JUNE 2020

Relative Value Approach to Fixed Income Investing

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

Newfleet is a fixed income specialist and a multi-sector manager that actively rotates across 14 sectors of the investable bond universe. Identifying relative value is the foundation of Newfleet's process, applied across all multi-sector and dedicated strategies at the sector, industry, and individual security levels. An integrated team of experienced sector specialists and analysts carry out disciplined and rigorous credit research to find relative value opportunities. The approach is both qualitative and quantitative. Years of collective experience provide an overlay of sound judgment on systematic processes.

INTRODUCTION

This paper describes the framework for the relative value approach as it applies to Newfleet's multi-sector strategies. We believe that active sector rotation and superior security selection, both driven by relative value, are the most effective means to achieve excess returns in the fixed income market.

We focus here on the three key steps of our relative value approach: (i) evaluate the attractiveness of each sector, (ii) compare sectors by risk category, and (iii) allocate sectors within individual portfolios.

To demonstrate the depth of our approach, an Appendix includes detail on the fundamental analysis done to identify relative value within the various sectors. We also describe the underlying systematic processes, including risk management, in implementing our approach.

EVALUATE – RELATIVE VALUE ASSESSMENT OF THE SECTORS

Relative value drives sector analysis and allocation. Over a full market cycle, we expect two-thirds of performance attribution to come from sector allocation, so we spend considerable time "getting the sector decision right." The sidebar shows the 14 sectors (asset classes) in which Newfleet invests. While we rotate across the 14, our focus is less on developed country government and government-related securities and more on spread sectors – the source of our added value (we classify emerging market sovereign debt as a spread sector). We note, however, that our sector allocation decisions, while framed by our views on valuation, will also reflect the risk profile of any given assignment.

The determination of relative value on a sector basis is a function of fundamentals, valuations, and technical factors. Fundamental analysis is comprehensive, combining quantitative and qualitative observations. This analysis varies by sector and requires substantial research (see Appendix for detail on our research process). Valuations tend to be more quantitative and thus unbiased. Sector specialists compare current yield/spreads to both short- and long-term historical ranges, adjusting for any changes to sector characteristics such as duration and quality. Technical factors must also be considered as supply and demand conditions (e.g., issuance and mutual fund flows) tend to have greater near-term significance.

On a monthly basis, a formal Sector Review meeting takes place at which the sector specialists share their sector assessments with the entire Newfleet team based on their daily research activities. These assessments are preceded by a presentation and discussion of Newfleet's Macro View that stems from ongoing conversations and bi-weekly meetings led by Newfleet's CIO. This discussion ensures that sector analysis and allocation decisions are made within the framework of a well-developed macro overview. The sector specialists then provide their assessment in summary form. The assessment of each sector considers relative value from multiple angles. For example, relative value is observed across credit quality

SECTORS COVERED

Newfleet invests across the 14 sectors (asset classes) of the investable bond universe. These sectors are the eight within the Bloomberg Barclays U.S. Aggregate Bond Index and six others (italicized) in which we have developed an expertise.

Government

- U.S. Treasuries
- Agency Securities

Corporate

- Investment Grade
- *High Yield*
- *High Yield Bank Loans*

Securitized

- Commercial Mortgage-Backed Securities (CMBS)
- Asset-Backed Securities (ABS)
- Agency Mortgage-Backed Securities (MBS)
- *Residential Mortgage-Backed Securities (RMBS)*

Municipal

- Taxable
- *Tax-Exempt*

Foreign

- Yankees/Foreign Corporates
- *Emerging Markets*
- *Non-U.S. Dollar*

and maturity tiers, by industry, and by near-term and longer-term historical levels. In our evaluation of emerging markets (EM) debt, our sector specialists look at relative value across sovereign and quasi-sovereign, corporate, and local currency-denominated issues.

COMPARE – RELATIVE VALUE ACROSS SECTORS BY RISK CATEGORY

After each sector has been thoroughly analyzed and discussed, Newfleet looks across sectors to compare relative value. At this stage of the process, Newfleet adds another layer of analysis by looking at the sectors in terms of five risk buckets (Exhibit 1). Not only does this exercise reveal how much of the portfolio is in any one broad risk category, it also helps in managing exposures within a category. That is, the sectors within each bucket can be substitutes for each other (or allocations can be modified) depending on relative attractiveness vis-a-vis market dynamics and/or their underlying valuations, fundamentals, and technicals. We then compare our findings from this level of analysis, which is essentially portfolio analysis from a different vantage point, with our sector views to move closer to the individual issue selection phase of our process.

Examples of our analytical process:

- Once we determine our level of exposure to Below Investment Grade (BIG) Credit Risk, we determine which sectors offer the best value based on the initial individual assessment of fundamentals, technicals, and valuations. The decision regarding bank loans versus corporate high yield, for example, will also take into consideration the spread between the two sectors as well as the shorter duration and negative convexity that are characteristic of bank loans.
- In terms of BIG, we will also compare a BB rated EM country under consideration with a similarly rated U.S. corporate or securitized product to determine whether it is worthwhile to invest in that particular country from a risk/return perspective. Speaking with other sector specialists helps the EM team to look beyond their role as economists analyzing economic fundamentals of a country to other sectors that have much different dynamics driving their credit risk changes.
- Note that ABS, CMBS, and RMBS straddle the Credit Risk and Securitized Risk buckets. ABS royalty fees, for example, warrant analysis as a securitized product but also require traditional credit analysis in terms of the underlying franchisor.
- In evaluating our exposure to the Credit Risk category, we routinely compare corporate high quality to ABS/CMBS due to the fact that the majority of the ratings of the latter are investment grade.
- Evaluating the Securitized Risk category involves an additional dimension of deal structure analysis (e.g., cash flow priorities and relative value within the capital stack). There are times when we may find the underlying collateral attractive, but not the deal structure.
- In the Interest Rate Risk category, one instance where tax-exempt securities can add value to a multi-sector portfolio is as a crossover trade versus U.S. Treasuries. The Municipal/Treasury ratio, which compares the yield of AAA-rated municipals to equivalent-maturity U.S. Treasuries, indicates the relative attractiveness of the two investments. A ratio that exceeds 100% (well above its historical average) indicates that municipals are potentially an attractive alternative to U.S. Treasuries. The Municipal/Treasury ratio typically is driven by technical factors of supply and demand such as mutual fund flows, issuance, and movements in U.S. Treasury rates.

The dynamic nature of our multi-sector process allows us the ability to re-allocate assets across different sectors and rating tiers as our team assesses risk and reward on a daily basis.

EXHIBIT 1: RELATIVE VALUE ANALYSIS BY DOMINANT RISK CATEGORY

BIG Credit Risk	Credit Risk	Securitized Risk	Interest Rate Risk	Currency Risk
Corporate High Yield	Corporate High Quality	Mortgage-Backed Securities	Agency Debentures	Non-U.S Dollar
Bank Loans	Asset-Backed Securities ↔	Asset-Backed Securities	U.S. Treasuries	
Emerging Markets High Yield	Commercial MBS ↔	Commercial MBS	Municipals	
	Residential MBS ↔	Residential MBS		
	Yankee High Quality			
	Taxable Municipals			

ALLOCATE – OPTIMUM SECTOR POSITIONING IN PORTFOLIOS

After the team considers the information from Sector Review – the culmination of Evaluate and Compare – the team then meets to determine target allocation in its Sector Allocation meeting. This meeting is an opportunity for the sector specialists to make the case for their respective sector's recommended target allocation. One outcome of the meeting is the "heat map" in Exhibit 2. Looking at investment grade corporates, for example, the cautious view on fundamentals reflects expectations of dismal second quarter earnings based on COVID-19 impacts. The constructive assessment of technicals is based on a continuation of record issuance and a surge in mutual fund inflows. Valuations had moved dramatically tighter early in June and then moved sideways as investors weighed the prospects of a second wave of the coronavirus.

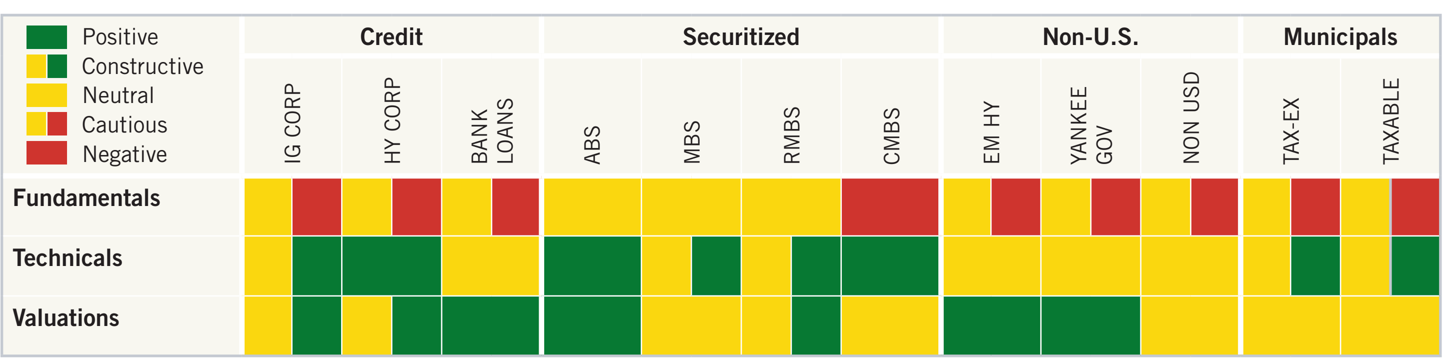
Let's consider several examples (as of this writing) where we have identified relative value: subprime auto within ABS, corporate investment grade, corporate high yield, and EM debt.

- Subprime auto represents value both within the ABS space and relative to shorter-duration counterparts in other sectors. While subprime auto may conjure up notions of a risky investment, Newfleet not only is favorable on the asset class for the reasons stated below, but has been a regular investor within the space for many years. First, as a shorter duration asset (two to four years), subprime auto deals provide an attractive spread versus a risk-free comparable U.S. Treasury. Second, deal structures are extremely simple and are defined as sequential pay deal structures. In other words, principal amortizes down the senior-most bond in the structures and follows a sequential path. As an aside, Newfleet has tended to focus on the mezzanine part of the capital structure (single A and BBB). All else equal, as the higher tranches within the capital structure amortize down, Newfleet's invested position benefits from this deleveraging aspect. In other words, the mezzanine bonds are protected from loss by other support tranches below the mezzanine bonds as well as excess spread (weighted average loan rate minus cost of funds). If underlying collateral losses do not breach the excess spread and the support bonds, the credit support for our mezzanine tranches grows over time. As the deal seasons, the credit support builds monthly to a point where rating agencies review the securities for potential upgrades. Historically, we have experienced a very high percentage of our mezzanine bonds being upgraded over time. The upgrades not only strengthen our initial assertion of receiving full principal and interest on the security but they also lead to spread compression as higher-rated securities trade at tighter spreads.

  Recent market disruptions due to COVID-19 negatively impacted the ABS sector from a mark-to-market perspective. However, the structural protections built into these transactions and enhanced over the years from prior crises have thus far protected ABS investors from loss. A clear example of structural protections is the recent rental car bankruptcy for which ABS investors are exposed to a rental car fleet liquidation in a weaker used car market. Structural deal improvements driven by prior bankruptcies of Alamo/National and Budget Rental enhancements have thus far proved beneficial as senior bonds within the current transaction are trading near par for a bankrupt entity. The ABS market has experienced numerous dislocations over the years either from an idiosyncratic basis or from an entire sub-sector experiencing stress. After each event, structural protections have improved materially and the deals have evolved to be more investor friendly.

  Newfleet's experience, asset size, and investment relationships within the securitized products space have provided a variety of advantages. During the COVID-19 period, one of the more important advantages was our ability to provide liquidity for our multi-sector portfolios. Like many fund managers, we experienced redemptions. Our experience, asset size and long-term relationships gave us the ability to sell assets within our securitized portfolio and raise cash without having to sell other assets at distressed valuations. In turn, this allowed our portfolios a chance to quickly earn back any drawdowns. Generally, these same characteristics

EXHIBIT 2: SECTOR ASSESSMENTS



As of 6/30/20

allow us to participate in smaller transaction sizes (i.e., $100 million to $200 million). These smaller deals offer attractive yields versus larger, commoditized deals and are accretive to the portfolio over time. Some examples of smaller niche sectors that we invest in are: subprime auto, unsecured consumer loans (peer-to-peer), equipment leases, royalty fees, timeshares, residential transition loans, seasoned loans, and single-family rentals.

- Within the corporate high quality sector, for example, the financial industry offers an attractive spread per unit of duration relative to the asset class as a whole. Our fundamental analysis reinforces our view that financials are attractive. These fundamental factors include: improving credit metrics (regulations have forced financial institutions to deleverage their balance sheets); limited event risk (regulators can block a merger or acquisition that would negatively affect the credit rating); and above average liquidity.

- Within the corporate high yield sector, we are overweight gaming as valuations are attractive and we believe the business models will ultimately recover from the Coronavirus-induced demand shock. We are also overweight cable and healthcare due to non-cyclical demand and structures that are often like near-monopolies. We are underweight energy as valuations do not provide enough compensation for the volatility in results and the limited visibility into future results.

- While credit spreads, broadly speaking, have compressed from the widest levels attained during the current cycle in late March, we continue to see value in EM debt. We started to increase our exposure to spread sectors, in general, just a few days after U.S. equity markets bottomed in late March. Caution prevailed during the initial phase of the rebound. As evidence, initially:

  – U.S. corporate debt outperformed EM.

  – High grade outperformed high yield within both the U.S. corporate and EM debt markets.

  – Within EM, non-USD underperformed USD denominated.

  Our interpretation (and positioning) was that cheap valuations, combined with extreme policy responses from governments (fiscal) and their central banks (monetary), emboldened investors to deploy some of the resultant liquidity into credit spread product; all while concern over the economic impact of COVID-19 was inducing market participants to refrain from moving too far out on the risk curve. We think this is validated by developed market countries being better prepared than EM countries (both economically and technologically) to manage the fallout from COVID-19. However, starting in early May, we modified two of the three themes above that had served us well during the earlier phase of the rebound in risk markets:

  – At the sector level, we started to add more EM than U.S. credit exposure in our multi-sector portfolios.

  – Within the EM sector, we had more investment grade than high yield EM exposure. While this is still the case in our EM holdings, recently we have been adding more high yield than investment grade. The benefit from moving down the credit quality curve has been meaningful.

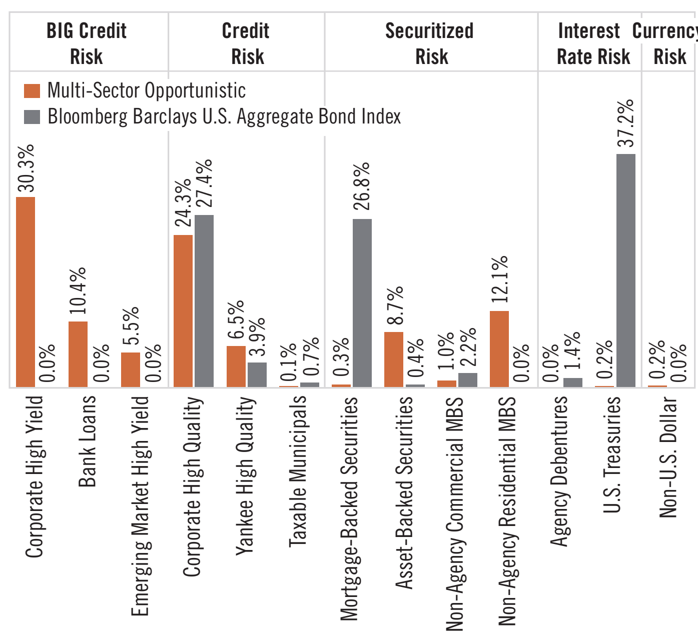
  Finally, our strong USD bias kept us largely out of underperforming local currency EM debt.

FROM RELATIVE VALUE ANALYSIS TO PORTFOLIO CONSTRUCTION

Relative value drives sector allocation and security selection and thus portfolio construction. From the exhibits that follow – using our most flexible multi-sector strategy as an example – we start to see how the structure of the portfolio emerges from our relative value analysis. For a representative account in the Multi-Sector Opportunistic strategy, Exhibit 3 shows sector allocation decisions; Exhibit 4 and Exhibit 5 show allocations by duration and credit rating, respectively.

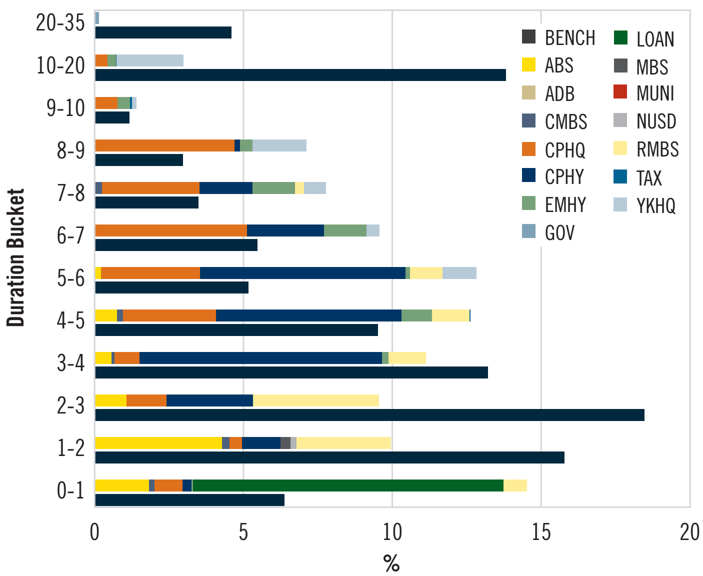
Our focus on relative value produces a well-diversified portfolio within client and prudent internal investment guidelines. We are aware of benchmark characteristics, but not bound by them. We are cognizant of key rate duration and continually monitor the duration of our portfolio relative to the benchmark. Our sector exposures drive our yield curve exposures, which we monitor routinely at both the sector and portfolio levels.

EXHIBIT 3: MULTI-SECTOR OPPORTUNISTIC SECTOR ALLOCATION



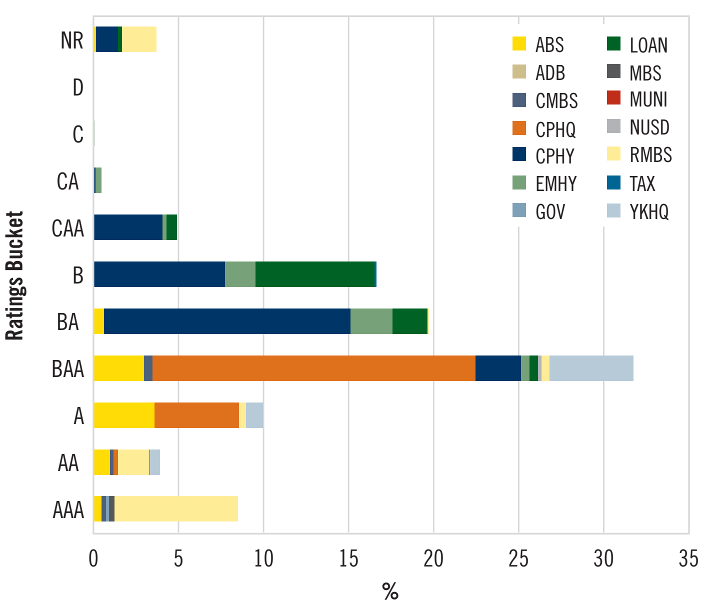
Source: Virtus Performance Analytics. Please note: Equity sector allocation of 0.02% and cash allocation of 0.38% are not included in this illustration. As of 6/30/20. Results presented are that of a representative portfolio.

EXHIBIT 4: MULTI-SECTOR OPPORTUNISTIC EFFECTIVE DURATION



Please note: Equity sector allocation of 0.02% and cash allocation of 0.38% are not included in this illustration. As of 6/30/20. Benchmark: Bloomberg Barclays U.S. Aggregate Bond Index – effective duration.

EXHIBIT 5: MULTI-SECTOR OPPORTUNISTIC RATINGS



Please note: Equity sector allocation of 0.02% and cash allocation of 0.38% are not included in this illustration. As of 6/30/20. Results presented are that of a representative portfolio.

WHY NEWFLEET

Newfleet has a number of strengths that facilitate the effective implementation of a multi-sector relative value approach.

- Newfleet has been managing multi-sector portfolios with a relative value approach for more than a quarter century. Key members of the team and essential aspects of the process have been in place over the entire period of time.
- The process is time-tested and repeatable. It has evolved prudently and thoughtfully with the expansion and organization of staff, and proactively as the market has evolved. Newfleet has been early in identifying new areas of opportunity and willing to allocate resources to their development.
- An integrated team approach enables cross-fertilization of ideas to maximize ability to identify best opportunities.
- Each sector has some element of differentiation. For example, we have the flexibility to do smaller deals in securitized products. Within the non-U.S. sectors, we have the ability to seek value across five sub-sectors – sovereign, quasi-sovereign, corporates (high quality and high yield), and local currency-denominated issues.
- In the period of COVID-19, like other events that trigger volatility in the market, dislocations can affect valuations and create opportunities that Newfleet can take advantage of in the course of implementing its multi-sector relative value approach.

APPENDIX

The body of the paper described the core components of Newfleet's relative value approach. Rigorous fundamental research and a systematic process drive and support the approach.

(i) Fundamental research and other elements of our multi-sector approach

The metrics that drive relative value analysis are similar across the **corporate sectors – investment grade, high yield, and bank loans –** and are integral to other sectors as well. These metrics cover business fundamentals, financial analysis, capital structure analysis, and industry analysis. The analysis of business fundamentals attempts to understand a company's basic business and products, e.g., supplier and customer concentrations, diversity of product, existing and future production capability, pricing and volume trends, and costs of goods sold. Quality of management is also an important consideration. Financial analysis includes a comprehensive assessment of financial statements including cash flow characteristics, working capital changes, composition of capital expenditures, costs of goods sold, debt/EBITDA, interest coverage, and liquidity. Capital structure analysis is a key part of the analysis that looks at asset coverage (generally 2x for bank loans and 1.5x for bonds), covenants, and opportunities up and down the structure to capture relative value. Finally, evaluation of a company always takes place within the context of its industry with consideration given to the life cycle of the industry, supply and demand factors, the nature of competition, and the regulatory environment.

Each analyst maintains relative value spreadsheets of each credit within an assigned industry. Relative value is assessed at both the industry sector level (e.g., energy versus the overall relevant index) as well as at the individual credit level (e.g., how much additional compensation does one get for 1.5x more turns of leverage at company X versus company Y) in an effort to accurately price risk. Further, we take into consideration the capital structure and leverage relative to the enterprise value of the business. Generally, for a loan that we believe we are 2x covered, we will expect more loan-type pricing. If it is a more levered capital structure, say 1.5x coverage, we would expect to get returns more like high yield. We also monitor the spread differentials intra-capital structure – valuation differentials between the secured part of the structure, second liens, and unsecured bonds to identify the best relative value within the capital structure and as a check against our fundamental view.

At the sector level, we look at valuations from multiple angles. We make comparisons across sectors, for example, investment grade versus high yield, investment grade versus EM debt in the aggregate, as well as more granularly versus EM sovereign issues. Given that ABS and CMBS have credit risk, we also will look at spreads between investment grade and securitized products. Spread analysis between high yield and bank loans is important in guiding our overall exposure to below-investment-grade credit risk. Lastly, spreads between new issues versus the secondary market is yet another angle.

Macroeconomic and country analyses play a defining role in identifying relative value in **emerging markets** where, in the aggregate, the prospects for EM debt are broadly influenced by the U.S. and other G10 central bank actions, commodity prices, global growth forecasts, and geopolitical developments. Our focus is on country rotation. We assess relative value between different countries across three regions – the Americas, Europe, and Asia. For the most part, we tend to focus on sovereign USD debt because it is the most liquid. If we invest in the USD corporate space, we do so if we deem the compensation in the form of incremental spread over and above the sovereign debt is attractive enough to compensate for the liquidity risk premium given that corporate instruments tend to be less liquid in most countries. Similarly, we will invest in smaller or less developed frontier markets that are even less liquid than the corporate debt of some of the larger EM countries only if we can receive adequate yield compensation for taking on those positions. Overall, we consider and invest across the full range of EM debt opportunities – sovereigns, USD corporates, and local currency debt – as long as the yield advantage makes sense. Our local currency debt holdings typically are more tactical and opportunistic, viewed as a trade we can exit quickly if conditions deteriorate rather than as a longer-term investment.

Fundamental research on EM countries requires more qualitative judgement and a deeper assessment of the political environment than does developed market country and company analysis. We look at structural conditions such as the degree of progression to a market economy and the business climate in terms of government effectiveness, commitment to reform, and the degree and types of regulation. We look at domestic economic performance and, more importantly, the underlying fiscal and monetary policies that affect growth, inflation, and other related variables. Our assessment of fiscal policy helps us to understand the impact of domestic economic behavior on the country's debt burden. In turn, to assess the country's external hard currency debt, we look at balance of payments, trading patterns, the source and type of capital flows into a country, as well as the degree of permanence of those flows. A country's debt as a percentage of its total economy is also a critical variable, and whether economic performance is increasing or decreasing that debt burden. We also monitor inflation as a measure of economic volatility or of the stability of the country's economy. Finally, we look at the maturity profile of a country's debt relative to its capacity to generate hard currency exports to meet maturity and interest expense requirements over time. Taking all of these variables together, we derive a relative value assessment for the risk premium we need to justify exposure to any given country. In evaluating the risk of a potential country investment, we are often less concerned with the absolute level of risk than how we think that risk is going to change going forward. In other words, we are willing to take on a riskier position as long as we believe it is priced appropriately and that the risk profile is likely to improve. That is a situation that may provide the most attractive total return opportunity.

EM corporate debt sectors are concentrated among telecom/utilities, extractive industries (oil/energy), and banks. Fundamental analysis thus needs to be focused and deep in these areas. Fundamental analysis of EM corporate issues (investment grade or high yield) is similar to that of U.S. corporates but with initial consideration given to the overall sovereign view as well as accounting differences, reporting transparency, corporate governance, and the importance of the company and its products to the local economy. Credit risk analysis otherwise looks at standard metrics such as cash flow generation, earnings expectations, leverage, management quality, and competitive position.

As a general rule, assessing the fundamentals of the **securitized product** sector requires understanding the underlying asset as well as the deal structure, particularly for ABS and RMBS; less true for CMBS where the structures typically are more homogeneous. Understanding the asset involves reviewing the motivation behind the financing, characteristics of the asset, and the history of the asset credit performance. Further, due diligence includes an overall assessment of the originator/management team in terms of the collateral underwriting practices and their alignment of interests with investors. Understanding the deal structure involves analyzing a deal under a normal operating environment, but also running numerous stress tests on deal cash flows and reviewing the results. In summary, qualitative and quantitative data are used to determine relative value with respect to our participation within the capital stack of a transaction.

MBS and RMBS have a set of fundamental metrics in common, including the health of the housing market (as measured by home prices, new and existing home sales, and construction data); the direction of interest rates (hence, mortgage rates); the unemployment rate (as a driver of credit performance); mortgage finance/credit availability; and delinquencies and defaults. Within RMBS there is further differentiation between prime and non-prime lenders (the alternative A paper or "Alt-A"). The prime lenders typically represent standard 30-year mortgage structures while Alt-A involves different risk layers and more hybrid structures (e.g., fixed to floating rate). FICO scores, loan-to-value ratios, and the specialized lenders all require additional scrutiny for evaluating the higher credit risk Alt-A mortgage paper.

In addition to general market factors, CMBS is further evaluated in terms of commercial property market variables such as LTVs, debt yields, lease rates, rent rolls, and vacancy rates across property types. Factors affecting the consumer – unemployment, consumer debt, personal income, FICO scores – are leading metrics for ABS.

From a relative value perspective, we evaluate MBS and RMBS spreads to Treasuries as well as to select bond sectors, e.g., RMBS versus Agency MBS. Additionally, RMBS spreads are further compared across the various subsectors of RMBS including credit risk transfer securities (CRT), single family rental (SFR), and non-performing and re-performing loans (NPL and RPL). Similarly, ABS spreads are compared to Treasuries, other securitized products, as well as within the subsectors of credit card, auto, student loans, royalty fees; all by credit quality and tenor. Finally, CMBS spreads are assessed by tranche, rating, and in comparison with other types of CMBS issuance (e.g., Single Asset Single Borrower or Commercial Real Estate CLO deals) as well as similar tenor and rated corporate bonds.

With regard to **municipal** securities, another high quality sector that we use in our multi-sector process is taxable municipal bonds. Taxable municipal bonds are bonds issued by municipal entities including states, counties, and other special purpose government agencies. The interest income generated from the bonds, however, is not exempt from federal income taxes. As a result of the Tax Act of 1986, limits were placed on the amount and types of bonds that municipalities could issue on a tax-exempt basis. While municipalities issue tax-exempt bonds to fund traditional public purpose projects, taxable municipal bonds are used to support private business activity and other borrowings that are not granted tax-exempt status. Some examples of taxable municipal bonds include pension obligation bonds, sporting arena and stadium bonds, and university and college bonds. Taxable municipal bonds are used to advance refund tax-exempt debt. Taxable municipal issuance will likely remain robust, as it is the only advance refunding tool available to issuers.

Similar in fashion to how we use tax-exempt municipal bonds as a substitute for U.S. Treasury bonds, we utilize high quality taxable municipal bonds as an alternative to investment grade corporate bonds. We leverage our municipal bond expertise into this high quality sector. Compared to investment grade corporate bonds, taxable municipal bonds provide the portfolio with similar yield spreads, but with much lower spread volatility and significantly less credit and event risk. The sector also provides another level of diversification to the portfolio.

While fundamental research is the core of our investment process, the overlay of Newfleet's Macro View is an important element of our multi-sector approach. Newfleet has a formal process for developing the firm's macro views that evolve from bi-weekly meetings led by Newfleet's CIO. The presentation and discussion of the macro view is the first step in the monthly Sector Review meeting and ensures that our relative value and sector allocation decisions are made within the context of the macro factors that influence them. The macro view takes into account a wide range of variables including how the various asset classes are performing, key risks, secular and cyclical trends, global growth, and central bank policy. Analyzing how these variables will impact portfolio strategy is an essential adjunct to a discussion of fundamentals, technicals, and valuations.

(ii) Systematic process

While the metrics are the substance of credit research, a disciplined process that includes formal documentation ensures that analysis is done thoroughly, timely, and captured for the entire investment team to follow and use.

Newfleet's flat and highly integrated organizational structure underlies the effectiveness of the systematic processes. Newfleet's multi-sector products are managed by a team of five portfolio managers that are supported by 18 sector managers/analysts. Further, all of Newfleet's investment professionals and staff are in one location and on the same floor. While this logistical detail maximizes interaction and communication, the functional integration of the multi-sector team is the defining advantage. No sector is viewed in a vacuum and all team members have a voice and can express their investment views. There are no siloes. A culture of collaboration goes hand in hand with Newfleet's organizational structure and the historical roots of its multi-sector approach. Collaboration is high and rewarded. Portfolio managers and analysts are compensated based on how well the multi-sector strategies perform overall, rather than on assets under management within a specific sector. Newfleet believes this allows for better relative value assessments across the portfolios, which leads to more attractive risk-adjusted returns.

Newfleet's relative value process is both qualitative and quantitative. While it is difficult to put a number on it, there are substantial amounts of both; each informs the other.

Analysts are experts in their assigned industries and understand relative value and corporate valuations. They are the first eyes on a new opportunity, and responsible for monitoring existing holdings. Their responsibilities include the development of financial models and spreadsheets that track and forecast a wide range of items – sales and earnings by business segment and region; total debt outstanding; credit statistics such as leverage and interest coverage; covenant compliance; free cash flow; and liquidity. Further, they build comp sheets that are used to determine relative value from numerous angles – across industries, across ratings, new issue versus existing, among others.

The analysts are required to produce standardized credit write-ups (“one pagers”) that are presented at selected meetings to put their credit “to the test” before senior team members and others. This is just one form of communication that is accompanied by daily morning meetings, regularly scheduled monthly and quarterly meetings, and ongoing communication by team members in close proximity to each other.

Documentation is the final element that supports the integration of Newfleet’s relative value approach. CFAR (Credit Fundamentals and Research) is the proprietary central depository for all credit research and opinions. It standardizes information, automates communication of new entries, changes, and opinions to the team, and provides the ability to search and filter on particular characteristics.

While risk management has not been the focus of this paper, we would be remiss if we did not note that risk management is embedded in the credit research process. Risk control and credit analysis are a function of our investment professionals rather than risk models per se. Analysts are directly involved in all aspects of investment decision-making and are responsible for both initial research and ongoing monitoring of portfolio holdings. Existing holdings are priced daily, and any unusual change is flagged for further review. Further, Newfleet’s multidimensional risk management platform includes an independent Risk Management Committee that provides oversight and continuous monitoring of all of the firm’s strategies.

Securities in the portfolio must continue to meet the rigorous criteria established by our strategy and process. Our analysts and sector specialists continually review the portfolio in an effort to uncover any potential problems with credit quality, liquidity, legislative impact, and valuation levels. Securities with deteriorating fundamental are immediately flagged and, if appropriate, sold. Our process incorporates a strong sell discipline that takes into account a number of factors including a change in sector outlook; change in prepayment outlook; security relative valuation; anticipated deterioration of credit/subordination quality; and assessment of leading indicators such as equity pricing, default swap levels, and delinquencies. Daily meetings by the entire fixed income team and ongoing informal communications ensure prompt identification of any deteriorating credits or changing market conditions that could affect the portfolio.

For more information about Newfleet fixed income strategies, please contact:

Bill Irvine, Senior Managing Director, Institutional Business Development, Newfleet Asset Management
T: 860.760.5832 | C: 781.329.9283 | William.Irvine@Newfleet.com
www.Newfleet.com

Past performance is not indicative of future results.

IMPORTANT RISK CONSIDERATIONS: Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and 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. **Foreign & Emerging Markets:** Investing internationally, especially in emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk. **Municipal Market:** Events negatively impacting a municipal security, or the municipal bond market in general, may cause the fund to decrease in value. **Bank Loans:** Loans may be unsecured or not fully collateralized, may be subject to restrictions on resale and/or trade infrequently on the secondary market. Loans can carry significant credit and call risk, can be difficult to value and have longer settlement times than other investments, which can make loans relatively illiquid at times. **Market Volatility:** Local, regional, or global events such as war, acts of terrorism, the spread of infectious illness or other public health issues, recessions, or other events could have a significant impact on the portfolio and its investments, including hampering the ability of the portfolio manager(s) to invest the portfolio's assets as intended.

The **Bloomberg Barclays U.S. Aggregate Bond Index** measures the U.S. investment grade fixed rate bond market. The index is calculated on a total return basis. The **S&P/LSTA Leveraged Loan Index** is a daily total return index that uses LSTA/LPC Mark-to-Market Pricing to calculate market value change. On a realtime basis, the Index tracks the current outstanding balance and spread over LIBOR for fully funded term loans. The facilities included in the Index represent a broad cross section of leveraged loans syndicated in the United States, including dollar-denominated loans to overseas issuers. Indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment. **LIBOR:** London Interbank Offered Rate.

This commentary is the opinion of Newfleet Asset Management. Newfleet provides this communication as a matter of general information. Portfolio managers at Newfleet make investment decisions in accordance with specific client guidelines and restrictions. As a result, client accounts may differ in strategy and composition from the information presented herein. Any facts and statistics quoted are from sources believed to be reliable, but they may be incomplete or condensed and we do not guarantee their accuracy. This communication is not an offer or solicitation to purchase or sell any security, and it is not a research report. Individuals should consult with a qualified financial professional before making any investment decisions.

FOR INSTITUTIONAL USE ONLY.