NEWFLEET ASSET MANAGEMENT

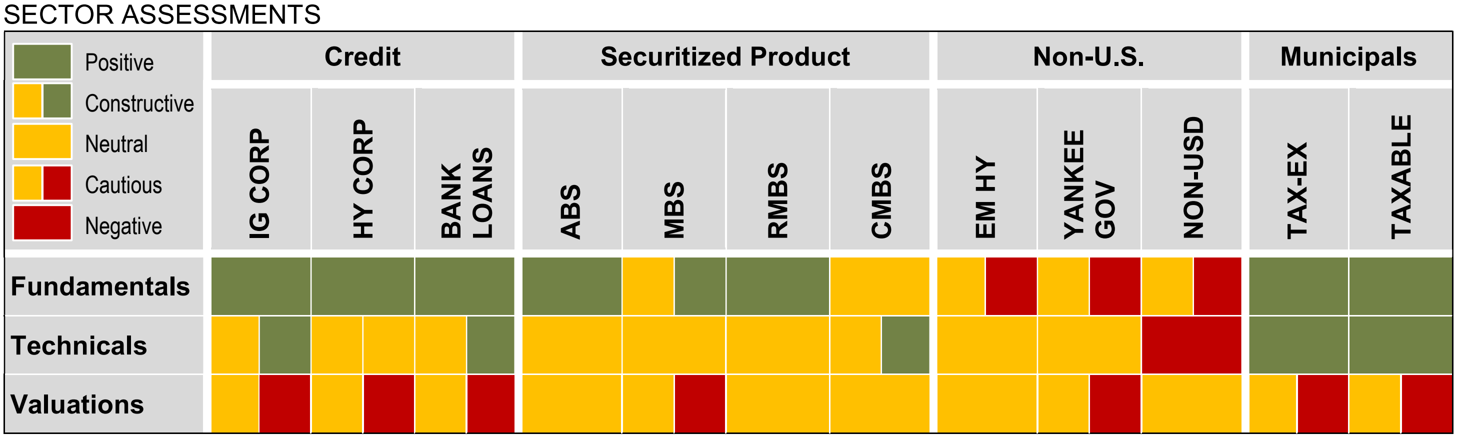
Fixed Income Sector Review

As of December 31, 2021

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- We are seeking to earn the carry plus some alpha from sector allocation.
- We still expect interest rates and risk spreads to remain in roughly well-defined ranges, with equities supported by earnings growth.
- Our YE22 10-year US Treasury yield sits in the low 2% range. While slower growth and continued central bank bond buying will cap interest rates from moving meaningfully higher, we think they will move a bit higher. Real (inflation adjusted) interest rates, which are now negative, are simply too low. The only other time they were negative was when the world faced much worse predicaments – stagflation and the Arab oil embargo.
- We expect vaccine rollouts and government aid to counterbalance recent spikes in case counts, including the impact of new variants. We believe this has been factored into the price of risk assets. The real risk is that markets start to worry about COVID statistics again.
- Inflation is a near-term problem, but we think it will also remain contained as supply chains adjust and the effects of tighter monetary policy slow the pace of price gains.
- Risk markets now expect three Fed rate hikes in 2022, three more in 2023, and accelerated tapering to be complete by mid-March 2022.

SECTOR ASSESSMENTS



Newfleet's assessments of non-government spread sectors as of December 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.

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SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds	• We enter 2022 with encouraging fundamental trends and tight valuations. The consensus forecast calls for a sideways year for spreads, which is hard to argue with given the parallels between the start of 2022 and the start of 2021 (which wound up being a flat year for spreads). Our allocation to the asset class is at a relatively low point historically due to the challenging valuations. This gives us significant capacity to add opportunistically. • Spreads tightened 7 basis points in December to end the year at 92 basis points after being range-bound between 80-90 from mid-April to early-November. Omicron caused a two-week sell-off, though spreads seem headed back to the prior trading range. • Earnings growth is expected to hit 20% in the fourth quarter, with 8% growth in 2022. These estimates have declined modestly over the past month, which is typical as reporting dates get closer. We were concerned about margins getting squeezed amidst supply chain constraints, but margins showed demonstrable growth in the year-over-year period as large companies succeeded in passing through higher costs.
High Yield Corporate Bonds	• While the emergence of the Omicron variant pushed the high yield index lower in late November, both news that the variant might be less severe than earlier strains and a supply shortfall helped propel the index to a positive return of +1.87% for the month of December. The positive performance was equally distributed across all ratings categories as BBs were +1.82%, Bs were +1.96% and CCCs were +1.90% in December. • The fifth monthly inflow of 2021 and lower supply due to the holiday season helped to create a supply shortfall. This positive technical backdrop paired with the Omicron data helped to push high yield asset valuations higher on light secondary volumes. • We participated in December's muted calendar selectively as concessions remained scarce. While we were positioned well for the December rally, we continue to monitor the impact of Omicron on corporate results with particular emphasis on labor costs, input costs and the bottlenecks on the supply chain. We head into 2022 with the bias to opportunistically rotate to higher quality paper while being cognizant of volatility in U.S. Treasury yields.
Bank Loans	• December's 0.64% return was a fitting close to a year that set multiple records and saw the first phase of the transition away from the loan market's base rate LIBOR. • Gross supply was $13.8 billion in December, the lowest level in a year which totaled a record $615 billion in gross issuance. Just over half of this issuance was M&A related – a record-setting amount. The loan market now stands at $1.35 trillion – another record. • Meanwhile, macroeconomic forecasts have been walked down – consensus GDP growth is 3.9% in 2022 – while the possibility of higher interest rates to curb inflation is increasing. • We expect retail demand to continue if a rising rate environment does develop. While today retail makes up roughly 10% of the market, that share has been as high as 20% in 2017/18 (rising rate period) and 30%+ in 2013 (taper tantrum). • CLOs printed $10.8 billion in December. While new CLO issuance could be slow to materialize as investors weigh return profiles in a SOFR-based world, we believe that the resilience of the structure, coupled with its protection against rising rates and its real income stream, should continue to create interest.
Securitized Product	• The yield curve continued to flatten during December as the 2-year U.S. Treasury note moved higher by 17 basis points to yield 0.73% and the 10-year Treasury note rallied by 7 basis points to yield 1.51%. The negative rate move on the front end of the yield curve was the primary driver of returns for the month for short duration risk assets. • The Federal Reserve announced it would reduce monthly purchases of U.S. Treasuries and agency mortgages by $30 billion a month beginning January 2022. New buyers need to emerge. • December supply was moderate, leaving valuations intact. The lack of new issue supply the last two weeks of December coupled with monthly principal amortization payments should drive demand for the new issue market in January.

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Emerging Market Debt	• EM outperformed in December by enough to finally bring full year 2021 performance in line with the broader bond market. Emerging market (EM) bonds as shown in the JPMorgan Emerging Markets Bond Index Global (EMBI Global) were up by 1.43% in December – 169 basis points better than the broader bond market (using the Bloomberg Agg. as reference), which was down 0.26% for the month. This brought the performance of the two indices to approximately the same total return level for the full year. • After two years of underperformance, we see potential opportunities in high yield EM. The credit risk spread differential between EM and US corporate bonds in the HY space is near the highest level in five years. Though there are plenty of risks, we believe much of it is already priced in. Another positive is that we see wide total return dispersion by country in the HY EM space. This opens the door to total return opportunities from country selection. • We continue to avoid exposure to China due to risks around slower-than-expected growth and ongoing regulatory crackdowns. We still have no exposure to Russia as its yields have yet to widen enough to compensate for the country's political risks. Though violent protests sweeping Kazakhstan pose risks, we maintain our neutral exposure as Kazakhstan's capacity is very high.
Municipal Bonds	• The federal government's rapid and historic support of the economy has stabilized municipal credit for the time being. Most sectors largely exited the crisis with balance sheets and operations buoyed by nearly two years of stimulus support and little need for cash borrowing. Meanwhile, upgrades have been outpacing downgrades by a wide margin. • Technicals remain supportive as investor interest in the sector remains strong as demonstrated by strong mutual fund flows. Meanwhile, the passage of the infrastructure bill will not necessarily equate to elevated supply going forward due to the longer planning and permitting required for many of the projects. • We expect municipal yields to mostly track US Treasury yields, but with less volatility. Credit risk spreads remain at historically tight levels.

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