NEWFLEET ASSET MANAGEMENT

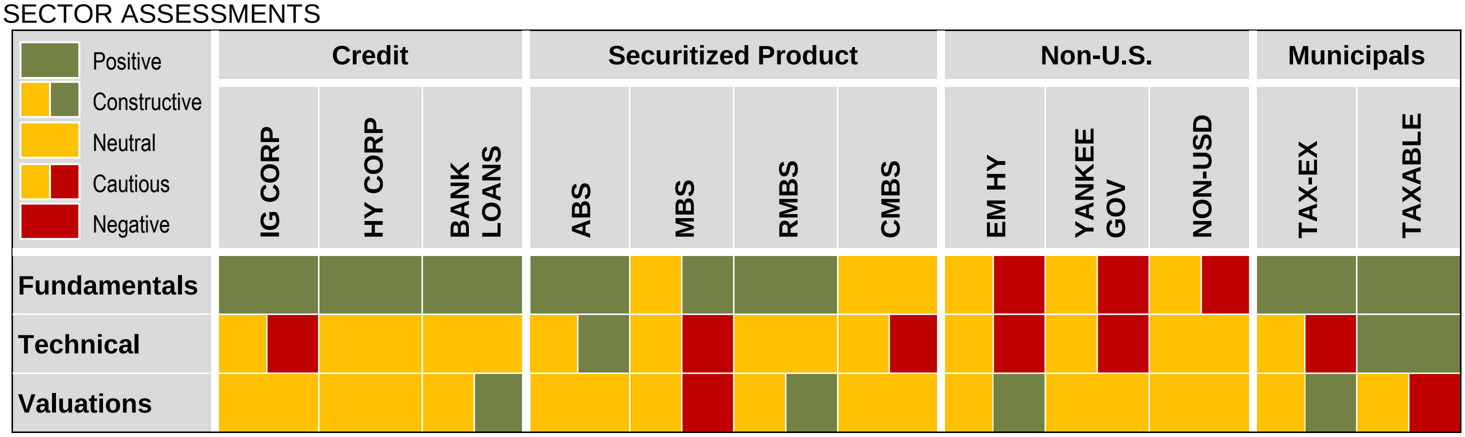
Fixed Income Sector Review

As of April 30, 2022

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- Once again, we were well-positioned for a tough market in April. While this enabled good relative performance, we were still down with the market.
- We reduced high spread beta exposure (including raising some cash) ahead of the selloff and remain light relative to our history in high-risk sectors, such as emerging markets (EM.)
- We continue to avoid non-US$ exposure despite pockets of value in EM local markets. We still expect the US$ to remain well supported.
- Fundamentally, we are retaining our macro/geopolitical view as “stagflation light,” which we define as higher-than-expected inflation coupled alongside weaker growth that falls short of outright GDP contraction.
- We remain focused on the Federal Reserve (Fed), the war between Ukraine and Russia, and China’s COVID-driven growth slowdown.
- We think more investors are coming around to our view that the Fed is behind the curve in fighting inflation, and we still expect the Fed to overreact by overtightening.
- Another important question is whether monetary policy will be effective in fighting inflation driven by lower commodity supply and continued supply chain disruptions.
- We do not expect the Russia/Ukraine war to disrupt markets meaningfully further, although the possibility of more short-term selloffs remains as Russia responds to more sanctions.
- We have kept our central case view that China will lock down COVID-impacted regions, and then move on, though we should also acknowledge the potential for a wider array of near-term outcomes if the lockdowns persist or broaden to other geographies.
- Overall, while we see some more downside in risky bonds, some longer-term value has been created. The yield-to-worst of the Bloomberg Agg is now close to its highest level in a decade.
- Pulling all this together, we continue to buy on meaningful weakness and are watching our risk management parameters closely.

SECTOR ASSESSMENTS



Newfleet’s assessments of non-government spread sectors as of April 30, 2022. 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	• Spreads and yields moved higher this month, with the latter now at 10-year highs. The asset class has lost nearly 13% YTD, which is in rarified territory – this marks the third worst period since 1970. • Unlike other asset classes, the technical environment feels nonplussed by rates/returns. Mutual funds have seen trickling outflows all year, corporate-only funds are surprisingly positive YTD, and aggregate and total return funds have seen outflows. Per JP Morgan, which blends these totals, YTD flows are functionally zero for the asset class. • Fundamentals, while improving, are backward-looking by nature, and investors are now hyper-focused on rate hikes and associated recessionary risks. Spreads are likewise in the zone that we would call, "historically wide, save for recessions."
High Yield Corporate Bonds	• April was another challenging month for high yield – with the index down 3.56%, this brings the year-to-date index return to -8.22%. BBs and CCCs were both down approximately 3.7% for the month, but for different reasons. The increase in U.S. Treasury yields had an outsize impact on higher-quality BBs, while CCCs saw spreads widen more than BBs and Bs due to increasing concerns that the Federal Open Market Committee may not be able to navigate a soft landing. • Early indications on earnings are that while fundamentals are holding strong, headwinds from supply chain issues and labor shortages persist, prompting companies to moderate their forecasts. • While we still favor commodity-related firms, we have begun to monitor higher-quality issuers with bonds trading at a deep discount to par. The increase in U.S. Treasury yields coupled with wider spreads have us considering this higher-quality paper over credits more sensitive to an economic slowdown or potential recession
Bank Loans	• Loans gained 0.22% for the month and continued to recover February's losses on a total return basis. As investors increasingly turn their focus to economic growth, we expect growth to decelerate but still stay at a level that is adequate for credit, above the 20-year trend line average of 1.9%. Our sensitivity analysis points to adequate debt service cushion pro forma for a rising rate environment and reductions in cash flow. But we recognize that the marginal borrower, particularly the 15% of the loan market with interest coverage of less than 1.5x, may be negatively affected. • Demand is still strong among CLO portfolios and retail funds. We suspect that non-traditional loan investors may be putting pressure on loan prices as they rotate into other asset classes based on relative performance. • We have pivoted up slightly in credit rating quality – specifically, increasing BB risk by over 3% in the month while reducing B risk by 2% – and have concentrated investments in seasoned borrowers where we have had a long history following the business and its drivers.
Securitized Product	• Total returns were negative again this month, driven by the backup in Treasury rates. Though ABS produced positive excess spreads, CMBS and MBS produced negative excess returns. We are still positive on the U.S. consumer and housing fundamentals, which drives our overweight to securities in both sectors. • Negative fixed income mutual fund flows continue to put pressure on spread product overall, while higher rates affect future MBS and RMBS supply forecasts. • With yields higher and spreads wider, we see a lot of value in the consumer space, which we are adding prudently to the portfolios. We continue to put emphasis on the front end of the yield curve, where we look to put dollars to work in investment grade amortizing assets and in deal structures that lead to de-leveraging.

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Emerging Market Debt	• EM debt declined by 5.48% in April, bringing the year-to-date total return down to -14.23%. Given our concerns, we are trying to manage the potential for near-term downside. However, fixed income markets have corrected significantly, and we expect the markets to settle eventually. • While we now see more value in EM debt, we must still get comfortable with some key macro issues before we will feel comfortable enough to increase our exposure meaningfully. Careful country selection in the current environment is critical. So far, in 2022, the bonds issued by Russia have lost almost all their value, Ukraine's bonds are close behind, and 17 others are down by over 15%. • Countries that outperformed the EM debt index include oil exporters such as Oman, Angola, and Nigeria. Weaker performers include China (particularly the HY property sector), and Egypt.
Municipal Bonds	• Following an unprecedented quarter of negative returns, municipal bonds are now showing better relative value than they have in quite some time. We do expect that market volatility will continue until the market gains more clarity on the Fed's intentions to tame inflation and U.S. Treasury rates begin to stabilize. • After seeing 86 consecutive weeks of inflows that created tremendous demand for tax-exempt bonds, the market has now seen 17 consecutive weeks of outflows, bringing the YTD outflows total to almost $44.7 billion. • However, municipal credit fundamentals are still mostly on solid footing – especially coming off the strong federal stimulus funding during the pandemic. According to the latest numbers from the U.S. Census Bureau, state and local tax collection receipts for income, sales, and property taxes showed growth of 13.1% for 4Q 2021 from 4Q 2020.

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