2021 Fixed Income Market Outlook

Newfleet
ASSET MANAGEMENT
A Virtus Investment Partner

Dave Albrycht, CFA, President and Chief Investment Officer

As a father of five, coaching numerous youth sports was a major part of my life over the past three decades. One piece of advice I always give younger parents is to encourage their kids to participate in multiple sports, as I have always believed that young athletes stand to benefit from exposure to a variety of different team sports at an early age. Too often, I have seen athletes focus on becoming an expert in one sport, operating under the false notion that specialization will give them an advantage. Per a 2017 Hegg Health Center Study, “Early diversification may lead to higher chances of accomplishing athletic goals, fewer injuries, as well as greater participation with sport and physical fitness throughout their lifetime.” Most professionals would agree. Legendary coaches like Dabo Swinney and Urban Meyer have been vocal about their preference in recruiting “multisport athletes.” In 2017, 30 of the top 32 NFL draft picks were multisport athletes. The results are clear.

In my view, successful investing in this environment is no different. We believe the optimal approach necessitates adaptability, flexibility, diversification, a willingness to learn, to fail, and to change direction. For example, the 2020 credit selloff driven by the COVID-19 pandemic allowed our multi-sector management style to rotate across sectors to capture the most attractive relative value opportunities. We shifted our weights from CMBS to investment grade corporates to take advantage of explicit government support for the corporate bond sector. We increased our historically low exposure to corporate high yield and bank loans to take advantage of price dislocations. Most recently, to take advantage of a low rate environment and a positive residential credit story in the housing market, we increased our allocation to non-agency RMBS to the higher end of our allocation range and we have eliminated any meaningful exposure to the highly rate-sensitive agency MBS universe.

Speaking of our approach, I often refer to my team of sector managers at Newfleet as sector specialists, though I now see the misnomer I have applied. While our sector specialists are experts in their respective areas of coverage, they are highly engaged with other sector specialists. Asking questions, challenging ideas, providing feedback. Not only does our team have ongoing scheduled meetings to discuss trends, ideas, and positioning, there are continual informal meetings between “specialists” who have plenty to learn from one another, and know it.

With the onset of the global pandemic caused by the spread of the coronavirus, there were countless examples of this on display in 2020. With our team conducting meetings via virtual conference rooms since mid-March, I have been able to drop in and witness more of the collaboration. To name a few, I have listened to:

1. Our mortgage-backed securities team and our corporate team discussing the latest H.4.1 release (Fed Balance Sheet – Fed’s announcement that it would purchase corporate bonds on 3/23)
2. Our REIT analyst and CMBS sector manager comparing collection and delinquency rates across a variety of property types
3. Our airline analyst and EETC analyst comparing relative values and liquidity runways
4. Our emerging markets team detailing likely government COVID-19 responses for our domestic analyst team (U.S. companies with critical foreign assets/exposures)

FREQUENT CHANGES IN PERFORMANCE LEADERSHIP SUPPORTS THE BENEFIT OF DIVERSIFICATION

2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD (09/2020)	12/10-9/20 Annualized
Municipals 10.70	EM Debt 18.53	High Yield 7.44	Municipals 9.05	Municipals 3.30	High Yield 17.13	EM Debt 9.32	ABS 1.77	IG Corp 14.54	CMBS 6.98	High Yield 6.43
EM Debt 8.46	High Yield 15.78	Bank Loans 6.15	IG Corp 7.46	MBS 1.51	NF Opportunistic 11.04	NF Opportunistic 8.00	Municipals 1.28	EM Debt 14.42	US Agg 6.79	NF Opportunistic 5.78
IG Corp 8.15	NF Opportunistic 15.52	NF Opportunistic 3.28	MBS 6.08	ABS 1.25	EM Debt 10.19	High Yield 7.50	Bank Loans 1.14	High Yield 14.32	IG Corp 6.64	EM Debt 5.47
US Agg 7.84	IG Corp 9.82	CMBS 0.23	US Agg 5.97	EM Debt 1.23	Bank Loans 9.88	Global Agg 7.40	MBS 0.99	NF Opportunistic 12.21	Global Agg 5.72	IG Corp 5.31
MBS 6.23	CMBS 9.66	ABS -0.27	EM Debt 5.53	CMBS 0.97	IG Corp 6.11	IG Corp 6.42	CMBS 0.78	US Agg 8.72	ABS 4.14	CMBS 4.39
CMBS 6.02	Bank Loans 9.43	MBS -1.41	CMBS 3.86	US Agg 0.55	CMBS 3.32	Municipals 5.45	US Agg 0.01	CMBS 8.29	MBS 3.62	Bank Loans 4.31
Global Agg 5.64	Municipals 6.78	IG Corp -1.53	NF Opportunistic 2.71	Bank Loans -0.38	US Agg 2.65	Bank Loans 4.25	Global Agg -1.20	Bank Loans 8.17	Municipals 3.33	Municipals 4.31
ABS 5.14	Global Agg 4.32	US Agg -2.02	High Yield 2.46	NF Opportunistic -0.63	Global Agg 2.09	US Agg 3.54	High Yield -2.08	Municipals 7.54	NF Opportunistic 3.04	US Agg 3.72
High Yield 4.96	US Agg 4.22	Municipals -2.55	Bank Loans 2.06	IG Corp -0.68	ABS 2.03	CMBS 3.35	NF Opportunistic -2.50	Global Agg 6.84	High Yield 0.57	MBS 2.98
NF Opportunistic 4.06	ABS 3.66	Global Agg -2.60	ABS 1.88	Global Agg -3.15	MBS 1.67	MBS 2.47	IG Corp -2.51	MBS 6.35	EM Debt 0.37	Global Agg 2.67
Bank Loans 1.82	MBS 2.59	EM Debt -6.58	Global Agg 0.59	High Yield -4.43	Municipals 0.25	ABS 1.55	EM Debt -4.61	ABS 4.53	Bank Loans -0.83	ABS 2.49

Returns in percent. As of 9/2020. **Past performance is not indicative of future results.** Performance of all cited indexes is calculated on a total return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. NF Opportunistic reflects a representative portfolio in Newfleet’s multi-sector Opportunistic Strategy. For index definitions, please see page 12.

It is incumbent upon me to point out that our team is incentivized to behave this way. No sector manager is compensated on the size of their allocation and they never will be. While each “specialist” has a different responsibility, they all have the same goal: Determining the proper allocation for our clients. Our track record of performance is built on the back of this collaboration and while our allocations across sectors will be in perpetual motion, this portion of our strategy will not change.

As we enter 2021, deriving alpha from these interactions has never been more crucial. The yield on the Barclays Aggregate Index is poised to begin 2021 at 1.15%, with a duration of 6.2 years. That will be the lowest starting point on record by over 1% (2020: 2.3%). Future investment returns are the lowest they have been in history. Therefore, investors should place a premium on diversification and agility. We believe that diversifying across uncorrelated return streams and maintaining the agility to take advantage of periodic dislocations will be the hallmarks of an outperforming strategy going forward.

As detailed in our following outlook, we are entering 2021 with what I would describe as a constructive view. Sectors we currently favor include out-of-index/off-the-run ABS, non-agency RMBS, high yield bank loans, corporate high yield, BBB rated investment grade corporates, and high yield emerging markets over investment grade emerging markets. These are subject to change quickly with shifting fundamentals, technicals, and valuations. Like the young athletes I have coached over my career, we believe investors will have a better chance of staying the course and maximizing their chances of success through agility and broad diversification in order to reach their investment goals.

We wish you and your families a safe and happy holiday season and we look forward to our continued partnership in 2021.

Executive Summary

The global pandemic caused by COVID-19 has had a major impact on the lives and livelihoods of all people globally. Uncertainty still remains despite promising news on the vaccine front as we end the “year of the shutdown.” COVID-19, like other events that trigger market volatility, can affect valuations and create opportunities that we can take advantage of in the course of implementing our multi-sector relative value approach. Newfleet believes that spread sectors will offer better value than U.S. Treasuries and other government-related debt in 2021.

Newfleet continues its “up-in-quality” bias across portfolios while currently constructive on the macroeconomic outlook. Stabilizing economic fundamentals, combined with continued provision of excess liquidity (beyond the real economy’s needs) by the major central banks should support further appreciation of risk assets. Newfleet is confident that in this environment, we can exploit inefficiencies within sectors and take advantage of dislocations. Credit selection, a major driver of performance last year, once again is in focus based on valuations.

GLOBAL MACRO EXPECTATIONS FOR 2021

- Overall: Constructive
- We expect divided U.S. government, stabilizing economic fundamentals, continued provision of excess liquidity, and growth in China to support further appreciation of risk assets.
- We view the shift of executive power in the U.S. administration as neutral. We expect the balance of forces to result in the executive branch pushing for additional fiscal stimulus to be positive for sustained growth outperformance versus other G-7 economies. At the same time, we expect the impact to be properly tempered by a Republican Senate that prevents the eventual size of the resultant budget deficit from becoming problematic.
- Credit spreads (averages versus historical) remain cheap relative to rich equities (defined by high P/E ratios) and low U.S. Treasury yields.
- We maintain an expectation for U.S. Treasury rates and credit risk spreads to remain range-bound, but with Treasury rates drifting slowly higher balanced by the slow economic recovery, but still suppressed aggregate demand and continued central bank purchases.
- We see U.S. relations with Russia cooling (i.e., less friendly). However, this should be risk-neutral as we anticipate a “healthy” tension to remain between the world’s most significant military powers. In other words, we see a return to where they were pre-Trump when too cozy of a relationship created problems in the other direction.
- With at least two vaccines expected to be mass distributed by Q2 2021 in the U.S. and elsewhere, and global central banks intent on supporting economies in the interim, the second half of 2021 could see strong GDP growth as global economies open up more fully.

KEY RISKS

- Similar to the start of 2020, lower starting points for spreads leave less room for bond prices to absorb unexpected shocks.
- The impact of COVID-19 on public health and global economies will remain a key risk in 2021 until vaccines are fully approved and easily accessible to the general public.
- Energy volatility, interest rate distortions created by global central bank accommodation, and a new U.S. government administration may create pockets of volatility during the year.
- A U.S./China relationship under the new administration is an uncertainty. Biden is viewed more favorably than Trump, however, anti-China sentiment is popular on both sides of the aisle and there is potential for further deterioration of the relationship.
- Republicans not holding onto the U.S. Senate majority, and a further rise in the already high government debt burden, may jeopardize the U.S. status as a "risk-free" credit.

ELEMENTS OF OUR BROAD VIEW AS WE ENTER 2021

- Newfleet expects most spread sectors to outperform U.S. Treasuries in 2021 due to their yield advantage and the potential for mild spread tightening.
- Negative-yielding debt reached $17.47 trillion in November, surpassing the previous all-time high set back in August 2019. Negative-yielding debt now accounts for approximately 26% of the global investment grade debt market. Notably, 90% of the global investment grade debt market yielding over 1.5% resides in the U.S.
- Within the investment grade corporate sector, Newfleet favors COVID-19-sensitive industries, BBB rated bonds, and banking.
- The outlook for high yield in 2021 is heavily dependent on the ability of global economies to reopen via containment of the coronavirus. If a vaccine is widely available, safe, and effective, we view high yield as well positioned to produce mid-to-high single-digit excess returns from coupon clipping plus credit spread tightening.
- Within the bank loan sector, despite a valuation that appears fair to long-term averages, we remain constructive on the asset class into 2021 and can see a coupon-plus type total return next year given the existing discount to par and re-emergence of LIBOR floors in new transactions.
- We continue to add emerging market (EM) debt exposure selectively and our view remains the same as last year: neutral. However, our strategy emphasizes when we own EM and to which countries we are exposed. The clearest distinction is along the credit quality spectrum. High yield EM remains the spread sector where we see the most relative value currently. High yield EM spread as a ratio of the investment grade EM spread is 4.00 as of this writing. By way of comparison, this ratio was 2.76 at the end of March.
- We continue to favor one-off asset types within the consumer ABS space such as subprime auto, unsecured consumer loans, timeshare, and whole-business securitizations. We will continue to search for new entrants into the ABS market and evaluate new asset types to determine the risk versus reward for our clients. Given the short duration nature of the asset class (1-3 years), we believe that ABS is very compelling versus risk-free assets or other alternatives on the short end of the curve.
- With spreads for RMBS securities still at attractive levels relative to corporate bonds of comparable maturity, we expect demand for RMBS to remain strong. RMBS will continue to be an important alpha-generating sector for Newfleet and also a valuable source of liquidity. We expect the technical (supply/demand) environment to remain constructive and expect the market to continue its growth in 2021. Fundamentals for housing have been reinforced as a result of the pandemic's work-from-home movement. Combined with the move to the suburbs and millennial household formation, the foundation for future housing strength is well intact.

—as of December 4, 2020

For the reader who would like more details on our sector outlooks, the following section provides in-depth views by Newfleet's sector specialists on their respective areas of expertise.

Spread Sector Outlook

CORPORATE INVESTMENT GRADE

By Ryan Jungk, CFA

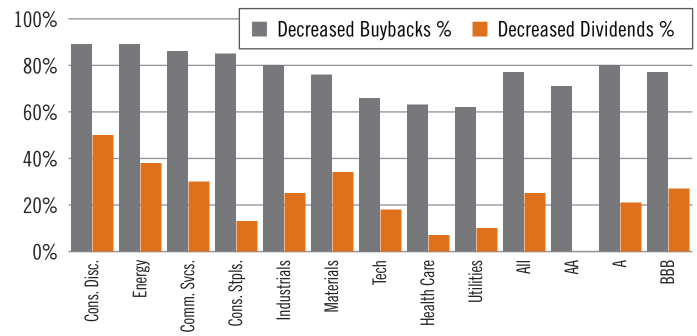
The path of least resistance for investment grade (IG) spreads in 2021 is tighter, as supply is set to diminish significantly after a record-breaking year for issuance. We favor COVID-19-sensitive industries, BBBs, and banking credits. As of this writing, the Fed is on track to lend $0 in the primary market and purchase less than $15 billion of bonds in the secondary market. Despite being used to just 2% of their potential, these programs had a compounding effect on the fundamentals, technicals, and valuations of the IG market. While the programs will expire at year end, they have proven their effectiveness as a market backstop and could be revived to reduce tail risk scenarios in future crises.

We believe 2020's issuance (nearly $2 trillion) was inflated by pulling future issuance forward. First, the size of the Bloomberg Barclays 1-3 year U.S. Corporate Bond Index is 5.5% smaller year to date while the overall Corporate Bond Index is larger by 16.5% to $6.8 trillion. Second, the cash to debt ratio for IG issuers is at a five-year high and climbing, indicating that issuers are sitting on a surplus of cash as the worst case scenario for cash burn was not realized. Combined, we believe this is a strong indication that issuers have either already addressed upcoming maturities or have the cash on hand to do so. Our outlook calls for subdued supply and stable demand as the global hunt for yield is ongoing with greater than $16 trillion of negative-yielding debt globally (up 45% year to date).

The fundamental backdrop is supportive of our view. IG companies demonstrated both discipline and flexibility during this current crisis. More than 60% of companies slashed share buybacks, 20% cut dividends, large-scale acquisitions were muted, and cash flow accrued to the balance sheet. S&P 500® earnings beat estimates by 23% in the second quarter and 18% in the third (the two largest beats on record), despite revenues falling largely as expected. Both leverage and cash balances are at multi-year highs. Companies tend to deleverage after recessions, and a large contingent of the index remains on negative outlook by the agencies. As a result, we expect constituents to exhibit good behavior in 2021.

With spreads having retraced 95% of their widening year to date, we are least bullish on valuations heading into 2021. Spreads are well through long-term averages and yields are hovering just north of all-time lows at 2%. While total return expectations should be tempered by a low starting point for yield, we see potential for additional returns via modest spread tightening.

PERCENT OF INVESTMENT GRADE COMPANIES REDUCING BUYBACKS, DIVIDENDS
(OF COMPANIES WHO PAID OUT IN 2Q19)



Source: Morgan Stanley Research, data as of 2Q20

CORPORATE HIGH YIELD

By Eric Hess, CFA

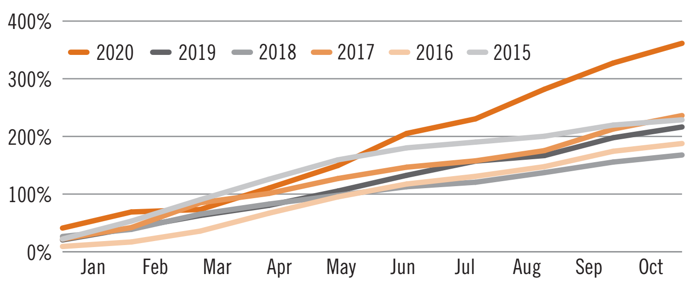
The outlook for high yield in 2021 is heavily dependent on the ability of global economies to reopen via containment of the coronavirus. If a vaccine is widely available, safe, and effective, we view high yield as well positioned to produce mid-to-high single-digit excess returns from coupon clipping plus credit spread tightening. In a scenario of fundamental improvement from economic reopenings combined with loose monetary policy, the possibility of additional fiscal stimulus, and a yield advantage over most other fixed income markets, credit spreads could return to post-crisis lows by year-end 2021. Absent this, we expect high yield to remain highly dependent on continued fiscal and monetary stimulus to support the economy with a more challenged return outcome.

The prospects for fundamentals in 2021 are obviously linked to the further spread of COVID-19 and vaccine rollouts. With the timing for a large-scale rollout of vaccines unlikely before spring, the economy remains susceptible to government-imposed shutdowns during the first part of the year and their consequent impacts. A complete reopening of the economy at some point during 2021 should lead to improving fundamentals. Aggregate fundamentals are currently weak with credit metrics at their worst levels in recent years. The fundamental picture is bifurcated between COVID-19 winners and losers with some companies in certain heavily impacted industries seeing their businesses all but shut down. While acknowledging the weak starting point, we generally expect fundamentals to have improved by the end of 2021 and still be on an improving trajectory into 2022, which should mitigate concerns around the absolute level of the metrics. A reopening scenario likely emboldens some companies to become more aggressive with their balance sheets after exercising broad-based restraint in 2020; however, firms that were impacted by the shutdowns should remain focused on balance sheet improvement.

Similar to fundamentals, the default rate is currently at a 10-year high but should decline throughout 2021.

The technical picture for 2021 should see a boost from a decline in issuance. 2020 is likely to set a record for high yield issuance as many issuers impacted by COVID-19 tapped markets in the spring in order to bolster liquidity ahead of potentially weak results. Issuers less affected were able to tap markets to lower interest costs and refinance maturities as risk-free rates declined and spreads came in post the March widening. In addition, the relative strength of the high yield market versus the loan market drove issuance to shift from loans to bonds. We expect these factors to all lessen in 2021 given that the need to bolster balance sheets should be limited to a much narrower set of firms (those impacted to a greater-than-expected extent by the economic shutdowns), the amount of debt available for refinancing is smaller, and the resumption of collateralized loan obligation (CLO) issuance should decrease the relative attractiveness of the bond market versus the loan market. In contrast, issuance driven by mergers and acquisitions and to fund payouts to equity were down sharply in 2020 given travel restrictions and the challenge of depressed valuations on M&A activity, while fundamental deterioration kept dividends muted. As the economy reopens and fundamentals improve, we expect these types of deals to return. Lastly, large inflows to high yield in 2020 supported the asset class but seem unlikely to repeat in size given the year's historically high flows. A continued search for income in a world that is even more yield constrained remains a positive factor.

CUMULATIVE ISSUANCE JANUARY TO OCTOBER (2015 - 2020)



Source: Barclays Research

Valuations have been volatile in 2020 and, while yields remain near their all-time lows, credit spreads remain higher than pre-COVID-19 levels. The current fundamental picture – elevated defaults and weakened credit metrics – would argue for higher credit spreads. A more forward-looking approach, which factors in scenarios where life returns to normal plus a lack of alternative investments with similar yields, can justify current credit spreads. Similar to 2020, credit spreads are likely to remain vulnerable to headlines over the next several months.

Our strategy for 2021 is to continue to evaluate the impacts of COVID-19 on the economy and how they flow through to individual companies and industries. Managing the level of exposures to those names and industries most affected will likely be a large driver of relative performance during the year. Hopefully, 2021 sees the rollout of mass vaccinations globally and financial performance beginning to revert to pre-COVID-19 levels, which should be a positive for most firms but will be a negative for COVID-19 winners. For specific companies, the focus will be on what level financial performance returns to, the speed at which that happens, and any permanent impacts from the shutdowns. Central bank activity always warrants monitoring but perhaps more so given the current level of involvement in the high yield market by the Fed and the potential for selling pressure should it start shrinking its portfolio of high yield bonds and ETFs. Lastly, our core fundamental analysis with a focus on investing in bonds with the best risk-adjusted returns remains unchanged.

BANK LOANS

By Frank Ossino

Despite a valuation that appears fair to long-term averages, we remain constructive on the bank loan asset class into 2021 and can see a coupon-plus type total return next year given the existing discount to par. The containment of the virus, and ultimately the development of a vaccine, continue to be the determining factors in the prospects for bank loans as well as other risk assets. The size and scope of additional stimulus, which is a necessary bridge to a vaccine, is another key variable. With the Fed and global accommodation providing support, we believe the case for bank loans can be made for income in a low-yield environment, especially as LIBOR floors are reintroduced into issuance and the market is still priced at a discount. The income pickup relative to other income asset classes provides a strong rationale for exposure to the space.

BANK LOANS VS OTHER ASSET CLASSES

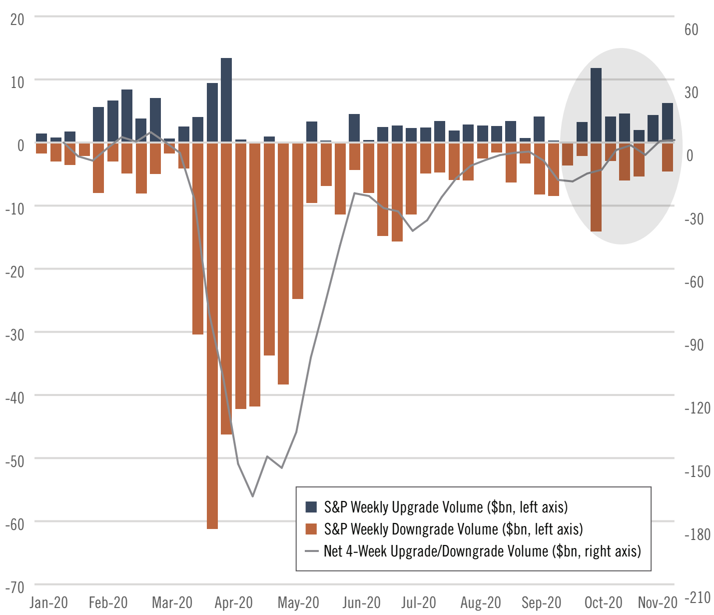
As of 11/12/2020	Price	Yield to Worst	Duration to Worst (yrs)
U.S. Aggregate	109.6	1.23%	6.4
U.S. Treasury	108.7	0.60%	7.1
Investment Grade Corporates	114.2	1.95%	8.7
Securitized — ABS	103.3	0.56%	2.1
Securitized — CMBS	108.6	1.48%	5.3
Securitized — MBS	106.4	1.34%	3.4
Muni Bond	113.5	1.32%	4.9
Emerging Market USD Aggregate	102.9	4.37%	6.9
U.S. High Yield	102.2	5.00%	3.6
Bank Loans	**96.0**	**L+525**	**0.25**

Loans are calculated on a 3-year discount margin basis
All indices are Bloomberg Barclays
Loan market is the S&P/LSTA Leveraged Loan Index

Considering fundamentals, the decline in GDP as a result of COVID-19 has dramatically and negatively impacted borrower cash flows and has reduced the ability to cover fixed charges such as interest, scheduled amortization, and non-debt-financed capital expenditures. The hardest hit industries have been those directly affected by stay-at-home orders and other social distancing policies such as airlines, gaming/hotels/leisure, consumer related, commodities, and areas within healthcare.

The result was a significant increase in downgrades and an increase in defaults (3.9% in November), which have since slowed as monetary and fiscal support has provided liquidity even to the most troubled sectors. A bottoming of earnings in the second quarter and sequential improvement in the third (especially in less COVID-19-impacted industries), coupled with open capital markets, have removed some of the tail risk in the near/medium term.

UPGRADES ARE PICKING UP



Source: Credit Suisse

Nonetheless, the velocity of downgrades and defaults took a toll on collateralized loan obligations (CLOs), as a number of vehicles reported failing numerous over-collateralization and interest coverage tests.

In terms of supply/demand, retail fund flows have been steadily negative, totaling over $19 billion year to date through November. As the 10-year declined from 1.88% to start the year to 0.98% currently, retail investors continued to redeem.

Conversely, CLO issuance has totaled over $80 billion year to date through November. CLO issuance has healed since March and remains the primary buyer of loans, representing over 70% of the market. This is long-term, non-marked-to-market capital with no forced sell triggers, providing real ballast to the asset class. While CLO issuance is behind the 2019 pace, it reflects continued interest in an income-producing strategy from investors with long time horizons that find the benefits of a CLO wrapper attractive. We expect CLO issuance to be in the $80-90 billion area in 2021. Regarding new issue loan supply, issuance was down roughly 12% in 2020 due to limited M&A opportunities, but also due to continued market share loss as borrowers elected to finance themselves through the high yield market where overall demand was more robust.

With retail funds now accounting for only 6% of the market, we believe any further redemptions will be manageable. In fact, the prospects of fiscal stimulus, possible infrastructure spending (bi-partisan interest), widespread COVID-19 vaccine distribution and its impact on reopening the economy can potentially be inflationary, resulting in demand for loans by the retail community. Such incremental demand in a flat supply backdrop could result in higher prices.

We expect the next twelve-month default rate to peak in the high single-digit area (from 4% today) and then slowly decline as COVID-19 vaccines provide a catalyst to economic recovery. This is generally in line with the credit rating agencies. The degradation of credit quality coupled with aggressive or loose documentation terms may impact loss given default assumptions driven by lower-than-historical loan loss recoveries. Indeed, while we continue to focus on credits with adequate capital structures and secondary sources of repayment, which typically enhance recovery, we have prudently reduced our internal recovery expectations to address these market developments.

Third quarter earnings have been reported, and the impact on our portfolios has been favorable. We have been very active in the secondary market, buying discounted short-tenor loans of borrowers we believe have adequate capital markets access and corresponding strong paths to a par refinancing. As we enter 2021, much of this strategy will remain unchanged. We continue to re-underwrite credits directly impacted by COVID-19 with a bias towards issuers with adequate liquidity and also sustainable business models that may have been overlooked, especially in light of meaningful progress towards a vaccine.

For more detail on the prospects for bank loans, see Newfleet's 2021 Bank Loan Market Update.

ASSET-BACKED SECURITIES (ABS)

By Nick Rinaldi

In last year's securitized product outlook, we emphasized that we were investing up in quality and waiting for a dislocation in the markets to take advantage of cheaper bonds. In a million years, we would never have imagined that a worldwide pandemic would create the dislocation. The markets came unglued in late March and securitized product was no different with respect to price action. Prices dropped and spreads widened dramatically at a rapid pace. Unlike the Global Financial Crisis (GFC) of 2008, when securitized product prices dropped gradually over time before recovering, the price drops this time around were quick and violent at times. Once federal stimulus packages were put into place, in addition to the Fed's explicit support of the corporate bond market, prices began to rebound in an orderly fashion. We were able to take advantage of the price dislocations by adding paper at spread levels last seen during the GFC.

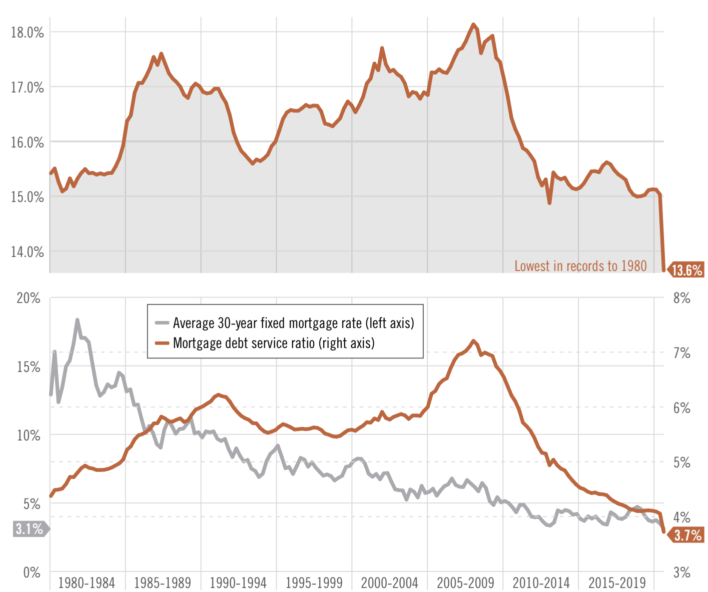
Last year, we also commented on the low rate environment as a positive backdrop for consumer refinancings. As of this writing, the 10-year U.S. Treasury has rallied 94 basis points since 12/31/2019 to yield 0.98%, and the 2-year Treasury has rallied 143 basis points to yield 0.16%. The U.S. Treasury curve thus sits today at or near the lowest interest rate levels in history. These low rates have enabled both consumers and corporations to refinance their debt at extremely favorable levels. Federal stimulus packages put a Band-Aid on the potential negative fundamental fallout of consumer credit and, coupled with an all-time low interest rate environment, have caused assets to reflate in price.

Today, consumer ABS spread levels have rallied back dramatically and in most cases are inside of 3-year average levels. That being said, given the short duration nature of the asset class (1-3 years), we believe that ABS is very compelling versus risk-free assets or other alternatives on the short part of the curve. In a nutshell, spreads are still compelling but yields are anemic given the rally in both rates and credit.

After reaching a historic low in unemployment of 3.5% in February of this year, unemployment shot up to 14.7%. As of November, we have a 6.7% unemployment rate with continuing jobless claims trending lower. Lower-wage workers were the most impacted during this latest crisis and we continue to witness some of the strongest job gains in this market segment. Consumers have been disciplined through 2020 with respect to their finances as they have continued to pay down their debt. Evidence of this is the fact that overall household debt fell for the first time since the second quarter of 2014. Additional evidence of U.S. consumer discipline is the U.S. saving rate as a percentage of disposable income, which today sits at the highest level over the last 20 years. Lastly, given the low rate environment, consumer debt service ratios are the lowest they have been over the last 30 years (see exhibit below).

A lot has happened in 2020 but as we end the year, the outlook for 2021 is similar to last year. Given the rally in prices and spreads that we have seen in this space, we need to be disciplined and err up in quality to take advantage of the next dislocation. We are positive on U.S. consumers as they have stayed disciplined during this crisis, and the overall economic figures continue to trend positively. In addition, a second stimulus package will be passed at some point in the near future, which will be another shot in the arm to struggling consumers. We have and continue to favor one-off asset types within the consumer ABS space such as subprime auto, unsecured consumer loans, timeshare, and whole-business securitizations. As of the writing of this piece, the ABS component of the Bloomberg Barclays U.S. Aggregate Bond Index (Aggregate Index) has returned 4.30% for 2020. Unless we witness another credit dislocation next year, 2021 should be a coupon-clipping year for the ABS sector.

CONSUMER DEBT SERVICE RATIOS



Source: Bloomberg L.P.

COMMERCIAL MORTGAGE-BACKED SECURITIES (CMBS)

By Nick Rinaldi

During 2020, we decreased our exposure to CMBS even further in favor of investment grade corporates for several reasons. Unlike the Fed's explicit support of new issue corporate bonds, it did not make such a bold statement for new issue CMBS. In addition, we believe the fundamental performance of the sector continues to trend negatively, with realized losses on some assets coming through in the next six to 12 months. That being said, CMBS spreads did rally in sympathy with other asset classes but still sit at wider spread levels than where we started the year. Note that the junior part of the capital stack of these transactions has widened dramatically and has not rallied back as hard as their senior counterparts.

From a technical perspective, new issuance with respect to private label CMBS has been very muted in 2020. As of today, new issue private label CMBS supply is trailing 2019 by almost 40%. Lack of supply is one of the reasons why the senior part of these capital structures has rallied in price. From a fundamental perspective, property types such as hotel and retail (malls) have suffered dramatically during this pandemic. Even the office sector has been challenged as technology has enabled the work-from-home phenomenon to accelerate. Delinquency levels for retail and hotel properties range from the low double digits to the 30%+ area. Delinquency levels for office, industrial, and multi-family properties have thus far fared well with low single-digit delinquency rates during the pandemic. That being said, as these troubled loans get worked out and losses start to flow through these transactions, we believe further price pressure will be placed on some of these tranches.

Our current allocation to the CMBS sector is on the historically low side in our portfolios in favor of investment grade corporates. We are convinced that as losses flow through some of these legacy transactions, we will see prices trend lower and allow better entry points into this space. As we have mentioned in the past, we are not favorable on the junior parts of the conduit capital structure from a risk versus reward standpoint. Going forward, new issue CMBS will be underwritten more conservatively as rating agencies typically over enhance new issue deals with additional credit support following a crisis. Looking ahead to 2021, we will continue to search for one-off asset types such as small-balance commercial deals that typically offer a concession in spread versus on-the-run CMBS.

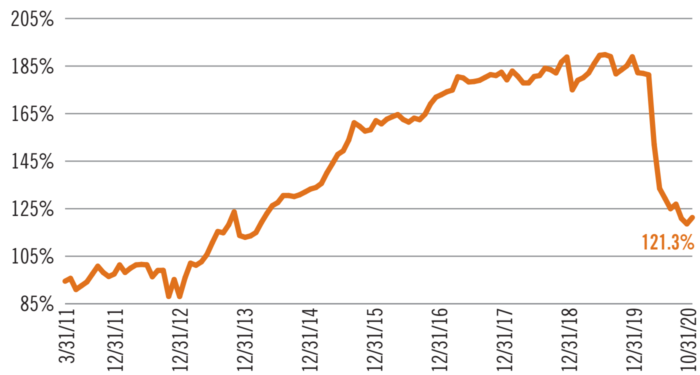
NON-AGENCY RESIDENTIAL MORTGAGE-BACKED SECURITIES (RMBS)

Andrew Szabo, CFA, and Zachary Szyndlar, CFA

The expansion in non-agency RMBS issuance volumes from 2019 was halted in the first quarter as the pandemic spread and mortgage credit quickly tightened. In just a few months, mortgage credit availability is back to levels not seen since 2014 (exhibit below). Although housing and mortgage credit has performed remarkably well during the pandemic, originators have turned their focus to agency refinancings as the drop in Treasuries has been accompanied by all-time low mortgage rates. We expect the agency refinance momentum to continue, but as the economy and markets find their footing, originators will once again return their focus to the non-agency market.

MORTGAGE CREDIT AVAILABILITY INDEX, INDEX LEVEL BY MONTH

(3/31/11-10/31/20; NSA, 3/2012=100)



Source: Bloomberg L.P.

A dearth of supply has led to spread compression, and the senior part of the capital stack has largely retraced back to pre-COVID-19 levels. In the non-QM (non-qualified mortgage) space, subordinate bonds have lagged senior securities as the market has repriced some of the deal triggers that up until the pandemic had largely been nonfactors. We have historically avoided these subordinate securities for this very reason and evaded much of the spread widening.

With RMBS spreads still at attractive levels relative to corporate bonds of comparable maturity, we expect demand for RMBS to remain strong. RMBS will continue to be an important alpha-generating sector for Newfleet and also a valuable source of liquidity. We expect the technical (supply/demand) environment to remain constructive and expect the market to continue its growth in 2021.

Fundamentals for housing have been reinforced as a result of the pandemic's work-from-home movement. Combined with the move to the suburbs and millennial household formation, the foundation for future housing strength is well intact. In the immediate future, the greatest limit to housing is on the supply side. The pandemic has disrupted supply chains, and the lack of labor needed to construct homes has been a constricting factor early into this demand cycle. Both factors should sort themselves out in 2021.

AGENCY MORTGAGE-BACKED SECURITIES (MBS)

By Andrew Szabo, CFA, and Zachary Szyndlar, CFA

2020 was another eventful year for agency MBS. Thirty-year mortgage rates rallied more than 100 basis points, coming into the year at 3.72% and now at a historical low of 2.71%, per Freddie Mac. MBS returned 3.51% through 12/3/20 with spreads well inside of 80 basis points as Treasuries have settled in. With prepayments remaining a concern, and agency MBS relative underperformance versus credit sectors, we look to maintain our overweight to the non-agency space.

The Fed has been the dominant player in the agency MBS market. As of 11/30/20, the Fed holds approximately $2 trillion of outstanding agency MBS and is still buying at a net rate of $40 billion a month. We expect this to continue into 2021 with the Fed committed to supporting housing and mortgage markets.

We are approaching 2021 in the same manner as 2020 when it comes to our residential MBS portfolios. We believe that non-agency RMBS and residential mortgage credit offer some of the best opportunities in the fixed income market. Agency MBS can offer some value but it is one of the most efficient markets within the fixed income universe, hence difficult to find alpha opportunities. Residential credit is still in the early innings and we feel there are alpha advantages to be found for our portfolios and versus our peers.

EMERGING MARKETS & NON-U.S. DOLLAR-DENOMINATED BONDS

By Peter Lannigan, CFA, and Daniel Senecal, CFA

Country Selection is Key

We continue to add emerging market (EM) debt exposure selectively. Our overall EM view remains neutral, as it was last year.

Our views, however, are far from stagnant. As an important nuance, our thinking has evolved toward considering EM debt as more than one market. While EM countries share common characteristics that make them part of the same broad market, our strategy emphasizes when we own EM and to which countries we are exposed. The clearest distinction is along the credit quality spectrum:

- Last year, we had a neutral EM view. However, we stressed our emphasis on adding exposure to investment grade (IG) EM countries. This was part of our overall view in both 2020 (through late March) and in 2019. IG EM outperformed high yield (HY) EM in both time periods.
- After the COVID-19-driven selloff in March, we added credit risk more aggressively. As the recovery in risk markets continued, we started to ratchet up our exposure in HY EM. HY EM remains the spread sector where we see the most value currently. The exhibit below shows the ratio of HY EM spread to IG EM spread.

RATIO OF HY EM SPREAD TO IG EM SPREAD

Source: Bloomberg L.P.

Much of our thinking is predicated on the ongoing global search for yield at a time when HY EM spreads remain slightly cheap versus history in a world where competing asset classes are rich. In this setting, we expect focus to remain on continued progress toward COVID-19 containment.

We retain our expectation for U.S. Treasury rates and credit risk spreads to remain range-bound, but with Treasury rates drifting slowly higher, balanced by the slow economic recovery but still-suppressed aggregate demand and continued central bank purchases. We are also encouraged by China's recovery and increased demand for commodities, which is very EM supportive.

We have successfully avoided EM local currency debt, which has underperformed again this year. Among the major developed country economic blocs, we still expect the U.S. to be the outperformer. As a result, we do not see the USD coming under pressure but, after several years of stability, we see it as largely range-bound. As a result, while we still do not embrace local currency debt as an asset class, the space has cheapened enough to induce us to look for individual pockets of value.

By Region

- Our largest regional allocation is still to Latin America. Our overall strategy has been to "increase beta" to earn incremental yield by moving down the credit risk curve within countries we like, rather than stretching too much by taking large positions in higher risk countries that can be difficult to exit during times of market stress. Retaining liquidity has enabled us to remain nimble in other regions as well.
- We still like the Sub-Saharan region. Many countries' bonds are cheap, and at the macro level, we still expect them to trade with well-supported equity markets. Of course, because of the high risk profiles of the underlying obligors, we must do our homework when selecting individual countries and we have to monitor closely developments in country fundamentals (economic and political), as well as bond price movements
- We also still like the Commonwealth of Independent States as a region (mainly Russia, Kazakhstan, and Ukraine):
  - We think Russia will continue to trade based on its strong credit indicators, healthy balance of payments profile, and low leverage. Political risk is ever present, but this is well known and is "in the price."
  - We view Kazakhstan as a stable, lower IG credit risk with good value. Now that political risk has subsided, we believe investors will continue to focus on the country's large fiscal and balance of payments surpluses, which have resulted in a very low debt burden and large holdings of liquid USD-denominated financial assets.
  - Ukraine continues to build on its improved relations with the international financial institutions (the IMF in particular). Meaningful progress has been made in securing external credit on concessionary terms as the country's progress in pursuing economic reforms has continued to surprise to the upside.

TAX-EXEMPT MUNICIPAL BONDS

By Tim Heaney, CFA, and Lisa Leonard

The municipal bond market should benefit from policies that have been put in place to help stabilize the economy during the current pandemic. Given the amount of government stimulus, it is difficult to imagine an environment of lower taxes and therefore less demand for tax-exempt income. While there is still much uncertainty as to future tax implications following the election, significant federal tax code changes appear unlikely without a senate majority. Recent rhetoric regarding the unwinding of Trump's corporate tax cuts, however, could potentially make municipal bonds more attractive to banks and insurance companies, boosting demand. As a result, we think solid demand should persist, especially for a sector of the market that has historically held a reputation as a safe-haven investment. That is not to say that the entire municipal market will be immune from the challenges that the pandemic has placed on revenues. While most municipalities came into the crisis far stronger financially than in previous economic downturns, many will likely be forced to manage with reduced revenue collections and face ratings downgrades. However, most will recover without actually defaulting as we have seen during past economic slumps.

With the general consensus being that lower rates will persist for the near term, municipalities should benefit from lower borrowing costs, while municipals on a tax-adjusted basis will remain an attractive investment even at these lower yields. We continue to believe that now is not the time to take on additional credit risk in the municipal market, especially with the growing financial challenges resulting from the pandemic. Despite the concerns surrounding lower rates, credit challenges, and likely ratings pressure, municipal bonds remain one of the lowest-risk, lowest-volatility asset classes and an essential allocation for individual investors.

MULTI-SECTOR OPPORTUNISTIC COMPOSITE GIPS COMPOSITE REPORT

		Composite Assets		Annual Performance Results					
				Composite			Benchmark†		
Year End	Total Firm Assets (billions)	U.S. Dollars (millions)	Number of Accounts	Gross	3 Yr Ann Std Dev	Net	Return	3 Yr Ann Std Dev	Composite Dispersion
2019	10.6	1,127	Five or fewer	12.21%	2.88%	11.49%	8.72%	2.87%	N.A.
2018	10.4	865	6	-2.50%	3.55%	-3.12%	0.01%	2.84%	N.A.
2017	12.0	724	Five or fewer	8.00%	3.96%	7.41%	3.54%	2.78%	N.A.
2016	11.7	610	Five or fewer	11.04%	4.51%	10.44%	2.65%	2.98%	N.A.
2015	11.4	502	Five or fewer	-0.63%	4.45%	-1.17%	0.55%	2.88%	N.A.
2014	12.6	584	Five or fewer	2.71%	4.60%	2.15%	5.97%	2.63%	N.A.
2013	12.3	606	Five or fewer	3.28%	5.60%	2.71%	-2.02%	2.71%	N.A.
2012	10.8	750	Five or fewer	15.52%	5.92%	14.89%	4.22%	2.38%	N.A.
2011	8.1	470	Five or fewer	4.06%	7.48%	3.49%	7.84%	2.78%	N.A.
2010	*	441	Five or fewer	14.91%	10.18%	14.28%	6.54%	4.17%	N.A.

†Benchmark: Bloomberg Barclays U.S. Aggregate Bond Index

Composite Dispersion: N.A. - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

*Prior to June 2011, the Multi-Sector Fixed Income Team was part of Goodwin Capital Advisers, a Phoenix Company. Since management of the mutual funds prior to this date was under a sub-advisory agreement with Goodwin and the predecessor firm, the requirements for performance portability for inclusion in the composite have been met.

The Multi-Sector Opportunistic Composite contains all fully discretionary, fee paying multi-sector opportunistic accounts. Emphasis is on investments in fixed income across all 14 sectors of the fixed income market with the following restrictions: maximum below investment grade securities 65%, average credit quality is at least BB and non-US exposure 0-50%. Emphasis is active sector rotation and disciplined risk management to portfolio construction avoiding interest rate bets.

For comparison purposes, the composite is measured against the Bloomberg Barclays U.S. Aggregate Bond Index. The index is composed of securities from the Government/Corporate Bond Index, Mortgage-Backed Securities Index and Asset-Backed Securities Index, calculated on a total return basis, which includes price appreciation/depreciation and income as a percentage of the original investment. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

Newfleet Asset Management, LLC is a registered investment adviser and an indirect wholly owned subsidiary of Virtus Investment Partners. The minimum account size for this composite is $15 million. The Multi-Sector Opportunistic composite was created on April 1, 2012. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results. The U.S. Dollar is the currency used to express performance. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Effective 1/1/13, accounts with leverage are no longer included in the composite.

Returns are presented gross and net of management fees and include the reinvestment of all income. Effective 3/1/2018, net of fee performance was calculated using 1/12 of the highest fee of 0.65%, applied monthly. Prior to 3/1/2018, net of fee performance was calculated using 1/12 of the highest fee of 0.55%, applied monthly. Actual investment advisory fees incurred by clients may vary. The management fee schedule is as follows: First $100 million – 0.40%, over $100 million – 0.35%. Newfleet Asset Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Newfleet Asset Management, LLC has been independently verified for the period January 1, 1990 through December 31, 2019.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Multi-Sector Opportunistic composite has been examined for the periods June 2, 2011 through December 31, 2019. The verification and performance examination reports are available upon request. The firm maintains a complete list and description of composites, which is available upon request.

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IMPORTANT RISK CONSIDERATIONS: Credit & Interest: Debt instruments are subject to various risks, including credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **High Yield Fixed Income Securities:** There is a greater risk of issuer default, less liquidity, and increased price volatility related to 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 non-repayment of underlying collateral, including losses to the fund. **Foreign & Emerging Markets:** Investing in foreign securities, especially In emerging markets, subjects the fund to additional risks such as increased volatility, currency fluctuations, less liquidity, and political, regulatory, economic, and market risk. **Municipal Market:** Events negatively impacting a municipality, 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 are subject to credit and call risk, may 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 Emerging Markets Hard Currency Aggregate Index** is a hard currency emerging markets debt benchmark that includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. The **Bloomberg Barclays Global Aggregate Index** is a broad-based measure of global investment grade fixed-rate debt investments. The **Bloomberg Barclays Municipal Bond Index** is a market capitalization-weighted index that measures the long-term tax-exempt bond market. The **Bloomberg Barclays U.S. Aggregate Bond Index** is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS. The **Bloomberg Barclays U.S. Corporate Investment Grade Index** measures the performance of investment-grade corporate securities within the Barclays U.S. Aggregate Index The **Bloomberg Barclays U.S. MBS Index** covers agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The **Bloomberg Barclays U.S. Asset Backed Securities (ABS) Index** measures ABS with the following collateral type: credit and charge card, auto, and utility loans. The **Bloomberg Barclays U.S. CMBS Index** measures the market of conduit and fusion CMBS deals with a minimum current deal size of $300M. The **Bloomberg Barclays U.S. Corporate High Yield Bond Index** measures fixed rate non-investment grade debt securities of U.S. corporations, calculated on a total return basis. The **Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index** is a market capitalization-weighted index that measures fixed rate non-investment grade debt securities of U.S. and non-U.S. corporations. No single issuer accounts for more than 2% of market cap. The **Credit Suisse Leveraged Loan Index** tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries. The **J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified** is an unmanaged index of USD-denominated bonds with maturities of more than one year issued by emerging markets governments. The **S&P 500® Index** is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. 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 real-time 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. **LIBOR:** London Interbank Offered Rate.

The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

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