Intermediate Taxable Quarterly Commentary

Fourth Quarter 2017

Macro Overview

Equity markets rode yet another strong earnings season and tax reform anticipation higher during the quarter, capping off an already solid year. Unemployment continued to decline, and labor market slack diminished further, but a lack of underlying inflation and subdued wage growth kept intermediate and longer-term yields in check. For the quarter, the US Treasury curve saw significant flattening with front-end rates rising as much as 40 basis points (driven by Fed policy) while the long bond was lower in yield by 13 basis points (lack of inflation). Jerome Powell was nominated to be the next Federal Reserve Chair, with the change largely interpreted as a continuation of dovish leaning leadership at the central bank. Powell, who became a FOMC member in 2012, has never dissented on a vote since he took office.

- The ECB modestly tightened monetary policy by reducing asset purchases but remains accommodative overall. UST yields, even at current levels, remain attractive relative to other sovereign debt.
- The FOMC continues to forecast 3 hikes in ’18, with low inflation, which the committee still views as transitory, rising near their 2% target.
- Balance sheet reduction will be slow and deliberate and in the near-term will not put significant pressure on intermediate and longer yields.
- Looking ahead we see two key questions for 2018. Can tax reform help perpetuate the already mature bull market in equities, and will the Fed be able to continue down its forecasted path of deliberate rate normalization in the face of modest price pressures?

Market Dynamics

The Bloomberg Barclays Aggregate Corporate Spread Index stood at just +93 basis points to end the quarter, last reaching that mark in June ’07. The late year passage of tax reform, accommodative global monetary policy, and sound domestic fundamentals accelerated interest in the sector. Looking into 2018, we see an environment where this trend could certainly persist. While there may be less room for further credit outperformance based on current levels, improved GDP growth and meaningful tax benefits for most investment-grade issuers should help keep spreads suppressed in the near to medium-term. The risk does remain that a reversal of recent equity market strength could push spreads wider in a flight to quality trade. While not of immediate concern, we are mindful of potential catalysts in the form of a very uncertain political landscape at home and abroad and a Federal Reserve that has already helped flatten the U.S. Treasury yield curve to levels not seen in more than a decade.

Composite Characteristics

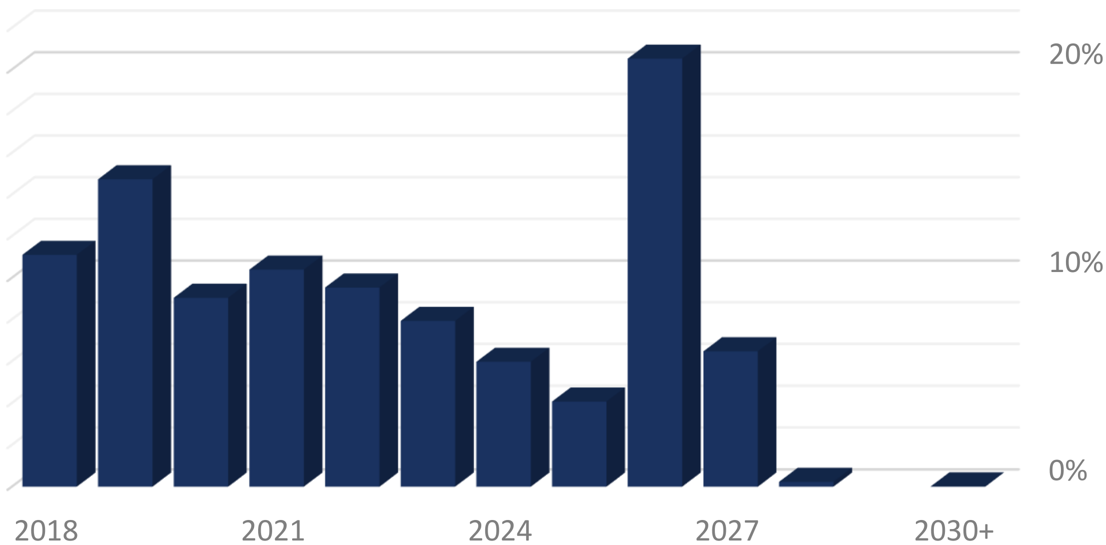
Duration: 3.94 yrs

Yield-to-Worst: 2.45%

Yield-to-Maturity: 2.46%

Maturity: 4.70 yrs

Maturity Profile



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Performance Notes

Over the quarter the strategy's emphasis on higher quality corporate credit continued to benefit from a constructive risk environment and incremental yield over and above the benchmark. Duration and yield curve positioning remained neutral as uncertainty surrounding the pace of monetary policy changes in the US and Europe was weighed against still modest price pressures. While spread levels have compressed over the last several years we continue to view the current corporate credit environment as sound, with revenue growth trends helping promote balance sheet stability. As such, we remain focused on judiciously selecting higher quality credits from larger, well-capitalized corporations that offer incremental income versus U.S. Government securities but with historically less volatility than other lower quality investments.

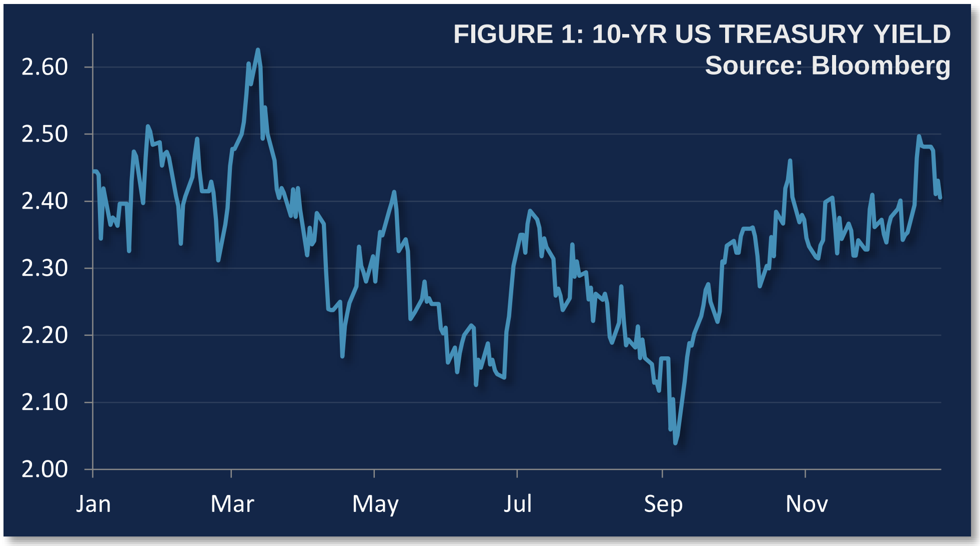

FIGURE 1: 10-YR US TREASURY YIELD
Source: Bloomberg

"While there may be less room for further outperformance based on current levels…

spreads on most investment-grade issuers should remain suppressed

…in the near to medium term given the favorable outlooks for both GDP growth and the benefits of the new tax plan."

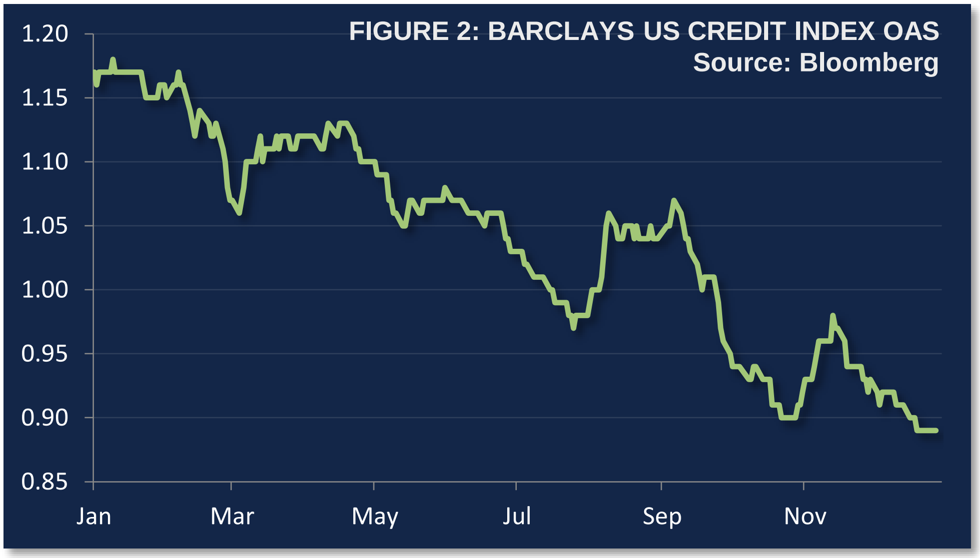

FIGURE 2: BARCLAYS US CREDIT INDEX OAS
Source: Bloomberg

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