NEWFLEET ASSET MANAGEMENT

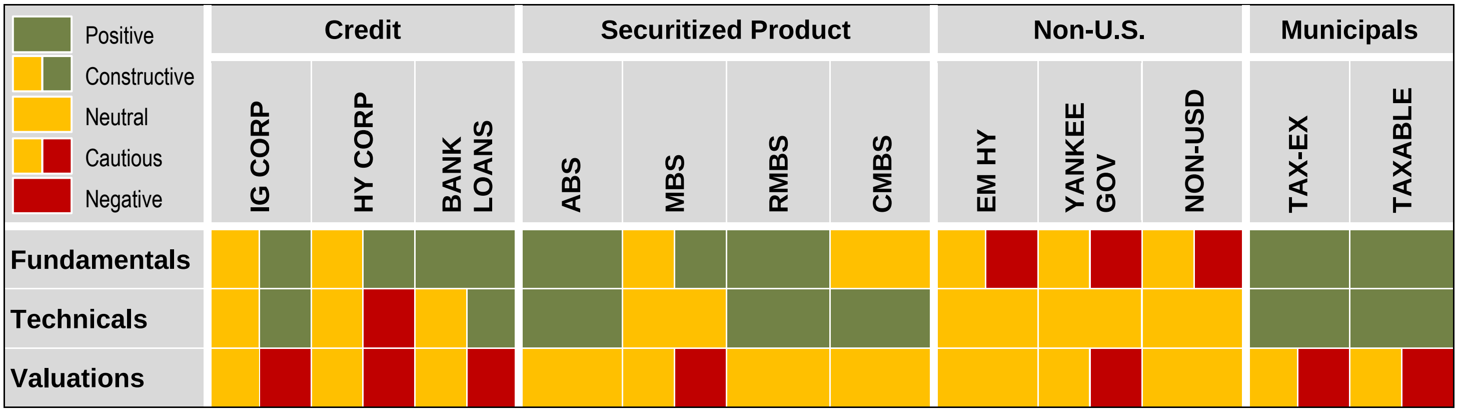
Fixed Income Sector Review

As of June 30, 2021

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- Our multi-sector portfolios remain:
    - Long credit risk spreads
    - Neutral interest rate duration
    - Relatively light in emerging markets (EM)
    - Within high yield credit, relatively more exposed to US corporate credit (high yield and leveraged loans) than to EM
    - Within high grade credit, relatively more exposed to structured credit than to corporates
- We expect credit risk spreads to remain range-bound. This, in turn, should enable us to earn our carry.
    - We see credit spreads capped by (not widen much):
        - Robust equity markets
        - Continued commodity price strength
        - Continued growth in aggregate demand as reflation persists
        - A still active Fed and ECB; both major developed market (DM) central banks are still buying bonds and eventual tapering is well-known and likely to be slow
    - We also see credit spreads as having limited tightening (capital gain potential) due to:
        - Their remaining tight versus historical levels
        - Despite the Fed and ECB continuing to buy bonds, they are going to slow down the pace in the near-to-intermediate-term.
- While we still see the global macro backdrop as benign and expect the global economy to continue to reflate, we note the recent (since 31 Mar 2021) decline in US interest rates and flattening of the yield curve. Both indicate the Treasury market's anticipation of slower future growth. While we do not anticipate a recession, we think the year-over-year growth path has peaked.
- As a result, our forecast for interest rates to drift slowly higher also remains intact. We believe that still contained inflation reflects accelerating growth, not a problematic harbinger of price driven inflation.

SECTOR ASSESSMENTS



🟩 Positive
🟨🟩 Constructive
🟨 Neutral
🟨🟥 Cautious
🟥 Negative

	Credit			Securitized Product				Non-U.S.			Municipals	
	IG CORP	HY CORP	BANK LOANS	ABS	MBS	RMBS	CMBS	EM HY	YANKEE GOV	NON-USD	TAX-EX	TAXABLE
Fundamentals	🟨🟩	🟨🟩	🟩	🟩	🟨🟩	🟩	🟨	🟨🟥	🟨🟥	🟨🟥	🟩	🟩
Technicals	🟨🟩	🟨🟥	🟨🟩	🟩	🟨	🟩	🟩	🟨	🟨	🟨	🟩	🟩
Valuations	🟨🟥	🟨🟥	🟨🟥	🟨	🟨🟥	🟨	🟨	🟨	🟨🟥	🟨	🟨🟥	🟨🟥

Newfleet's assessments of non-government spread sectors as of June 30, 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.

Newfleet Asset Management's industry trends and observations are the result of research conducted by the portfolio management / research team. These observations reflect their industry expertise and have been prepared using sources of information generally believed to be reliable; however, their accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice.

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SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds	• First quarter sales and earnings growth for the S&P 500 came in at 11% and 50%, respectively. For the full year, consensus estimates call for revenue and earnings growth of 12% and 35%, respectively. These numbers have been creeping higher as companies have been issuing positive EPS guidance at a high rate. • Gross and net supply of $142B and $40B, respectively, were within range of their five-year averages. Flows have shifted from “mixed” to “positive” with corporate-only funds shifting to inflow mode in May and June. Aggregate fund flows have been solidly positive all year. • Spreads tightened 4 bps during June to set a fresh 15-year low. At +80 on a duration of 8.6, the spread/unit of duration is below the tights hit in 2004-2005 when spreads hit +75 on a duration below 6.0. Yields declined for the third straight month, ending June at 2.04%. This is 100 bps below the five-year average.
High Yield Corporate Bonds	• First quarter earnings came in stronger than expected with very few companies missing estimates and many companies announcing positive guidance. • High Yield funds saw their second consecutive outflow, and sixth out of the last seven months, with $2 billion leaving the asset class. Year-to-date outflows have accumulated to -$13.8 billion. • The High Yield Index spread finished the month at +267 after 27 basis points of tightening in June. June finished at the low end of the range, after peaking at +301. The average Yield-To-Worst decreased by 28 basis points in June to finish the month at 3.75%. Much like the average spread, the YTW also finished at the June low, rallying from a high of 4.05%.
Bank Loans	• The macroeconomic recovery continues at a pace that has exceeded many expectations. Standard & Poor’s has recently increased its global growth forecast for 2021 to 5.9% from 5.5% noting strength in the US (6.7% growth) and China (8.3%). Collectively, these two nations account for roughly 40% of the global economy. Coupled with continued monetary policy accommodation and perhaps additional fiscal spending, macroeconomic strength should underpin favorable credit market conditions for the near/medium term. • Despite June’s slide in rates, demand for loan exposure remains healthy. Investor need for income and interest rate protection is resulting in record demand from retail and institutional investors, while net new supply – despite an increase in activity – is not yet keeping pace. Retail inflows totaled $3.6B, the seventh straight month of inflows. YTD inflows now total over $20B and exceed the 2020 outflows of $19B. CLO new issuance was $15.2B ($81B YTD) and on record issuance pace. • Loan spread to a 3-year life tightened to L+417 in June. For context, while we remain tight to historical (post GFC) averages (L+532), we have seen valuations tighten to mid L+300s during the last rising-rate environment of 2017/18.
Securitized Product	• Personal income and the savings rate remain much higher than historical averages pointing to positive consumer behavior moving forward. • Insatiable demand for securitized product backed by the consumer and U.S. housing persists. • A strong technical picture with continued improvement in consumer fundamental performance helped keep spreads steady for the month. • Historically low mortgage rates, pandemic-related demand, and limited housing inventory continue as tailwinds for residential real estate. • We continue to position the securitized portion of the portfolio around the U.S. consumer and single-family real estate.

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Emerging Market Debt	• The macro backdrop remains supportive driven by accommodative G-3 monetary and fiscal policies. However, the slower deployment of vaccines across EM will contribute to a more prolonged and shallow recovery for most EM economies. We expect to see downward pressure on sovereign ratings as higher fiscal deficits have led to material increases in debt relative to GDP in some cases. • Rising inflation is also a problem for many EM countries, and as a result, there is growing pressure on EM central banks to begin hiking local rates despite an incomplete economic recovery. We have already seen rate hikes from Brazil, Russia, Mexico, and Hungary, among others.
Emerging Market Debt, cont'd	• Support from multi-laterals will remain generous; for example, we expect the IMF to implement its plan to increase special drawing right (SDR) allocations by the end of August 2021, which will boost international reserves across emerging market countries. • EM retail investor flows into hard currency and local currency funds remain strong. Valuations have cheapened a bit over the last month, especially within the below-investment grade space, and relative to U.S. high yield, but may be warranted given the challenging recovery path faced by many sovereign issuers.
Municipal Bonds	• Municipalities have benefitted from federal stimulus and an improving economy, easing credit concerns in the near-term. The municipal bond market has been favorable for issuers as low borrowing costs, increased investment returns, an improved housing market, and access to capital have also boosted credit. • Technicals remain mostly supportive for valuations as the prospect of higher federal income tax rates has created tremendous demand for tax-exempt income while supply remains manageable. • 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.

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