NEWFLEET ASSET MANAGEMENT

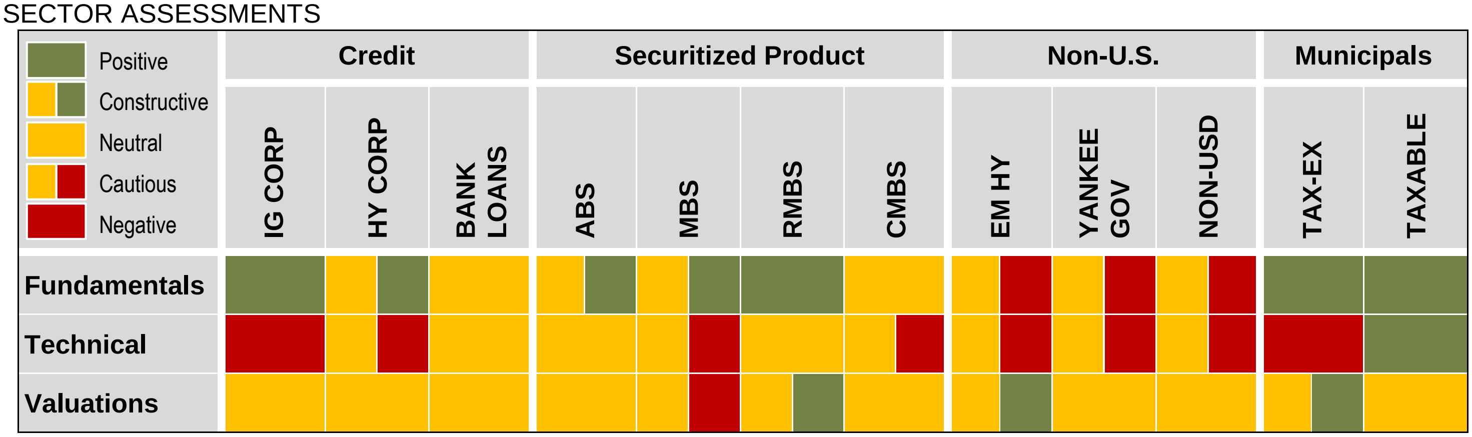
Fixed Income Sector Review

As of May 31, 2022

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- In our main multi-sector funds, relative performance was weak in May as Treasury yields fell and risk sector spreads widened.
- We pared emerging markets (EM) and U.S. leveraged finance weightings back further due to increased concern around global growth and inflation.
- Fundamentally, we are retaining our macro/geopolitical view as “stagflation light,” which we define as higher-than-expected inflation coupled with weaker growth that falls short of outright GDP contraction.
- The Russia/Ukraine conflict and the related sanctions on Russia imposed by the West have contributed significantly both to a major downward shift in global growth estimates, and a shift toward even higher inflation.
- We remain concerned growth estimates may still be too high as the conflict grinds on. Since March, a full 1% or more has been shaved from global, U.S. and Europe consensus growth estimates, which are now at 3.3%, 2.6% and 2.6%, respectively, for 2022.
- We expect China to continue to pursue its zero-COVID policy to the detriment of its overall growth outlook, which continues to be revised lower, with consensus 2022 expectations now at 4.5%.
- We remain focused on rate policy in the U.S. and Europe, where both central banks, in our view, are behind the curve.
- Another important question is whether monetary policy will be effective in fighting inflation driven by a commodity supply shock and ongoing supply chain disruptions. Supply chain disruptions seem to be improving but remain challenging in many areas.
- Fuel and food prices remain elevated, and, in our view, may persist, since sanctions against Russia are unlikely to end anytime soon.
- Overall, while we see some more downside in risky bonds, some of the recent spread widening has created longer-term value. Furthermore, the Bloomberg U.S. Aggregate Bond Index (U.S. Agg) yield is near its highest level in a decade.
- Pulling it all together, we are re-underwriting risk positions, and watching our risk management parameters closely.

SECTOR ASSESSMENTS



Newfleet’s assessments of non-government spread sectors as of May 31, 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

- May started off ugly, with spreads peaking at a post-COVID high of 147 bps on May 20th before a 19-bps rally in the final six trading days of the month brought spreads and yields back from YTD highs. At 129 bps, spreads are 15 bps higher than the five-year average.
- The new issue market slowed in May with $108 billion of gross issuance, but just $10.5 billion of net issuance (down 76% year-over-year). With yields at ten-year highs and cold investor reception for new issues, the market took a breather towards the end of the month that allowed the rally to take place. However, we do not expect this to last, as we anticipate some large deal potential in June.
- A volatile earnings season concluded with aggregate numbers that were positive, though forward visibility is becoming more challenging.

High Yield Corporate Bonds

- After reaching yields in mid-May not seen since late 2020, higher-quality high yield led the rally as BBs finished the month with a positive total return of 1.54%. Lower rated companies lagged, with Bs finishing with a return of -0.63% and CCCs at -2.83%.
- Another paltry month of issuance coupled with a jump in rising stars offset outflows and created a supply shortfall of $35.5 billion.
- While our cash balance remains elevated entering June, we plan to continue to add opportunistically to higher-quality paper given our overall risk profile.

Bank Loans

- The loan market was down 2.56% in May, posting the third worst month since the Great Financial Crisis, only behind March 2020 (down 12.37%) and August 2011 (down 4.41%). Increasing recessionary concerns spurred by both persistent inflation and the impact of higher interest rates on borrowers made its way into the loan space.
- Downgrades exceeded upgrades in the month, with inflation and supply chain pressures the driving factors behind nearly 30% of the downward rating actions. This put the rolling 3-month average of downgrades to upgrades at 1:1. For context, the ratio has averaged 1.4 downgrades to 1 upgrade for the (normalized) period of January 2010 to December 2019.
- We will look to selectively take advantage of the upcoming primary issuance market, which we expect will come with wide spreads and new issue price concessions.

Securitized Product

- Total returns were positive this month, driven by the rally in Treasury rates. Securitized product spreads firmed up in general during the last week of the month as a settling rates curve and wider spread product nudged investors to put money to work.
- We are still very positive on the U.S. consumer and housing fundamentals, which are driving our investment thesis and overweight to both sectors. We are currently booking yields in the 4% to 5% range for short average life investment grade assets.
- We see value in select high quality CMBS offerings as spreads widened in May.

Emerging Market Debt

- Emerging markets debt (EMD) rose by 0.19% in May, bringing the year-to-date total return to -14.07%. The slight bounce was, again, less than that of the U.S. Agg, which rose by 0.64% in May to bring its YTD total return to -8.92%.
- Given the moderation in the downward move in financial markets, some value has opened up. This, combined with our low level of EM exposure, has induced us to start looking for bargains.

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- We continue to see a meaningful risk of the Federal Reserve overtightening as it plays catchup. This same conundrum is also in play in Europe, where growth is even slower and inflation higher. While debates are intensifying over how rapidly rates should rise, there is little doubt over whether a policy rate of -810 bps is appropriate, especially with the Eurozone unemployment rate at 6.8% – the lowest ever.

Municipal Bonds

- Municipal bonds enjoyed a rally at the end of the month, driven by the crossover bid for bargain-priced municipals, a lower and more stable U.S. Treasury rate backdrop, and, to some degree, favorable seasonal trends set for the summer with a net negative supply of -$33 billion expected from June to August.
- Lipper reported combined weekly and monthly outflows of $1.0 billion for the period ending May 25th. This marks the 20th consecutive week of combined weekly and monthly reporting fund outflows, increasing YTD outflows to $58.6 billion.
- Municipal credit fundamentals are mostly solid as many states are still flush with cash from the pandemic-driven federal stimulus and stronger-than-expected tax revenue during the pandemic.

Paul Privitera

Director – Institutional

Paul.Privitera@Newfleet.com

Phone: (860) 839-0705