NEWFLEET ASSET MANAGEMENT

Fixed Income Sector Review

As of March 31, 2021

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- We project a much stronger global economic recovery in 2021 and 2022 than we anticipated last year. We expect the range of recovery paths to widen further, tilting even more toward the two major economic engines – the U.S. and China.

- Consensus estimates for U.S. growth this year are now approaching 5.8%-6.0%, up from just over 3.0% for most of the onset of the recovery in mid-2020. Estimates for China have moved up to 8.5%. We expect developed Europe and Japan to continue to lag, primarily due to less favorable demographic trends. The pandemic affected EM countries more than DM countries and the subsequent recovery paths to prior GDP levels will be slower.

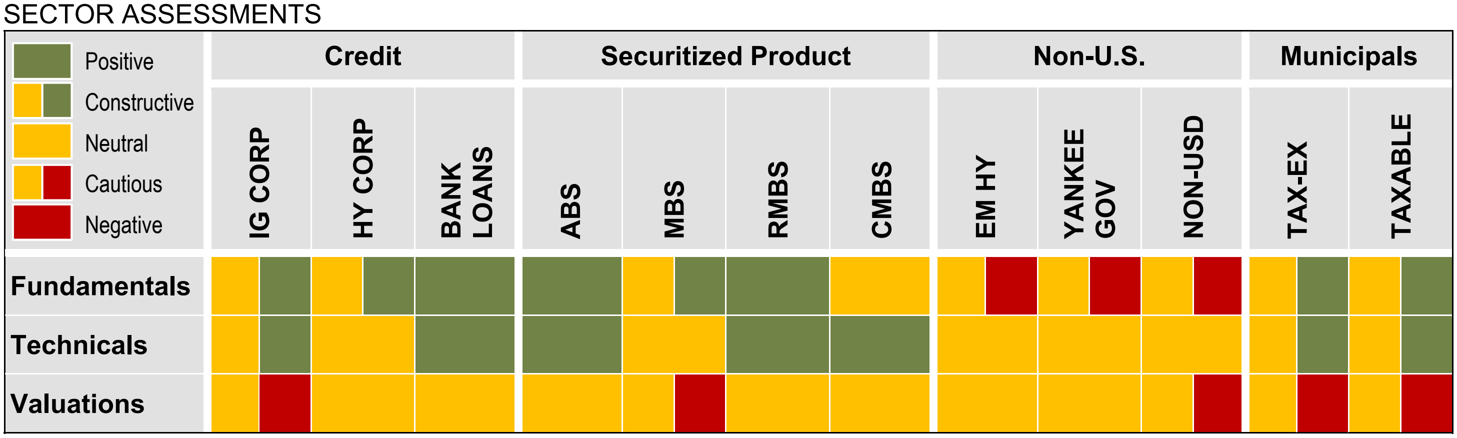
- While the U.S. Treasury market has settled for now, we expect U.S. growth outperformance of the G-7 to continue and for this to eventually push U.S. interest rates higher once again. The Biden administration is already talking about more (even larger) fiscal stimulus on the heels of the most recent fiscal package.

- We see two challenges ahead: 1) tax hikes, which will be needed to pay for the fiscal programs, and 2) a government debt burden that is at its highest level as a percentage of GDP since World War II. The offset for now is the low cost (interest rate) of servicing the debt. Higher interest rates will clearly start to cut into growth, whether now or eventually.

- Our consistent view is that we expect growth to “reflate”, and for this to continue to put upward pressure on interest rates (higher rates for “good” reason). We still do not expect rates to move meaningfully higher, just a slow and steady rise. The risk is if rates were to rise for the “wrong” reason, i.e., higher inflation.

- After the strong post-COVID-19-driven recovery rally in equities and credit spread compression since late March of 2020, the backdrop has shifted to a phase where the big capital gains from the rebound in risk assets have passed and returns in credit spread fixed income, including EM, will come mainly from carry.

SECTOR ASSESSMENTS



Newfleet’s assessments of non-government spread sectors as of March 31, 2021. Assessments are determined by analyzing a sector’s fundamental data, technical indicators, and relative valuations. Sectors (l to r): **Credit**: Investment Grade (IG) Corporate Bonds, High Yield (HY) Corporate Bonds, Bank Loans. **Securitized Product**: Asset-Backed Securities (ABS), Agency Mortgage-Backed Securities (MBS), Non-Agency Residential MBS (RMBS), Non-Agency Commercial MBS (CMBS). **Non-U.S.**: Emerging Markets HY, Yankee Government, Non-U.S. Dollar. **Municipals**: Tax-Exempt, Taxable.

Continued

SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds	• Though metrics have deteriorated with massive debt growth and EBITDA declines, issuers have largely avoided burning cash and are sitting on elevated liquidity. For 2021, the consensus forecast sees 25% earnings growth for the S&P 500. • Gross and net supply in March totaled \$201B and \$63B, respectively, well ahead of five-year averages but have now fallen behind last year's record pace. Flows remain positive for Aggregate and corporate-only funds, but have slowed. More rate volatility could blunt retail demand even further. • Spreads have been range-bound thus far in 2021, between 90-100. Yields are up 58 bps YTD; still nearly 1% below the five-year average and 115 bps lower than year-ago levels.
High Yield Corporate Bonds	• With Q4 earnings now reported, aggregate credit metrics have improved from the prior quarter but remain at elevated levels. The upgrade to downgrade ratio, based on issuer, improved to 1.2 in March, while the LTM issuer-weighted default rate decreased to 5.50%. • High yield saw a fourth consecutive month of outflows as \$5.9B left the asset class. Another month of record new issuance was set in March with \$64.8B of gross new issuance, resulting in a supply surplus of \$25.1B. • The average spread tightened 16 bps in March to finish at +308 with a monthly range of +308 to +337. The yield to worst decreased by 2 bps to 4.23%, while the average dollar price ended March at \$104.16 having started the month at \$104.55.
Bank Loans	• Favorable macroeconomic conditions, supportive monetary and fiscal policies, and strong, liquid capital markets provide a solid backdrop for loans; inflation is a looming concern. The default rate, now at 3.15%, has declined for six straight months and may have peaked in the current cycle at 4.17% last September. • Retail inflows totaled \$4.1B for March, the fourth consecutive month of inflows, and CLO new issuance (\$14.7B) remained robust. Record issuance has brought supply/demand into better balance though demand remains strong as investors search for yield and seek to manage duration risk. • Loan spread to a 3-year life widened to L+434 in March. While this level is inside historical long-term averages, we believe loans still have room to tighten on the back of an improving economy, increased demand to hedge duration risk, market discount, LIBOR floors, and serious investor need for yield.
Securitized Product	• An improving unemployment picture, a third stimulus package, and impending tax refunds all point to continued positive consumer behavior going forward. • Securitized product issuance continues to be met with robust demand. • A strong technical picture with continued improvement in consumer fundamental performance helped keep spreads steady for the month. • Historically low mortgage rates coupled with the pandemic and limited housing inventory create continued strong demand for residential real estate. • We continue to position the securitized portion of the portfolio around the U.S. consumer and single-family real estate.
Emerging Market Debt	• The macro backdrop remains supportive with consensus 2021 GDP growth estimates for the U.S. now at 6% (and for China at 8.5%) on the back of unprecedented government fiscal stimulus and accommodative DM monetary policies. • EM economies are also recovering but with a wide variance in the pace. We generally expect the pace of recovery across most EM economies will be lower than the U.S. due to the continued spread of COVID-19 and a much slower pace of vaccine rollout in comparison to the U.S. • Retail investor flows slowed and turned modestly negative in March while new issue supply remained low. The overall technical backdrop was relatively neutral over the course of the month with spreads trading in a tight range.

Continued

Emerging Market Debt, cont'd	• EM bond yields remain attractive on a relative basis to other fixed income sectors and we will look for opportunities to add as U.S. Treasury market volatility eases.
Municipal Bonds	• Federal stimulus support and better-than-expected revenue growth should ease fundamental challenges brought on by the pandemic. Low borrowing costs, increased investment returns, an improved housing market, and access to capital have been favorable for municipal issuers. • Technicals remain mostly supportive for valuations, although the market is historically weaker as tax season approaches. While recent supply of new bonds has been above average, much of this increase is a result of taxable municipal issuance. • Valuations are historically rich, but given the prospects of higher tax rates, they may become more attractive for some investors on a tax-adjusted basis.

For information about Newfleet fixed income strategies, please contact:
Paul Privitera, Director, Institutional Business Development
Newfleet Asset Management
O: 860.760.5809 | C: 860.839.0705

Investing is subject to risk, including the risk of possible loss of principal. Past performance is not indicative of future results.