing.

With that in mind, I'd like to ask Steve if potentially over time we were to see this nationalistic approach in the markets, how would the fixed income market react? Because I think the fixed income markets are most sensitive to that change in global economic policy, in particular when you have the rest of the world operating in negative rates, and here domestically we're seeing a 50 basis point rise in the U.S. 10-year Treasury in the last 72 hours and a Federal Reserve that's going to normalize rates another 25 basis points. So Steve, how is the fixed income world going to treat this move towards nationalism, away from globalization?

Steve Hooker: Yes, thanks, Joe. It's certainly a topic on everybody's mind, and I would say that's largely because of the political developments we've seen over the last couple of years, more recently here in the U.S., and even more so in Europe as well. The developments are relatively new so we're going to have to watch how it plays out very carefully. But I would say most importantly is to really watch where the rhetoric potentially differs from the policy. Where actual policy is being implemented, does that confirm this view that we may be moving towards a more nationalistic approach versus globalization? It's early as you highlight. We're going to have to watch and see what actual policies are implemented. Clearly evolution in global trade has the potential to have meaningful impacts on the likes of inflation, commodity price growth, and trends in global credit quality. But I actually think that plays well toward our multi-sector approach to the market, and having this broad look at the markets, being able to take advantage of all the sectors wherever those developments lead.

Joe Terranova: Dave, I'd like to ask you about president-elect Trump's policies that he's suggested. The reality of what may come remains to be seen. But clearly you're looking at a market right now that's looking at growth possibilities. On the other side of growth is the risk of inflation – something the Federal Reserve has been chasing the last couple of years, and we're finally seeing it talked about in the investment banking community. How do you view inflationary pressures? Do you see the conditions appearing? And if so how would Newfleet adjust the portfolio positioning as it currently exists in that type of environment?

David Albrycht: From what we've heard, the newly elected president's policies will be growth-oriented, and therefore have the potential to increase inflation, but I think more importantly, to cause a backup in rates, and as you had mentioned, Joe, we've already seen the yield on the 10-year Treasury go from the 1.70's to 2.11%. We've seen the 30-year Treasury back up 40 basis points to 2.92% — that's down almost 5-1/2 points. The Trump candidacy we believe means united government, no gridlock, it's easier to get policies through. And as you mentioned it's going to be in the form of fiscal stimulus and infrastructure spending, which means an increased supply of Treasuries….Tax cuts, both on an individual basis and a corporate basis….A repatriation tax holiday to have corporations bring their cash back to the U.S….A reduction in regulated expectations: Dodd-Frank, Obamacare, and trade….and then as you mentioned, monetary policy has hit its limit. Clearly, any type of fiscal stimulus is going to be welcomed. The central bank Ponzi scheme may be over.

Regarding our portfolio, the adjustments we've made, even prior to the elections, we were already favorable on floating rate loans, especially with the three-month LIBOR at 90 basis points. We're adding loans, as they benefit in a rising rate environment. Secondly, we'll continue to add credit, which obviously performs extremely well if there is growth with a steepening curve. Typically, spreads contract faster than rates back up. And then our focus, which is duration management, is short to the intermediate part of the curve. And we'll take duration in credit, which we think is the best way to play a steepening yield curve with potential growth increasing in the future.

Joe Terranova: Steve, let me ask you a question. Dave highlights yield, and clearly there has been a search for yield the last couple of years. Investors have been able to successfully find that search for yield in the emerging markets. In an environment where we're seeing rates rising domestically here in the U.S., consequently on the other side of that, there's a currency effect where the U.S. dollar will rally, and you'll see emerging market currencies cheapen, which leads to capital outflows. How should be thinking about emerging market debt as we look forward to 2017? It's been a great place for yield; do you think it continues on a valuation basis? What's your expectation?

Steve Hooker: Yes, it's been a good year for emerging market (EM) debt. But there's been a combination of both "push and pull" factors. The push factors have been the result of low core market yields everywhere else in the world. But there have also been pull factors too, in that we think that fundamentally EM has started to show some signs of green shoots emerging. Growth looks like it finally bottoms in 2016 and should improve in 2017. Obviously having a supportive global backdrop is helpful, with commodity prices being in a sweet spot. Right now EM is certainly adjusting to what's happened on the electoral front.

I actually see valuations which I would have called before Tuesday as fair, having cheapened a little bit as again the market's trying to adjust to what the new electoral situation means for the asset class. And as I look at it at the country level, I think there are things to be done in both U.S. dollar denominated debt. I think that there's the prospect for certain currencies to do well also. But it's very country-specific. I think investors need to focus on country-level fundamentals and pay attention to relative valuations. It may be a touch early given the evidence we see from a political standpoint here in the U.S., but, it looks cheap to me and is something that we're taking a hard look at.

Joe Terranova: Steve, you mention country fundamentals. Tom asked me at the beginning of this conversation about a move away from globalization towards more of a nationalistic approach. We're all very tired of this campaign that we just went through here in the United States. And clearly, although we have a winner – and many have said neither candidate was electable – someone won and that is president-elect Trump. "None of the above" as I've suggested probably was the best candidate. So we're going to turn the page into 2017 and look towards Europe and there's going to be two elections. One in France I believe in April and another in September in Germany. Steve, how as investors do we incorporate those elections into our strategic plan for 2017? And going back to Tom's question, do you think that adds credibility and advances this move away from globalization towards a nationalistic approach and the impact potentially it could have on a portfolio?

Steve Hooker: That's a great point. The electoral calendar next year starts to look pretty busy. It calms down a bit in emerging markets, but in Europe in particular, as you correctly point out, there's some important elections going on. And I would even argue that the Italian referendum in the beginning of December is also an important one to watch because we have seen this rise in the anti-establishment sentiment, certainly starting in Europe and move here to the U.S. and arguably some in Asia as well. In the past, that has impacted primarily more of the peripheral countries in Europe. Next year we get to see how it potentially impacts some of the core countries as you highlighted, France and then Germany. We're going to have to watch and see – does the success of Trump's campaign here in the U.S. lead to successes and more gains of the anti-establishment parties in Europe? And what does that mean for the European experiment? It's a bit early to say. But I know there are nationalistic parties that have made gains in the polls. April for France and September for Germany are a long ways away. And we'll have to see how things progress. But it should be, and will be, on everybody's radar over the next several months for sure.

Joe Terranova: Yes, and we have the Netherlands in March, and then Norway in September. You talked about the December referendum in Italy – briefly expand your thoughts on that.

Steve Hooker: That should have been a fairly easy referendum. It's a constitutional referendum that's supposed to make governing in Italy simpler and cleaner. But the current prime minister tied it to his political fate and to his government. And, of course, the opposition parties in Italy grabbed hold of that and have used it as a potential referendum on his government, rather than simply a referendum on the constitution. And given the rise in anti-establishment rhetoric and sentiment, this has caused his administration to be in jeopardy. Now, of course, it's not binding that he resign, but he has pledged to do so if the referendum fails. I hate to cite polls, because almost every poll in every election that I've looked at in the last 12 to 18 months has been wrong, but the polls on the Italian referendum suggest that that may not go his way. So we're going to have to see if he follows through on his resignation. Again, what does that mean for Europe?

Joe Terranova: Dave, could we talk about the high yield market. It's been a volatile year, a strong year in terms of performance. Coming into the year, no one wanted to touch high yield, then it had strong performance. I've heard a lot of conversation in the last six to eight weeks about high yield being used as an equity replacement. But I think you would agree with me, much of the strong performance in high yield came in the beginning of the year as energy prices recovered. Now what you're witnessing quarter to date is energy prices down as much as 7%. I think it's very surprising to everyone that energy prices have not lifted here along with the S&P 500® and other global equity prices since president-elect Trump was declared on Tuesday evening. Are you concerned? And could you walk us through the high yield market for the remainder of the year and the beginning of next year about energy prices retreating? Could we see a shift to underperformance for high yield?

David Albrycht: Yes, first of all, Joe, you're exactly right. Energy coming into the year by February was down about 5%. Oil hit its low, then turned the corner and we were up as much as 16.5% through the end of October. Big drivers of the high yield market were energy, number one. Energy was down 23% last year; and through the end of October; was up 31%. Metals & mining were off 24% last year, and was up 42% through the end of October. And then chemicals, were down almost 30%, and was up almost 40%. So that 20%, if you take energy being 14%, metals & mining and chemicals really drove a lot of the high yield market. Coming into October, just as you mentioned, oil prices got up into the low $50's and then we saw a retracement. It was a little more than 7% and we came to the conclusion that a lot of the names that had run dramatically were fully valued and had gotten ahead of themselves. So, that contributed to the weakness that we saw, then also uncertainty about the upcoming election. We thought it would be very prudent to start to rotate out of high yield into bank loans. Just looking at the differential between the two, back in February where high yield was a screaming buy, you were picking 300 to go from bank loans to high yield. And now it's back into about 1%, which says obviously you want to start reallocating to bank loans. And we've seen 13 weeks of flows after almost 24 months of outflows. So we do like loans versus high yield.

As far as high yield is concerned, there are some clear winners with the recent elections: pharmaceuticals, banks, brokers, finance, energy names, private prisons, and some select aerospace defense names. Then I would also say that the big sells based on the Trump election: hospitals, longer duration lower coupon with this steepening of the curve. As far as we're concerned, the energy positioning within our high yield holdings, we have an up-in-quality bias. We really look at companies that have strong balance sheets.

What we think are the best assets, the best basins, low-cost producers, good liquidity – those that over a two to three year period could actually withstand oil in the $30 to $40 a barrel range; Continental Resources and Antero. I think it's less about trying to predict the recovery in oil but rather investing in companies that are going to be survivors in just about any type of oil market.

In general from an industry perspective, we favor E&P midstream and only the highest quality, best positioned oil service credits like a Transocean or a Parker Drilling. And then I would say at the end of the year and going into next year, the best opportunities outside of the energy space that we like in high yield would be consumer-driven industries such as gaming, airline double ETCs (equipment trust certificates); homebuilders, like a Toll Brothers or a TRI Pointe; building materials, such as a Standard Industries or Boise Cascade.

So there's still value. It's a bifurcated market. Yields right now in the BofA Merrill Lynch U.S. High Yield Master II Index are about 6.52%, the Bloomberg Barclays U.S. High Yield Index is right around 6.50%. You've got to really pick the right credits. Credit selection has never been more important. Rising rates could ultimately impact some of the double-B credits which are much more interest-rate sensitive. So credit selection's never been more important. I'll go back to what I said originally, duration management is a concern. And from a liquidity perspective, size matters.

Joe Terranova: How about liquidity, Dave, as an overall concern as it presented itself at the beginning of the year? That was such a conversation back then. I think of it, largely, was based on what happened with the August 2015 selloff on that Monday in the ETF market. And a lot of it involved high yield and investment grade ETFs. But is liquidity a concern at this point as it was at the beginning of the year?

David Albrycht: Well it's much less than it was back then. Any time you have an event or a turmoil in the market, it's a lot less liquid where bids go away, or if there are 10 million bonds, traders are willing to maybe take two and work the other eight. So it becomes much less liquid. In an extreme environment, there may be no bids. There's always liquidity at some price; it may not be a price that you like. But, as far as we're concerned, something we've done not only for the last two to three years but over the last 20 years, is factor in liquidity of the underlying issue that we're buying into our analysis.Having a multi-sector process, we're able to rotate among sectors and actually find something that's liquid. It may not be the high yield bond you want to sell; it may be an asset-backed or an agency mortgage-backed, to provide liquidity for the portfolio. And that's the advantage of not being in a dedicated strategy when the high yield market or loan market becomes extremely illiquid.

Also I would say that our size allows us a meaningful advantage. Size does matter. Bank loans trade in $2 to 5 million blocks; high yield will get done in $10 to 15 million blocks. When there's an illiquid market, it's very difficult to get sizable trades done. So from that standpoint I think we're in a really good position.

And then you have to be proactive. If you have a deteriorating credit that everybody else is trying to sell, you've got to dig down deep for relative value and decide whether it's fully valued, overvalued, or you're in favor of buying a cheap bond, whatever your strategy may be.

So it goes back to having a proven process for the last 20-plus years, how we evaluate credits and liquidity is definitely a concern. But I think at our size it bodes very well for our strategy.

Joe Terranova: I'd like to get some final thoughts as it relates to portfolios at Newfleet. Could you share with us through October what has been the key detractor or contributor to portfolio performance?

David Albrycht: Yes, we've had great performance through October. And I think it really goes to great issue selection – such as asset-backed securities, jumbo mortgages, investment grade corporate bonds, and emerging market high yield bonds. You know, our underweights in U.S. Treasuries and agencies have also benefited us pretty dramatically.

Corporate high yield has been a very positive contributor. We got very engaged, moved the multi-sector products to an overweight in the high yield sector back in February, and we got aggressive on what we were buying in the energy space. But we also "barbelled" that with some quality, investment grade companies that were able to issue equity, companies that we thought would be around, like an Anadarko, ExxonMobil, and "barbelled" those with QEP Resources, some more aggressive energy names.

Corporate high quality bonds have had record supply. But you've also had great demand because of negative yields around the world and indexes in the U.S. and Europe that were identical four years ago yielding 3.2%. But now you look at the high yield corporate bond indices, and the U.S. is yielding 2.8% while the European index is yielding about 0.75%.

If I'm a bank and insurance company and pension fund, I'm definitely coming to buy U.S. dollar assets and I'm definitely going to have demand for U.S. investment grade. And as far as emerging markets high yield, Steve mentioned it's been relatively selective but…

Steve Hooker: Yes, there's been a large divergence in performance at the country level. Getting your credit calls right have been key. But with the push and pull factors and the global search for yield, the asset class has certainly benefited. Countries specifically – Argentina, Venezuela – surprisingly, given what's happening there but the assets have performed incredibly strongly – and Brazil. There have been tremendous gains out of emerging markets this year.

David Albrycht: I throw on top of that some of our non-dollar picks early in the year worked out very well. The dollar had moved quite a bit coming in through the rate increase of last December. We did a lot of large-cap currencies: Russia, Indonesia, Brazil, South Africa, all of which have done very, very well.

I will also throw out detractors, Joe. If I would point to anything, even though we've had great performance, we could have been a little more aggressive in credit quality and dipped down to the triple C's. You know distressed debt was up almost 65%.The only thing I can think of that we really missed was not getting overly aggressive. We were moderately aggressive, and I think that's fine for some of our portfolios but we could have been a little more aggressive for our intermediate-duration products.

Tom Franco: Steve, can you comment on how Newfleet's multi-sector strategies fit within the fixed income allocation of an investment portfolio?

Steve Hooker: Sure. We recognize that risk is not a one-size-fits-all approach, and that individual investors have varying degrees of risk tolerance. We have a suite of strategies that takes advantage of that, and dials up or down risk depending on what the individual investor's risk tolerances are. So people who are comfortable with our approach to the markets, just understand that there is a strategy that would fit based on the individual investor's risk tolerance.

Tom Franco: Thank you, Steve, and thanks to everyone for joining our call today. Newfleet delivers a robust suite of both diversified and targeted offerings, allowing for customized solutions for investors' various fixed income needs. At Virtus, we're committed to driving better client outcomes, and believe that insightful market perspective is key to helping investors meet their objectives.

Virtus Low Duration Income Fund (A: HIMZX, I: HIBIX)
Virtus Multi-Sector Intermediate Bond Fund (A: NAMFX, I: VMFIX)
Virtus Multi-Sector Short Term Bond Fund (A: NARAX, I: PIMSX)

Top 10 Holdings, as of 9/30/16

Virtus Low Duration Income Fund

Security	*% Total*
U.S. Treasury Note, 0.75% 12/31/2017	4.83
U.S. Treasury Note, 1.38% 04/30/2020	3.61
iShares iBoxx $ Investment Grade Corporate Bond ETF	1.83
U.S. Treasury Note, 1.63% 02/15/2026	1.69
FNMA, 2.5%	1.66
FNMA, 3%	1.38
FNMA, 2.5%	1.20
FNMA, 3%	0.79
FNMA, 3%	0.78
UAL Pass-Through-Trust, 6.64% 07/02/2022	0.70
Total:	***18.47***

Virtus Multi-Sector Intermediate Bond Fund

Security	*% Total*
Virtus Credit Opportunities Fund Class R6	3.06
FNMA, 3.5%	0.74
CarFinance Capital Auto Trust, 3.58% 06/15/2021	0.72
FNMA, 3%	0.72
United Mexican States, 6.5% 06/09/2022	0.68
Sunoco LP (Sunoco Finance Corp.), 6.38% 04/01/2023	0.61
Argentine Republic, 8.28% 12/31/2033	0.60
Republic of Turkey, 4.88% 10/09/2026	0.58
Republic of Indonesia, 8.38% 09/15/2026	0.54
FNMA, 3%	0.53
Total:	***8.79***

Virtus Multi-Sector Short Term Bond Fund

Security	*% Total*
Virtus Credit Opportunities Fund Class R6	0.96
U.S. Treasury Note, 1.25% 03/31/2021	0.86
FNMA, 3%	0.79
America West Airlines Pass-Through-Trust, 7.1% 04/02/2021	0.62
FNMA, 2.5%	0.58
FNMA, 3%	0.51
Wells Fargo (Wachovia Bank) Commercial Mortgage Trust, 5.59%	0.48
Republic of Indonesia, 8.38% 09/15/2026	0.45
U-Haul S Fleet LLC, 4.9% 10/25/2023	0.45
Republic of Turkey, 6.25% 09/26/2022	0.39
Total:	***6.08***

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Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a security may fail to make payments in a timely manner. Values of debt securities may rise and fall in response to changes in interest rates. This risk may be enhanced with longer-term maturities.

High Yield-High Risk Fixed Income Securities: There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities.

ABS/MBS: Changes in interest rates can cause both extension and prepayment risks for asset and mortgage-backed securities. These securities are also subject to risks associated with the repayment of underlying collateral.

Bank Loans: There may be no ready market for loan participation interests. The fund may have to sell the interests at a substantial discount. Such interests are subject to the credit risk of the underlying corporate borrower.

Leverage: When a fund leverages its portfolio, the value of its shares may be more volatile and all other risks may be compounded.

Foreign & Emerging: Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk.

Prospectus: For additional information on risks, please see the fund's prospectus.

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