NEWFLEET ASSET MANAGEMENT

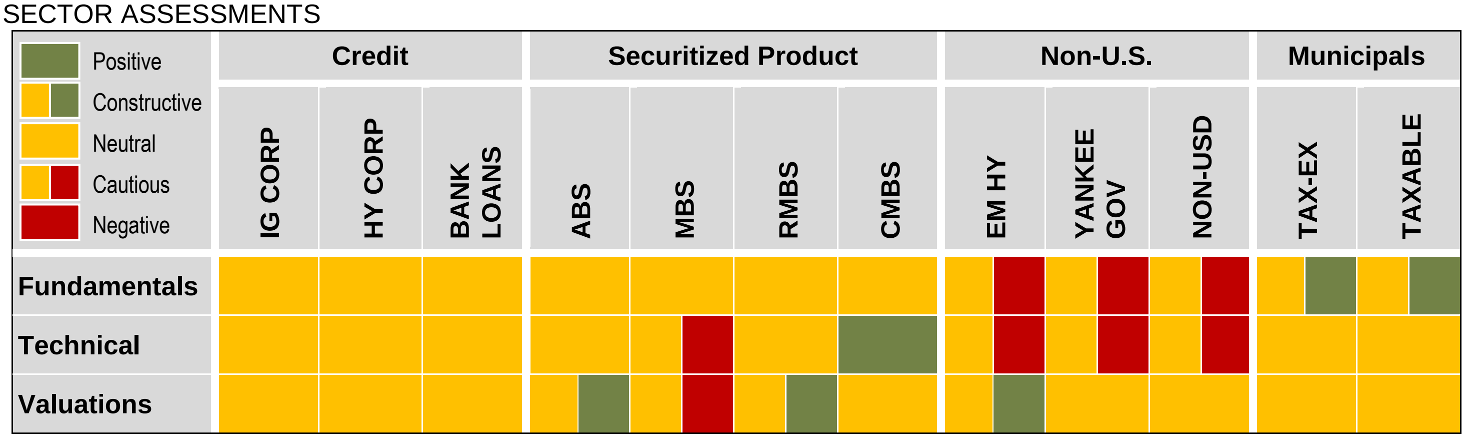
Fixed Income Sector Review

As of August 31, 2022

OBSERVATIONS ON THE MACRO ENVIRONMENT & MARKET CONDITIONS

- The old market adage, "never fight the Fed," was fully in play this month. Like much of this year, both risky and safe-haven financial assets declined.
- Expectations of further Fed tightening drove weakness in financial markets, which showed a high degree of cross-asset correlation. Treasuries moved first: yields across the entire curve rose consistently by about 60 basis points (bps) during the month.
- The S&P 500 declined by 8.1% during the second half of August. Global equity markets followed, pushing credit risk spreads wider.

SECTOR ASSESSMENTS



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

SELECT SECTOR HIGHLIGHTS

Investment Grade Corporate Bonds

- Estimates for the back half of the year are falling as expected, now suggesting 6-7% growth, down from a peak of over 10%. Note that estimates usually beat by 4%, so if that trend held, we would be right back at 10%, which still seems optimistic given the macro backdrop.
- Gross and net supply of $135 billion (second highest of all time) and $79 billion (third highest of all time), respectively, in August. This is nearly double the 10-year average for gross supply as issuers pour into an open market.
- While the market appears shaky, we expect a high level of issuance in September that will only add to the pressure on index levels. We expect large new issue concessions and will look to opportunistically deploy capital into a cautious market.

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High Yield Corporate Bonds

- The high yield market gave back some of July's gains in August as it finished with a negative return of -2.30%, driven by rising risk-free rates.
- As expected, August was a seasonable slow month with limited primary activity and thin secondary markets. Our activity was light to avoid the high transaction costs that are typical for this time of year, but which were also worsened by the elevated volatility in U.S. Treasury rates.
- Our theme stays the same – add higher quality credits with intermediate duration as we move back towards a neutral duration and look to trim some credit risk. We were able to do this as rising rates led to BBB- and BB-rated securities underperforming, leading to attractive entry points.

Bank Loans

- Fundamentals have become more challenging as the Fed's commitment to fighting inflation leads to a continued path of higher rates while growth slows. The full impact of these rate increases will become more apparent in coming quarters.
- The primary issuance market is reopening, with some long-awaited transactions starting to launch. Such deals could be compelling, as they may need to arrive with attractive terms to clear the current environment.
- As investor angst increases around slowing growth and its impact on credit markets, our current up-in-quality position has performed well. We expect to maintain our current positioning.

Securitized Product

- Total returns were negative this month, with longer duration asset classes within securitized sectors underperforming the most. The U.S. Treasury 2-year/10-year curve continued to invert, ending the month at a negative 30 bps.
- With yields higher and spreads wider, our consumer loan-backed bonds offer value. The unemployment rate, unchanged at 3.5%, and current job openings, still at an elevated 11 million, mitigate the effects of higher rates on the consumer.
- We continue to add up-in-quality residential exposures as prepayments remain muted. In CMBS, we prioritize liquidity over marginal spread pickup and recommend names with large deal sizes and well-capitalized sponsors in CMBS SASB investment grade securities.

Emerging Markets Debt

- Emerging markets debt (EMD) gave back much of its 3.2% July gain in August, declining by 1.17%. This brought the YTD EMD debt total return to -17.21%.
- While we are not embracing high yield EM bonds en masse, we prefer high yield EM over investment grade EM due to valuations. Our preference is supported by performance in August, when high yield EM stayed essentially flat at -0.09% while the S&P 500 was down by 4.1%, Treasuries were down 2.5%, and investment grade EM fell by 1.9%. We think this shows the potential for outperformance once the macro backdrop stabilizes.
- We remain more bearish than consensus on the Russia/Ukraine war. We expect Russia will keep disrupting natural gas supply to Europe, then wait for the onset of winter to shut off supply completely. The economic impact to Europe as the European Central Bank tightens monetary policy could be significant, with geopolitical ramifications that are sure to affect more than just the EU.

Municipal Bonds

- Municipal bond performance for the month returned -2.19%, bringing YTD returns to -8.62%.
- Lipper reported a combined monthly and weekly outflow of $2.5 billion leaving municipal bond funds for the period ending August 31st, increasing YTD outflows to a new record of $83.7 billion.
- Upgrades continue to lead downgrades, albeit at a slower pace, as reported by S&P. Improving finances were the most common reason for upgrades in the second quarter; on the downside, finance led, followed by school-specific rating actions or enrollments.

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