Q2 22 MULTI-SECTOR FIXED INCOME
MARKET REVIEW AND OUTLOOK

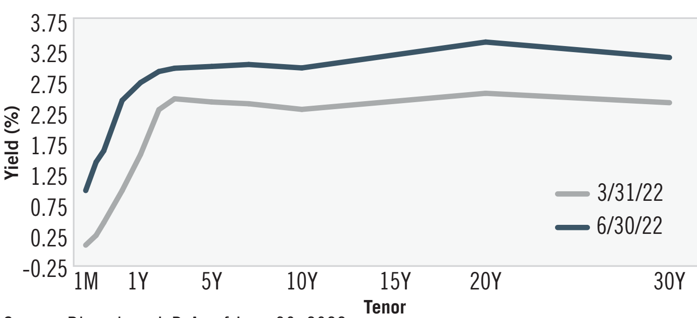
Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

Global central banks intensified their fight with inflation during the quarter, signaling they will remain vigilant until inflation objectives are met. This backdrop clouded the outlook for global and regional economic growth, resulting in negative total returns for most assets. The pandemic remains a global issue, with China's zero-COVID policy continuing to delay the normalization of supply chains. Meanwhile, the war between Russia and Ukraine is an ongoing economic shock to food and energy prices. These unresolved issues make economic forecasting and modeling a challenge and will likely contribute to a volatile investing environment for the next several quarters.

The Federal Reserve (Fed) and other major central banks shifted to a more hawkish tone in response to elevated inflation metrics. The Fed raised its main policy rate 125 basis points (bps) and indicated its resolve to restore price stability while relying on economic data to form future policy action. The Fed has also begun to shrink its $8.9 trillion-dollar balance sheet in what we expect to be a largely passive exercise. As the European Central Bank (ECB) is also poised to signal interest rate increases and its own balance sheet run-off, it will have to manage the complex task of preventing financial fragmentation among its member countries. The Bank of Japan remains a relative dove given local economic conditions, but it remains to be seen how much yen weakness will be tolerated, given the policy divergences. Global central banking has a complicated task ahead.

Financial markets have priced in significant changes to the economic and earnings landscape during the quarter, as shown by total returns. The U.S. Treasury curve shifted higher: the 5-year Treasury yield jumped up 58 bps, the 10-year Treasury yield went up by 68 bps, and the 30-year Treasury yield moved 74 bps higher.

U.S. TREASURY YIELD CURVE



Source: Bloomberg L.P. As of June 30, 2022.

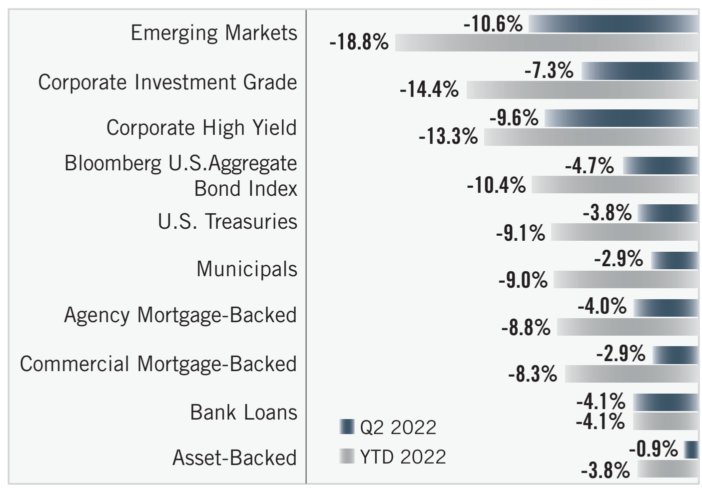
Despite the quarter's volatility, we see value being restored across most of the fixed income sectors in which we invest. It is our expectation that supply chains will heal over time and the Fed will be successful in returning inflation to acceptable levels. We continue to watch the economic data to inform our views on the possibility of recession. Our base case is still that any contraction would be mild, but recession risks have risen.

As the markets digest global developments, we continue to believe active sector and issuer selection is critical to take advantage of market volatility as it arises. Our approach to fixed income – the approach we have implemented for over three decades – enables us to scan the bond market for the most attractive investment opportunities and is ideally suited for the current environment.

FIXED INCOME SECTOR PERFORMANCE

Most spread sectors underperformed U.S. Treasuries with the shift in economic conditions.

FIXED INCOME SECTOR PERFORMANCE



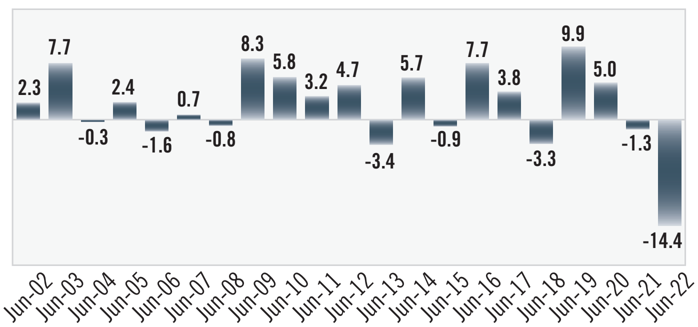
Performance as of June 30, 2022. Sources: J.P. Morgan: Emerging Markets (EMBI Global), Corporate High Yield, Bank Loans; Bloomberg Municipal Bond Index: Municipals; Bloomberg U.S. Aggregate Bond Index: All other sectors.
Past performance is no guarantee of future results.

The following sections reflect the views of the individual sector specialists.

INVESTMENT GRADE

This was the worst first half on record for the investment grade market, with total returns of -14.39%. Quarterly returns were below -7% in both quarters year-to-date (YTD). 75% of the performance can be attributed to the rate move, with 25% owing to wider spreads. Spreads ended the quarter at a two-year high (156 bps) and were 41 bps wider during the quarter (64 bps YTD). Spreads sit between the historical averages and recessionary levels, suggesting further downside should recession fears materialize. For context, the following is a list of valuations during historic periods of volatility: COVID – 285 bps, Oil collapse – 200 bps, Euro debt crisis – 250 bps, Great Financial Crisis (GFC) – 600 bps.

U.S. INVESTMENT GRADE TOTAL RETURNS YTD



Source: Bloomberg Finance LP. As of June 30, 2022.

Yields, meanwhile, have doubled YTD to 4.66% and touched 5% during the quarter for the first time since 2009. Newfleet has been selectively adding to the asset class via the new issue market where concessions are at extreme levels but are cautious to add significant credit risk at this stage.

Fundamentals are not yet the problem. Credit metrics have fully retraced the COVID-era weakening, interest coverage metrics are healthy, and cash balances are high. Because the average maturity of an investment grade bond is longer than 10 years, the average coupon will take years to meaningfully increase – borrowers are not overly sensitive to rising rates. We saw a jump in shareholder returns YTD, but at the lower credit tiers (BBB and BBB-), this behavior was significantly less noticeable. Earnings expectations for the full year have remained firm at 10% for the S&P 500®, though we, and consensus, have significant doubts that these forecasts are reliable given softening macroeconomic data.

Market technicals are increasingly shaky. Per J.P. Morgan, outflows were negative every week this quarter for the first time since the first quarter of 2004. Fortunately, while steady, these outflows have not been particularly large (2% of AUM YTD), especially considering that total returns on a trailing 12-month basis are the second worst on record, aside from returns from the GFC. Foreign flows, which helped push the market tighter over the last several years, have largely subsided as yields across the globe have risen and volatility has increased. On the long end, traditional buyers, mostly comprised of insurance companies and pension plans, have been active, pushing the 10-year/30-year spread curve to historical tights.

On the supply side, issuance has been stubbornly average despite tepid demand. YTD net supply of $314 billion is actually above the recent average when backing out the pandemic-inflated 2020. As the second quarter progressed, issuers that had to come to market paid the price, with new issue concessions approaching extreme levels. These deals seem to continually pull the secondary market wider.

CORPORATE HIGH YIELD

High yield had a terrible quarter as a combination of widening credit spreads and higher Treasury yields led the index to return -9.8%. The YTD return of -14.2% is the all-time worst first half of a year. The index spread entered the quarter at +326 and made a largely one-way move wider through late May, when there was a sharp reversal. However, spreads more than retraced to hit a new wide in late June at +570. Not surprisingly, CCCs underperformed given the widening credit spreads. At quarter-end, the index yielded 8.9% at an average price of $85.90. The widening credit spreads are driven by recession fears as continued high inflation prints are forcing the Federal Reserve to aggressively tighten policy.

Aggregate credit fundamentals are still in a relatively strong place ahead of a potential slowdown, with leverage declining again in post-first-quarter numbers. Leverage is at its lowest level since COVID hit, though still above late 2019 levels. More concerning are revenues and EBITDA, which both posted sequential declines along with margins compressing. Aggregate interest coverage ratios look strong at over 5x. However, lower-rated issuers that use floating rate loans in their capital structure, face near term refinancing, or both, will have little room for error in this new higher rate and spread environment. Overall, fundamentals are likely to deteriorate in the forthcoming quarters, but there is room for weakening before they reach problematic levels for the sector.

The technical picture remains the same as the first quarter. The asset class continues to see meaningful outflows. However, issuance has largely dried up, with multiple weeks this quarter in which was just one issuer, or none. Most deals that are coming to the market are for M&A activity where the issuer has little choice but to tap the market. The heavy issuance of the last two years has left little debt left to refinance. Meanwhile, the move wider in rates and spreads have sharply reduced the amount of bonds with economic calls.

During the quarter, we reduced exposure to high yield and increased the quality within the index. We think current spreads offer insufficient compensation for the risk of recession, since recessionary spreads for high yield are generally north of +800 bps. Our trades generally focused on reducing cyclical industries. We also cut consumer-exposed companies – both products and services providers – including most cruise line exposures. Additionally, we reduced our heavy overweight to commodities given its relative richness versus other sectors. However, we are still generally constructive on commodities given the sector's continued

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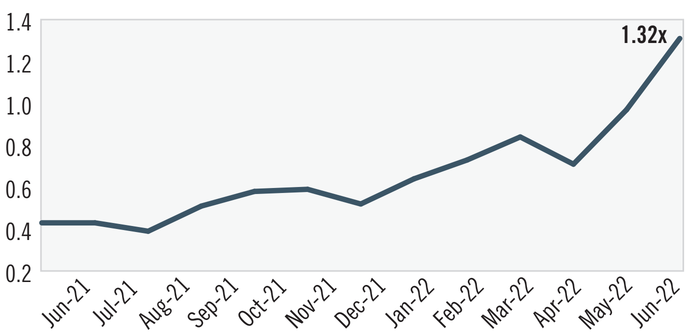
focus on balance sheet improvement and still-elevated price levels. At these valuations, bullish arguments can be made for strong forward returns over a longer period, especially if one views no recession or a mild recession as a base case scenario. However, we see the potential for more near-term negative moves given sustained Fed hawkishness despite deteriorating economic data, since they are focused on reducing inflation over protecting growth.

BANK LOANS

Risk-off sentiment driven by fears around inflation, supply chain issues, recession, rising rates, and the war in Ukraine caused loan prices to tumble during the second quarter, producing negative returns in May (-2.5%) and June (-2.1%), and a quarterly return of -4.35%. The loan market had not seen two consecutive months of negative performance since COVID, with the last instance before that going back to 2018.

In another worrying sign, a 16-month stretch of positive upgrade bias in credit ratings – a closely watched measure that can impact broader market credit quality – came to a close this quarter when downgrades exceeded upgrades by 1.3x – the first time the pace of downgrades surpassed upgrades since January 2021. Meanwhile, default rates, though starting from a very low base, have started to tick up, with one default in May and another in June. This may represent an inflection point for loans if defaults start to spike meaningfully in the coming months.

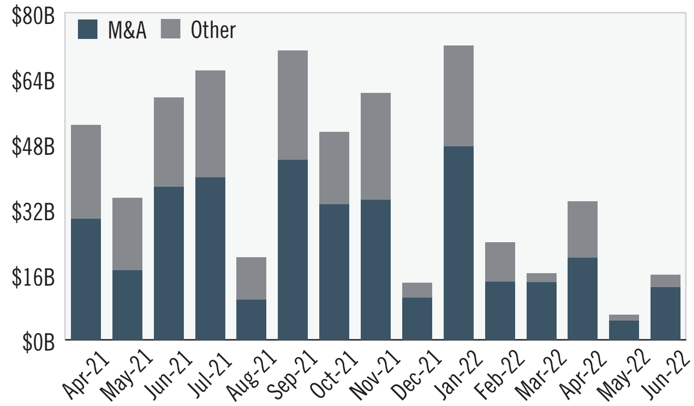
U.S. LEVERAGED LOANS: RATIO OF DOWNGRADES TO UPGRADES



Data is rolling 3 months; through June 30, 2022.
Sources: Leveraged Commentary & Data (LCD); S&P/LSTA Leveraged Loan Index.

As the market became increasingly worried over recessionary headwinds, it began to pivot from pricing in rate risk to credit risk to account for the impact of higher cost of borrowing and slowed growth. No risk assets were spared the rout, including leveraged loans. Consequently, demand declined – in the 8-week period ending June 29, a net $7.7 billion flowed out of loan funds, according to Lipper. On the supply side, new issuance volumes were down 50% from last year due to stalled M&A and LBO activity.

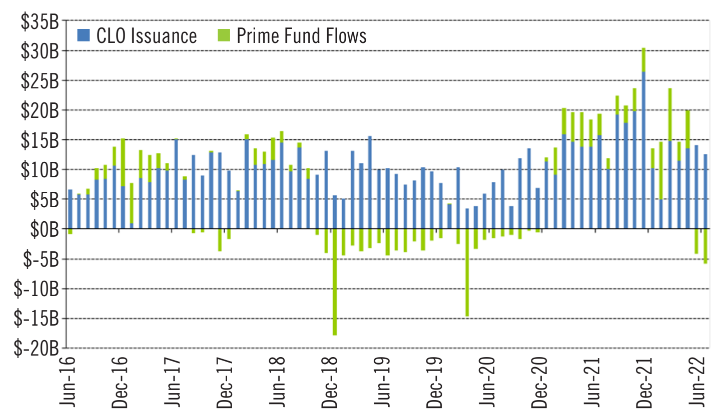
U.S. INSTITUTIONAL NEW-ISSUE LEVERAGED LOAN VOLUME



Data through June 30, 2022. Source: Leveraged Commentary & Data (LCD).

In the face of these headwinds, CLO issuance has been surprisingly resilient, averaging roughly $11 billion-$13 billion of issuance a month even as recession fears persist. CLO managers have had to be creative in coming to market, pushing through to the finish line by printing deals with less conventional terms. Thus far, average loan prices have dropped from 99 to 91.75, but the durability of CLO demand has likely prevented this from getting worse, as its outsized impact plays an important role in creating stability for this market.

CLO ISSUANCE AND PRIME FUND FLOWS



Source: Leveraged Commentary & Data (LCD). As of June 30, 2022

Nonetheless, we're seeing the effects of this pressure on CLO warehouses as smaller and mid-size managers have largely stopped activity. Triple-A buyers, mostly made up of banks, insurance companies, and Japanese buyers, are starting to slow down purchases – a worrisome sign, as they make up two-thirds of the structure. Given summer is typically a slow season for the market, we may see further slowdown ahead.

There may be a silver lining in all the gloomy news: outside of the Global Financial Crisis, loan markets have reached current prices only a handful of times. This may not represent the bottom – prices still have room to move lower

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from here. Nevertheless, given current levels, the market may have priced in much of the recession and default risk already. This may be an attractive entry point for investors looking for a dollar cost averaging opportunity, depending on their time horizon, and especially since loan prices tend to mean revert eventually.

Indicators we will be closely watching in the quarter ahead include second quarter corporate earnings reports, inflation data, and unemployment rates. After Consumer Price Index (CPI) data from June overshot forecasts with a 9.1% increase, we expect the Fed to hike rates aggressively in July, and again in September.

Given the current environment, we are shifting from single B-rated credits to double Bs and exiting credits that we think are particularly vulnerable to disruptions around supply chain, rising wages, and higher cost of borrowing.

EMERGING MARKETS DEBT

EM Sovereign Debt: The emerging (EM) sovereign debt index (JPM EMBI Global) total return of -10.55% was the second worst in the last 20 years (supplanting the first quarter of 2022) only topped by the COVID selloff during the quarter ending March 31, 2020. In the entire history of the index going back to the mid-1990s, there have only been four worse quarters. Rising rates, higher recession risk for the United States and Europe, and a dimmer outlook on China's growth recovery all contributed to the sector-wide drawdown in asset values.

Some performance highlights from the quarter:

> The EM index spread was wider by 114 bps, ending the quarter at 458 bps on June 30, 2022 – approximately 100 bps wide of the long-term average spread.

> In something of a replay of the first quarter 2022, U.S. Treasury rates rose with 10-year and 30-year yields moving higher by 67 bps and 73 bps, respectively, as the markets aggressively repriced in anticipation of a much more hawkish Fed. Front end rates were up even more (6-month U.S. Treasury up 145 bps) as the overall curve bear flattened.

> EM high yield bonds materially underperformed at -14.1% versus EM investment grade at -8.0%, led by the lowest-rated CCC tier, which recorded a -28% return for the period. The high yield sub-index spread widened by 261 bps to 919 bps and is roughly two standard deviations wide of its 10-year average of 654 bps.

> Long duration bonds also underperformed, with maturities 10 years or longer recording a -15.6% total return. There was no hiding as every rating tier, every maturity bucket, and nearly every issuer recorded a negative return.

> Worst performers included Sri Lanka (-41%), which defaulted, Ukraine (-34%), as the war with Russia continues to grind on, and Argentina (-28%), which looks to be headed for another default. Several countries with returns worse than -20% that are feeling a material impact from higher food and energy prices include Ecuador, where protestors shut down nearly half of oil production for over two weeks, Egypt, El Salvador, Ghana, Kenya, and Nigeria.

EM Corporate Debt: Corporate debt fared better than sovereign debt, although returns were still dismal at -6.02% on the EM corporate index (JPM CEMBI Diversified). Unsurprisingly, investment grade returns were better than high yield by 327 bps, albeit still negative at -4.61%. Short duration returns were much better than long duration. Macau (i.e., the Chinese gaming sector) and Ukraine's corporate sectors were among the worst performing, with the former impacted by COVID lockdowns throughout major portions of China, and the latter impacted by the ongoing war.

EM Local Debt: Local market index returns (JPM GBI-EM Global Diversified) were also deeply negative at -8.63% on an unhedged basis, though they were better than sovereign hard currency index returns. No single country produced a positive return in the period, with Turkey faring the best at -0.62%. The worst performances came from Hungary, due to inflation and war impact, Chile, due to falling copper prices and political uncertainty, and Colombia, where investors negatively received the presidential election outcome.

Our outlook remains cautious. We recognize some value has been restored in the EM hard currency space, with index spreads now trading well wide of long-term averages, driven by EM high yield index spreads at over 900 bps. However, risk of a U.S. recession has risen in recent weeks, and in our view, China's growth recovery will continue to be hampered by its COVID policy and depressed property sector. Higher inflation and tighter monetary policies have resulted both in increased social tensions across many EM countries, and governments supplying increased fiscal support to the detriment of their credit quality. Finally, capital markets have been essentially closed to EM high yield borrowers for the better part of the last three months, leaving those with funding requirements increasingly vulnerable. We cannot make the call on when the Russia/Ukraine conflict will end, but we envision sanctions on Russia and damage to food production and trade channels will persist.

SECURITIZED DEBT

The theme of higher interest rates and a flight to quality continued to play out during the second quarter. Interest rates backed up materially while investors moved more of their

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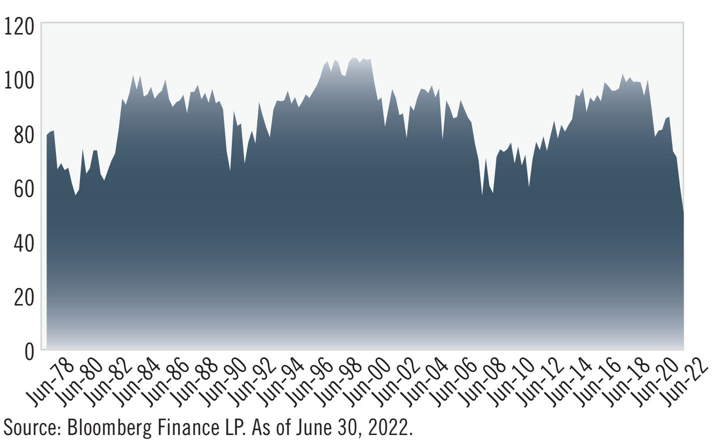
investable dollars to safer parts of the credit curve. Spreads widened across all rating categories but was more pronounced on the lower-rated and higher-leveraged parts of the capital structure. In general, longer-duration, credit-sensitive product underperformed higher-quality, shorter-duration product. The securitized components of the Bloomberg Aggregate index returned -0.91% for asset-backed securities (ABS), -2.85% for commercial mortgage-backed securities (CMBS), and -4.01% for mortgage-backed securities (MBS).

On the technical side, ABS and CMBS continue to outpace last year's supply by approximately 15% and 35%, respectively. However, recent spread volatility is leading to lower CMBS supply forecasts for the second half of 2022. The residential mortgage-backed securities (RMBS) new issue market ran heavy during the second quarter as the market wrestled with selling off newly minted discount collateral. We expect 2022 RMBS supply totals to be higher than 2021 on a net basis.

The new issue market for securitized product has not slowed down, but the duration to bring a new deal to market has lengthened as investors demand more of a spread premium for taking on credit risk with a possible recession looming. Investors are thus now able to put money to work at wider spreads and higher yields. For instance, as the 2-year U.S. Treasury backed up 222 bps since year-end, spreads for higher-rated securitized product have widened 100-125 bps. Investors have therefore been able to invest in higher-quality securitized product yielding around 4.50%-5.50% on the 2-year part of the Treasury curve.

The fundamental picture for the U.S. consumer for the second quarter was a bit of a mixed bag. Low unemployment rate (3.6%), strong wage gains (especially for the lower income quintile), a strong excess savings profile, and an abundance of job openings (11 million) were all positives. However, consumer sentiment hit an all-time low as consumers came under stress around higher energy, food, rent and housing costs.

UNIVERSITY OF MICHIGAN CONSUMER SENTIMENT INDEX



Source: Bloomberg Finance LP. As of June 30, 2022.

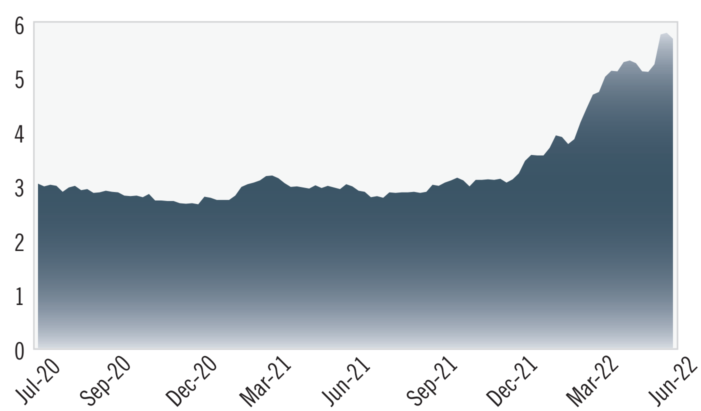
Consumer and mortgage delinquencies continue to stay low from historical standards. The key to sustained strong consumer performance is employment – it remains to be seen if the U.S. can enter a recession with the unemployment rate so low. If we do not see materially higher unemployment, the credit performance of our securitized assets should perform as advertised.

With respect to the commercial mortgage market, fundamental performance is still solid, as evidenced by the benign delinquency profile for all the major asset types. Rent growth has been strong for industrial and multifamily properties, while the increase in domestic travel has helped hotel properties rebound to pre-pandemic levels. The outlook for the office sector is still uncertain as the work-from-home phenomenon persists. While office properties demonstrate stability due to long-term leases already in place, the verdict is still out on their medium-term performance as underlying tenant leases begin to roll, especially in high-cost markets. Looking ahead, higher interest rates will negatively affect commercial real estate valuations as cap rates reset higher.

According to the Real Capital Analytics (RCA) National Property index, which measures appreciation or depreciation based on repeat sales, the commercial real estate market has appreciated 18.60% on a year-over-year basis through May 2022, led by strong performance in multifamily and industrials. Suburban office properties have lagged as RCA reports asset appreciation up 10.5% on a year-over-year basis.

The housing market is still hot, with the latest report showing 21% year-over-year gain for April 2022. Rising homeowner equity continues to support credit performance within non-agency RMBS. We will be watching closely to see how the residential market performs during the next few quarters as mortgage rates reset sharply higher and affordability issues arise.

FREDDIE MAC U.S. MORTGAGE MARKET SURVEY 30 YEAR HOMEOWNER COMMITMENT NATIONAL – LAST PRICE



Source: Bloomberg Finance LP. As of June 30, 2022.

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Securitized market spreads stabilized at the end of the quarter. Given the partial retracement of spread widening in the investment grade and high yield markets, we feel there are opportunities available within securitized products. Our efforts are focused on the new issue markets, which continue to experience demand across all securitized sectors. We have focused new dollar investments on the more conservative parts of the capital structure and aim to be selective when taking on credit risk. We continue to monitor and adjust the portfolio based on ever-changing economic news. More importantly, we are positioned to take advantage of any future credit dislocations.

TAX-EXEMPT MUNICIPAL BONDS

Just as in the first quarter, yields in the second quarter moved higher across the curve. Volatility remained above average as the market vacillated between fear of extraordinary inflation and recession. The Bloomberg Municipal Index, a broad measure of the municipal market, returned -2.94% for the second quarter, bringing the YTD return to -8.98%. YTD, the Bloomberg Municipal Index outperformed the Bloomberg Aggregate Index (-10.35%), Bloomberg Corporate Index (-14.39%) and Bloomberg Treasury Index (-9.14%).

During this period, the municipal market posted its first positive monthly return for the year (1.49% in May), although not enough to overcome the negative bias that gripped the market from the beginning of the quarter. Yields in the long end rose more than yields in the front of the curve in a bear steepener. The slope of the curve (2-year/30-year) increased from 77 bps to 123 bps as the 2-year increased by 19 bps, the 10-year by 54 bps, and the 30-year by 65 bps.

Given the changes in yield, the longer the duration, the larger the negative return. The Bloomberg Municipal 1-year Index was the best performer, with a positive return of 0.38%, while the Bloomberg Long Bond Index was the worst at -6.59%. Credit spreads widened during the quarter – more the result of selling pressure than credit fundamentals – though future economic headwinds may worsen this trend. The Bloomberg AAA Index outperformed the Bloomberg Baa Index by 200 bps (-2.52% versus -4.52%).

Negative fund flows, as reported by the Investment Company Institute (ICI), continued to pressure the market as more than $60 billion was redeemed from municipal mutual funds, bringing the YTD total to $88 billion.

The 10-year municipal yield was a good example of the volatility that characterized this quarter – the yield rose only 54 bps but ranged as much as 86 bps. The lowest yield for the quarter was 2.16% on April 4, the high was 3.02% on May 17, and the yield ended the quarter at 2.72%. A closer look at this movement highlights the speed with which both corrections and illiquidity happen in the market. The Municipal Market Data (MMD) 10-year AAA-rated Muni hit a 12-month high on May 17 at 3.02%, a level that appeared to be the catalyst investors needed. As the Treasury market benefited from a flight to quality bid and weaker economic numbers, so did the municipal market. The 10-year municipal yield dropped 59 bps between May 19 and June 1 to 2.43%. That rally however, quickly reversed over four days beginning June 8, sparked by fears of record-setting inflation. Ten-year yields moved higher by 46 basis points.

Municipal credit quality remained sound. Virtually all states ended Fiscal Year 2021 with surpluses, and budgetary reserves hit new record highs thanks to growing revenues and the final serving of federal relief authorized under the American Rescue Plan Act. Local governments also boosted their reserves over the last two fiscal years, leaving them in a materially stronger position. The challenge will be to see if credits can remain strong in the face of inflation, slower growth, fewer employed, and rising pension costs.

While optimistic for better performance in the second half of the year, we do expect market volatility will likely continue until the market gains more insight and confidence in the Fed and the economy. A decline in issuance and an increase in demand during the near-term summer months will mitigate some spread widening. The overall cheapening of the market has created attractive reentry levels for high-quality sectors like state GO and water/sewer bonds. We continue to recommend high-quality paper for both defensiveness and liquidity.

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Authored by:

The Newfleet Multi-Sector Team

Newfleet leverages the knowledge and skill of a team of investment professionals with expertise in every sector of the bond market, including evolving, specialized, and out-of-favor sectors. The team employs active sector rotation and disciplined risk management to portfolio construction.

Bloomberg U.S. Aggregate Bond Index measures the U.S. investment grade fixed rate bond market. **Bloomberg Municipal Bond Index** is a market capitalization-weighted index that measures the long-term tax-exempt bond market. **J.P. Morgan GBI-EMGD** tracks total returns for local currency debt instruments issued by emerging markets sovereign and quasi-sovereign entities to which international investors can gain exposure. **J.P. Morgan CEMBI Index** tracks U.S. dollar-denominated debt issued by emerging market corporations. **J.P. Morgan EMBI Global Index** tracks the total return for the U.S. dollar-denominated emerging markets debt, including Brady bonds, Eurobonds, and loans. The **Credit Suisse Leveraged Loan Index** is a market-weighted index that tracks the investable universe of the U.S. dollar denominated leveraged loans. The **Bloomberg U.S. High-Yield 2% Issuer Capped Bond Index** is a market capitalization-weighted index that measures fixed rate non-investment grade debt securities of U.S. and non-U.S. corporations. No single issuer accounts for more than 2% of market cap. The **S&P 500® Index** is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The indexes are calculated on a total return basis. The indexes are unmanaged, returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

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